2002•2003

Economic survey

OF LATIN AMERICA
AND THE CARIBBEAN

UNITED NATIONS

ECLAC

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As is customary, the Economic Development Division was assisted in this task by the Statistics and Economic Projections Division, the ECLAC subregional headquarters in Mexico and Port of Spain and the country offices of the Commission in Bogotá, Brasilia and Buenos Aires. Special support was provided by the Latin American and Caribbean Institute for Economic and Social Planning (ILPES) and the Special Studies Unit of the Office of the Executive Secretary of ECLAC.

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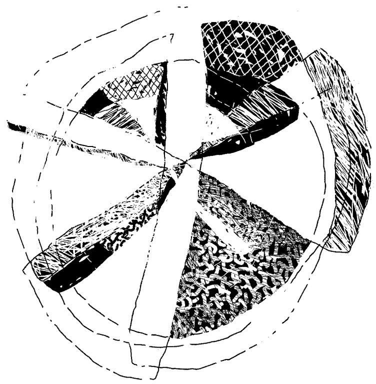
Notes

The following symbols have been used in the tables shown in the *Survey*.
Three dots (.) indicate that data are not available or are not separately reported.
A dash (–) indicates that the amount is nil or negligible.
A full stop (.) is used to indicate decimals.
The word "dollars" refers to United States dollars unless otherwise specified.

2002-2003



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NOTE

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Foreword

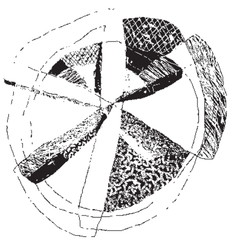
The *Economic Survey of Latin America and the Caribbean, 2002-2003* is the fifty-fifth edition in this series and contains an analysis of economic developments in the region during 2002 and of the observable trends as of mid-2003. The publication is divided into three parts dealing with the region, the Latin American countries and the Caribbean, respectively. It also includes a statistical appendix which presents regional data. The data used in most of the analyses are provided on a CD-ROM.

The first part of the *Survey* consists of three chapters. Chapter I provides an overview of the current status and trends of the main macroeconomic variables in the region. Chapter II covers four subject areas: the external sector, economic policy, domestic performance and external debt issues. The section on the external sector examines trends in the components of the balance of payments, commodity prices, the terms of trade, capital flows and credit conditions. It then moves on to review the fiscal, foreign-exchange and monetary dimensions of economic policy. The domestic performance of the region's economy is then analysed in terms of growth, investment, inflation, wages and employment. In this final portion of this chapter, external debt issues are explored on the basis of the new types of debt renegotiations that have been employed by some countries in the first half of 2003. Chapter III looks at the advisability of strengthening the development banking system as a means of promoting investment, given the current shortage of long-term finance, existing information asymmetries and the segmentation of the countries' financial systems.

The second part of the *Survey* comprises a series of reports on recent macroeconomic developments in 27 countries of the region. The tables and figures presented as part of these reports differ from those appearing in earlier editions because of the methodology that was used on this occasion. The changes made in this respect include the new approach used to measure investment financing in current values, the calculation of real interest rates based on annual nominal rates previously converted into monthly values and the recalculation of monetary values as annual averages. The indices for merchandise exports and imports and for the terms of trade used 1997 as their base year, even when the original series correspond to estimates in constant 1995 dollars, as in other ECLAC publications. In addition, the statistical appendix has been expanded to include 25 tables.

First part

The region



Chapter I

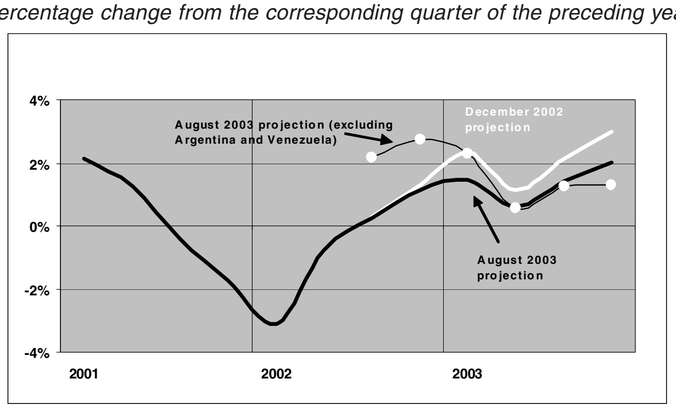
Current conditions and outlook, 2003

Introduction

The Latin American and Caribbean economy will grow by 1.5% in 2003, thereby making a modest recovery from its 0.6% contraction in 2002. With per capita GDP for the year remaining flat, at 2.0% below its 1997 level, this will be the sixth year in a row that has been lost to the region in terms of economic growth.

This economic picture denotes a levelling-off of growth in the region in 2003, in contrast to the outlook a few months ago,[1] when ECLAC had projected growth of 2.1% for 2003. That projection was based on the strengthening trend observed in 2002 as the economy made steady progress after reaching its lowest point in the first quarter. This growth profile, which pointed to a moderate upturn in the economy, had been expected to continue throughout 2003. Figure 1 compares the growth profile projected for 2003 last December with the current projection (with and without Argentina and Venezuela, the economies expected to turn in the year's highest and lowest growth rates, respectively). This comparative view attests to the weakening of the moderately rising trend that had been expected.

Figure I.1
LATIN AMERICA AND THE CARIBBEAN: QUARTERLY GDP, 2001-2003
(*Percentage change from the corresponding quarter of the preceding year*)



Source: ECLAC, on the basis of official figures.

1 See ECLAC, *Preliminary Overview of the Economies of Latin America and the Caribbean,* (LC/G.2196-P), Santiago, Chile, 2002. United Nations publication, Sales No. E.02.II.G.126.

A. The international environment

1. A different scenario

In December 2002, it was assumed that there would be a "short war" in Iraq, followed by a recovery of growth in the developed world (particularly the United States) along with a substantial decrease in international oil prices. The more robust growth of the world economy was also expected to halt the deterioration in non-oil-exporting countries' terms of trade. Marginally more favourable conditions on international financial markets were projected, particularly in comparison to the third quarter of 2002, when country-risk indicators had peaked. This was also the most likely scenario according to most analysts.

The war did indeed prove to be short, but the other elements in this scenario have not turned out exactly as expected. The United States economy has not rebounded as analysts thought it would,[2] European economies have experienced an unforeseen loss of momentum, and Japan has yet to emerge from the stagnation in which it has been languishing since 1998. Moreover, these conditions are exacerbated by the fact that few degrees of freedom remain available to the United States and Japan for further expansionary policies, as there is very little margin left for making monetary and fiscal policy stances more expansionary than they already are. Europe has somewhat more manoeuvring room, although it is constrained by the rules of the European Union's Stability and Growth Pact. Nor have international oil prices fallen as much as expected. Forecasts regarding the region's terms of trade and a moderate improvement in external financial conditions are the only projections to be borne out by the facts. In sum, the world economy has not served as an engine to drive the region's growth during the year.

2. The trade balance

Despite the situation in the world economy, the current value of the region's total merchandise exports in 2003 will increase by an estimated 4.4% (3.5% if petroleum exports are excluded), which constitutes a strong recovery from the stagnation seen in 2002 (0.8%). The Latin American economies with the more competitive exchange rates and those in which investment has been concentrated in non-renewable natural resources are the ones exhibiting higher rates of export growth in relative terms.[3] The value of imports will grow by 0.8% in 2003 for a marginal recovery from the 6.7% drop recorded in 2002. This indicates that the region's trade balance will continue to strengthen as it registers a surplus (estimated at US$ 37 billion) for the second year running.

This improvement is concentrated in South America, which will post a US$ 56 billion trade surplus, as compared to US$ 46 billion in 2002. Brazil will record an exceptionally high export growth rate (15%) that will enable it to boost its trade surplus to US$ 22 billion in 2003 from the US$ 13 billion level posted in 2002. These results, together with the country's fiscal accounts, spurred the strong rebound seen in Brazil's country-risk

2 Some leading indicators (especially stock prices), point to an economic recovery in the United States but its reactivation has clearly been slower and later in coming than had been projected.

3 Costa Rica is an exception. This country's economic performance has been influenced by Intel, whose international production strategy has helped boost its exports in 2002-2003. Costa Rica will see its exports jump by 15% in 2003 and will consequently join Brazil in posting the region's top export growth rates.

indicators. Argentina will post considerable export growth (10%) as well, but since its imports are also recovering, its trade balance will remain at around US$ 17 billion. The Dominican Republic, Haiti, Mexico and the Central American economies will all register trade deficits. Their combined deficit will total some US$ 19 billion, somewhat of an improvement over the 2002 figure of –US$ 22 billion. Among the group of countries that are more fully integrated with the United States economy, Mexico constitutes a special case, since the rest of the subregion's exports to the United States will strengthen, while Mexican exports (other than petroleum) will be almost flat, reflecting an apparent loss of relative competitiveness.

The non-oil-exporting economies' terms of trade deteriorated by 14.9% over the period 1998-2002, with the hardest hit countries being Peru (–22.7%) and Chile (–17.5%), whereas the oil-exporting economies posted a cumulative improvement of 3.5%. Marginal gains are expected in 2003 for both oil exporters (1.2%) and non-oil-exporting countries (0.8%). Among the latter, rates of variation will range from a high of around 3% for Bolivia[4] and a low around –1% for Guatemala. These variations are smaller than they have been in past years and show that, even if the terms of trade improve in 2003, their level will remain depressed. The variation in the purchasing power of exports (the net effect of export volumes and the terms of trade) for the year will consequently be determined by the volume of exports. The purchasing power of the non-oil-exporting economies' external sales is expected to climb by over 10% in 2003.

The projected trend in the regional trade balance is not based solely on the impulses generated by the world economy. It also takes into account a number of endogenous components, such as the increased competitiveness of many of the currencies, maturing investments in export sectors and internal cyclical factors affecting imports.

Important events in the area of trade include the free trade agreement concluded by Chile and the United States, along with the progress made in the Central American Common Market's negotiations with that same country. The newly elected authorities in Brazil and Argentina have also galvanized the Southern Common Market (MERCOSUR) and efforts to increase these countries' integration with the Andean Community. These advances herald a new stage in regional trade integration initiatives. The efforts being made in this direction are a noteworthy development, in view of the recent turbulence experienced by the region. Trade among the member countries of the three major subregional pacts in Latin America has expanded at high annual rates during the past decade,[5] but growth projections for 2003 are varied. Intraregional trade within MERCOSUR is expected to expand by 12% after having plunged by nearly 25% in 2001-2002. Trade within the Central American Common Market (CACM), however, will only expand by about 2% (8.2% in 2001 and –0.7% in 2002). The Andean Community constitutes the most critical case, since trade within this integration scheme will actually decrease (–15%) in 2003 (9.0% in 2001 and –6.5% in 2002).

3. The current account

The balance-of-payments current account will reflect the improvement in the trade balance, since the other components of this account will not register sharp changes. The non-financial services balance will remain virtually unchanged.[6] A slight deterioration in the income (or factor services) account will bring it back to around its 2001 level (–US$ 54.8 billion). The region's current transfers will remain on an upward trend, rising to US$ 29 billion in 2003 (US$ 27 billion in 2002). The largest component of current transfers is the remittances sent by workers residing overseas. These remittances are becoming a significant source of income flows, especially in Ecuador, Mexico, Central America and the Caribbean. The region's current transfers have doubled every six years.

4 Bolivia is classified as a non-oil-exporting country, but it is an important exporter of natural gas.
5 In 1990-2000, intraregional trade grew at annual average rates of 13.4% in MERCOSUR, 12.7% in the Andean Community and 13.8% in the Central American Common Market (CACM).
6 A US$ 14.6 billion deficit is projected for 2003, versus one of US$ 14 billion in 2002.

The net effect of these various components will be that the current account for the region as a whole will be virtually balanced in 2003 (–US$ 3.7 billion, or –0.2% of GDP) for the first time since 1990. As will be discussed later on, this trend will have important implications in terms of the behaviour of investment and national saving.

As in the case of the trade balance, the improvement in the region's current account is chiefly attributable to the results for South America, especially Brazil (which will balance its current account in 2003 after posting a deficit of –US$ 7.7 billion in 2002) and Venezuela (whose current account surplus will climb to US$ 8.8 billion, or 11.2% of GDP). The rest of South America will maintain a surplus of around 1.4% of GDP. Ecuador and Bolivia (–3.7% of GDP each) –the two most dollarized economies in this subregion– will lower their current account deficits in 2003, although they will still have the largest shortfalls in South America. The Dominican Republic, Haiti, Mexico and the Central American economies, meanwhile, will run deficits averaging 2.5% of GDP, which is similar to the figure for 2002. The case of Costa Rica warrants specific mention since, despite the forward momentum provided by a 15% increase in its exports in 2003, a marginal deterioration in the country's current account is expected. This is accounted for by the expansion of the deficit on its income account, which is largely attributable to increased profit remittances by businesess operating in the country's free trade zones.

4. Financial conditions

From the standpoint of the region, the international financial situation will take a turn for the better in 2003 in terms of both flows and international market conditions, although the fact remains that 2002 is a poor basis for comparison. On the balance of payments, total capital flows are expected to make a comeback, with net inflows amounting to US$ 40 billion. Nonetheless, net resource transfers from abroad will be negative for the fifth year in a row (–US$ 15 billion, or 1% of the region's GDP) owing to the hefty deficit that, as noted earlier, will be recorded on the income account. The net transfer of resources is equal to total net capital inflows minus the income balance (net payments of profits and interest). Total net capital inflows correspond to the capital and financial accounts, plus errors and omissions, the use of IMF credit and loans, and exceptional financing. Even so, the scale of this outward transfer will be much smaller than in 2002, when it amounted to –US$ 40.4 billion, or 2.4% of GDP.

The transfer of resources associated with foreign direct investment (FDI) and the transfer associated with purely financial flows are following dissimilar trends. Net FDI transfers to the region (net inflows of FDI minus profit remittances) will still be positive in 2003 (0.6% of GDP), but they will also remain on the downward trend they have followed since peaking at 3.7% of GDP in 1999, thus falling to levels similar to those seen in the first half of the 1990s.

Net transfers of financial resources, on the other hand, will still be negative (–1.6% of GDP), but significantly less so than in 2002 (–3.9% of GDP). The trend in 2003 is chiefly a result of the turnaround in MERCOSUR and particularly Argentina. In fact, the Argentine economy may even manage to record a small positive transfer in the wake of the –US$ 20 billion transfer that occurred in 2002, thanks to a change in the direction of short-term capital flows; the possible elimination, or at least reduction, of negative official flows in net terms; and the continuation of exceptional financing (arrears in amortization and interest payments). The other MERCOSUR economies will manage to make moderate reductions in their resource outflows with respect to 2002; in Brazil's case, this will be made possible by larger inflows of financial capital. The Andean area is expected to have a smaller outward transfer of capital than in 2002 thanks to a reduction in Venezuela's capital outflows. Central America will continue to record a positive transfer of resources, as it has for several years now, while Mexico will see a reduction in its net inflow of resources, primarily as a result of higher factor payments.

From the region's perspective, the international financial market has been making progress, at least in relation to the low point it reached in the third quarter of 2002. As reported by ECLAC at that time,[7] during the run-up to Brazil's presidential elections an

7 ECLAC, *Preliminary Overview of the Economies of Latin America and the Caribbean*, 2002.

extraordinarily severe deterioration was observed in sovereign-risk indicators, which led international experts to develop a number of analyses for assessing the sustainability of the public and external debts. It was also during that same quarter that the risk spreads of almost all the economies of the region which trade in sovereign bonds in international markets reached their highest point. The most fiscally vulnerable economies (Brazil and Colombia) exhibited the sharpest increases in their sovereign spreads, but these upswings have since been reversed as policy makers have made a firm commitment to maintaining fiscal discipline. Other economies that have been steadfast in upholding fiscal discipline (e.g., Chile and Mexico) experienced circumstantial increases in their sovereign spreads, but these upsurges also subsided when they took steps to clarify their public debt accounts. The case of Brazil is particularly noteworthy, since this country's sovereign spread narrowed from a high of 2,500 basis points (bp) in September 2002 to 750 bp in July 2003, thereby defining a downward trend that is expected to continue throughout the remainder of the year.[8]

When conditions on financial markets began to improve, sovereign bond issues resumed. Issues rose from a low of US$ 3.5 billion for the period June-November 2002 to US$ 21 billion in the first half of 2003, which is comparable to the figure for the first half of 2001.

The international financial system has also made a great deal of headway in dealing with sovereign risk in 2003. As a result of the crisis in Argentina, the idea has resurfaced that, in addition to the traditional domestic adjustment efforts and multilateral loans, private creditors should also make a coordinated effort to help deal with extreme situations of sovereign insolvency. Two main proposals have been put forward in this respect. The first, modelled on the idea of a bankruptcy law, is the Sovereign Debt Restructuring Mechanism (SDRM). The second focuses on the issuance of new sovereign debt bonds that include collective action clauses (CACs) under which a quorum rather than unanimous assent is required to clear the way for restructuring.[9]

Apart from the fact that they call for the use of different legal and institutional procedures, the main difference between the two is that the SDRM would focus on existing debts whereas the CACs would remain valid for new issues. Some emerging economies (particularly Brazil and Mexico) opposed the SDRM proposal and advocated the CAC formula as being a less traumatic mechanism (it would not entail a change in the rules of the game) that would provide greater security in terms of the cost of credit. It was feared, however, that this formula might not provide a solution for emerging economies, that are in default, such as Argentina.

Two events turned this debate in favour of the CAC formula in the first half of 2003.[10] The first was the deferral of the implementation of the SDRM proposal by the Governors of the International Monetary Fund. The second and more important event was the success of the issues of sovereign bonds containing CACs launched by Mexico, Brazil and Uruguay during the first semester. In all three cases, the bond contracts containing CACs have been trading at lower spreads than equivalent bonds that do not include these clauses (see figure I.2). Thus, the market has assigned a higher value to a mechanism that provides for a negotiated solution in cases of insolvency than to issues that lack this mechanism and therefore only offer the extreme option of default.[11]

Uruguay, which has the largest sovereign spread of the three, is the most interesting case,[12] since it undertook a debt swap involving bonds with CACs which the

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8 Colombia's spread fell from a high of 1,100 bp to 460 bp during the same period. Mexico, Ecuador and Peru also halved their sovereign spreads, while Chile's and Panama's spreads were reduced by one third. Argentina's spread has also been trending downward, but it continues to reflect the market's perception of insolvency. Uruguay's spread is narrower than Argentina's but moves in step with its neighbour. The Dominican Republic has suffered the effects of the failure and intervention of the Banco Intercontinental (BANINTER) last May, and its sovereign spread is consequently twice as high now as it was in the third quarter of 2002. Venezuela's spread peaked in the first quarter of 2003 as a result of the political crisis in that country.

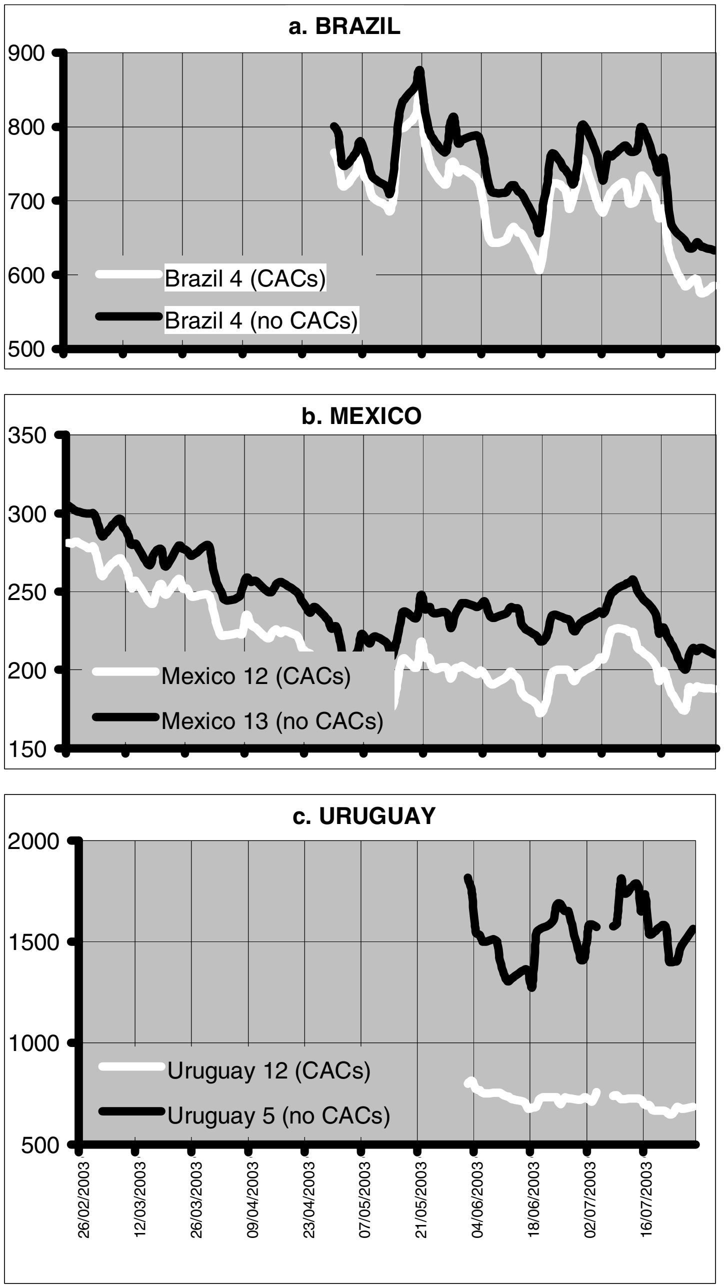
9 Provisions under which restructuring can be undertaken by majority decision are included in sovereign bond contracts concluded under the laws of the United Kingdom, Japan and Luxembourg, but they are not usual in bond contracts governed by the laws of the State of New York, which currently account for most of the sovereign bond issues undertaken by emerging economies. Consequently the decision taken by some emerging economies to include such clauses in the bond contracts they issue on the New York market represents a significant institutional innovation.

10 The debate regarding private-sector involvement in crisis situations has not, of course, been settled yet.

11 Other ways of calculating the rates could indicate that bonds with CACs have not led to any gains in terms of spreads, but in no case have there been adverse effects.

12 In the case of Uruguay, there is no market price for bonds having a residual term similar to the bond contracts containing CACs. Figure I.2.c. therefore gives a weaker comparison between the market price for Uruguayan bonds with and without CACs.

Figure I.2
EFFECT OF COLLECTIVE ACTION CLAUSES (CACs)[a]
(*Daily spreads over Treasury bonds, in basis points*)



Source: ECLAC, on the basis of Bloomberg.
[a] The number shown beside the name of the country indicates the time to maturity of the bond (e.g., "Brazil 4" refers to a sovereign bond issued by Brazil that has a residual term of four years).

market perceived as having a lower level of risk than its existing debt. It is possible that the high spread demanded by the market for bonds not involved in the swap is due to the perception that they are higher-risk assets than the bonds that were swapped. This is certainly a case of the utmost interest for Argentina, which must find an orderly way out of its current default position.

5. Summary

In sum, the international economic environment in 2003 is mixed. Because the expected reactivation of the world economy has been slow in coming, no external engine of growth has been available. It is clear, in particular, that most of the economies that are more closely integrated with the United States (Mexico, Central America and the Caribbean) have continued to perform poorly in 2003. In South America, where the major economies faced crisis situations in 2002, the response to more competitive exchange rates has been apparent in a number of them, and the financial situation, although still troubled, is improving. Brazil is a particularly noteworthy case, since its combination of a growing trade surplus and declining sovereign risk (in conjunction with fiscal discipline) is providing it with more degrees of freedom that may allow it to achieve a faster pace of growth in the medium term. Meanwhile, the non-oil-exporting economies are obtaining some relief as the deterioration in their terms of trade has come to a halt for the first time since 1997. Finally, there are also some economies for which the international environment is of secondary importance in explaining their behaviour in 2003, such as Venezuela and the Dominican Republic.

B. Economic policy

1. Changes in economic policy

The most remarkable events in the realm of economic policy in 2003 have been the deepening of structural fiscal reforms throughout the region and the recovery of degrees of freedom in the management of monetary policy in the major South American economies. This latter development stands in contrast to the situation the year before, when, as discussed by ECLAC in the *Preliminary Overview 2002*, a great deal of autonomy was lost in terms of the capacity to use these policy tools in most of the economies, especially those of the MERCOSUR countries.

In fact, 2002 was the fifth year of what ECLAC has called the "lost half decade", and in this issue of the *Economic Survey*, ECLAC points out that 2003 will be the sixth year in a row that has been lost to the region in terms of economic growth. The adverse international environment was transmitted to the region through various channels. In a number of economies –especially those of MERCOSUR– the main factor was the deterioration in international financial conditions. For Mexico, the five CACM economies, Panama, Haiti, the Dominican Republic and part of the English-speaking Caribbean, the major factor has been the United States economy's loss of forward momentum since 2001. For other non-oil-exporting countries (especially Peru and Chile), the downtrend in the terms of trade that began in 1998 has been the most influential external factor in the slowing pace of growth. In several economies, the implementation of restrictive macroeconomic policies in 2002 has been an additional factor. Some countries' currencies came under attack, and their central banks were forced to opt for tight monetary policies, hiking interest rates. In other cases, the economic slowdown brought to light problems with regard to the sustainability of the public debt, which also made the use of contractionary fiscal policies necessary. In other words, the adverse external environment was compounded by a policy mix that magnified the contractionary forces already at work. Of all the economies in the region, only those of Barbados and Chile (both of which had built up their degrees of freedom during the preceding boom years) implemented expansionary fiscal and monetary policies simultaneously.

2. Structural changes in fiscal policy

One of the hallmarks of economic policy in 2002-2003 has been the scale of structural fiscal reform efforts. This indicates that the region's fiscal problems are not purely short-term in nature, but rather pose challenges that should be addressed from a more institutional perspective. El Salvador is the only Latin American economy that has neither legislated fiscal reforms nor attempted to do so during this biennium, although such reforms have been a subject of public debate. All the other economies in Latin America have either passed tax reforms (Argentina, Brazil, Chile, Colombia, Guatemala, Honduras, Nicaragua, Panama, Peru (partially), Uruguay and Venezuela), are in the process of doing so (Costa Rica and Ecuador) or have attempted to do so but without success (riots in Bolivia, public demonstrations in Mexico and deadlocked Executive and Legislative branches in Paraguay)[13]. There have also been a large number of changes and attempts to introduce

13 Paraguay's newly elected Administration has stated that it intends to undertake a tax reform programme.

new tax codes, fiscal responsibility laws, structural changes in public expenditure (or rules governing changes in spending levels), pension reforms aimed at reducing structural fiscal deficits, and adjustments in public rates and charges.

Chile's and Brazil's efforts in these directions are of interest in this respect because they may prove instructive for other economies of the region. The Chilean Congress has just passed an increase in the value-added tax (VAT). Its main reason for doing so was to generate enough funds to make up for the revenue that will be lost as a result of the tariff reductions provided for in the free trade agreements recently concluded with the European Union and the United States (0.6% of GDP less per year). Because of its structural nature, this decrease in revenue could jeopardize compliance with the country's fiscal policy rule.[14] This reform bill indicates that the Chilean economy has taken prompt action to meet the fiscal challenges posed by the recent substantive trade agreements concluded by the country. Negotiations on a trade agreement between the United States and the CACM economies are likely to reach a successful conclusion in the near future as well. The fiscal challenges that such an agreement will pose for the five Central American economies may be proportionally more formidable than those faced by Chile because tariff revenues represent a larger portion of public-sector income in their case. By the same token, future progress in advancing the Free Trade Area of the Americas (FTAA) agenda with other economies and subregional integration schemes will also have a fiscal impact that should be dealt with on a synchronized basis in order to uphold public-sector solvency.

Another interesting case is that of Brazil, which has five years of fiscal efforts and public-sector structural reforms to its credit. Brazil's newly elected Administration has set itself a strict target for its primary surplus of 4.25% of GDP for 2003 (which is higher than the goals agreed with the International Monetary Fund) in an effort to make rapid progress in achieving greater credibility and building up its reputation on external financial markets. The logical route for Brazil to take in the short run entails reducing the still abnormally high spreads on its external sovereign debt and domestic interest rates. The efforts already made in the areas of fiscal policy and foreign trade will enable the country to remain on a path of fiscal and external financial solvency provided that it can obtain reasonable interest rates, which lately seem to be determined more by expectations than by any other factor.

The main point for the region overall is that during the biennium 2002-2003 a transition process from short-run fiscal adjustment towards more structural fiscal reforms is clearly in progress. There are still numerous challenges to be met in this respect, but the region is headed in the right direction. The inescapable short-term corollary, however, is that during 2003 fiscal policy will not serve as a means of spurring domestic spending to rise from its 2002 levels in any country of the region except in those economies where fiscal revenues decline for cyclical reasons rather than as a result of policy decisions. The absence of an external engine of growth is thus compounded by the absence of a fiscal engine capable of providing the driving force for a reactivation.

3. A more active monetary policy

Monetary policy is clearly the short-term economic policy tool for which the most degrees of freedom have been regained. In an effort to defend themselves from the exchange-rate pressures generated in 2002, many economies of the region (especially in South America) shifted towards a more restrictive monetary policy stance. In other economies, monetary policy was tightened in order to counter the effects of expansionary fiscal policies (particularly some of the Central American and Caribbean economies, such as Costa Rica and the Dominican Republic). The economies in which monetary policy was expansionary (Chile, Colombia, Guatemala, Peru and some English-speaking Caribbean economies) or neutral (Mexico and the dollarized economies)[15] in 2002 were the exception to the rule.

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14 Early in 2000, Chilean economic authorities adopted a structural fiscal rule designed to isolate fiscal policy from short-run, cyclical forces. This rule targets a structural surplus (i.e., calculated on the basis of potential GDP and a long-term price for copper) of 1% of GDP. In addition to the VAT rate hike, the Chilean Government announced that an effort would be made to cut public spending by US$ 300 million in 2003.

15 Ecuador, El Salvador and Panama are dollarized economies; thus, they do not have an explicit monetary policy.

In some of those cases, the efforts of the monetary authorities were weakened to some extent by other forces. In Colombia, for example, monetary policy was loosened in 2002, with reductions in the interbank rate and increased liquidity. In the third quarter, as mentioned earlier, the country's sovereign spread widened considerably, thus driving up long-term domestic rates (which are more directly connected to the business cycle). As a result, the yield curve grew abnormally steep (low short-term rates and very high long-term rates), affecting operations involving public debt securities. Since then, monetary policy has been tightened and long-term rates have been lowered, thereby creating a yield curve that makes more economic sense. This was a case in which the monetary authorities' efforts and the financial market's response were at odds with one another.

The case of Bolivia exhibits some similar features. Up to the third quarter of 2002, the authorities' monetary stance was becoming increasingly contractionary. Market rates were rising in step with the interbank rate. In the fourth quarter, a major shift in monetary policy towards greater liquidity reversed the upward trend in the interbank rate. The market, however, did not follow in the authorities' steps, and deposit rates decoupled from monetary policy. This is a case in which, in effect, policy makers lost control of the market; some progress has been made, albeit slowly, in regaining that control in 2003.[16] At the same time, lending rates decoupled from deposit rates, with the spread between the two widening. This gave rise to an exceedingly odd situation in which monetary policy was injecting liquidity into the economy but the cost of credit was rising. This type of phenomenon has been seen before in other economies of the region when the domestic banking systems adopts a strategy aimed at reducing its portfolios' risk levels at a time when steps are being taken by the monetary authorities to boost liquidity.

Another case that merits special attention is Brazil. This is an economy in which deposit rates and interbank rates have moved in step with one another. In other words, it is a case in which the monetary authorities' and the market' actions have been synchronized. During 2002, exchange-rate pressures caused inflation to accelerate. Nominal interest rates also rose, but not as steeply as inflation had, and real interest rates consequently fell. Inflation then began to decline, but the reduction in nominal interest rates has lagged behind and real interest rates have consequently risen in 2003. The fact that inflation has been more volatile than nominal interest rates has generated a curious effect in which the expansionary and/or contractionary effect of interest rates has been determined more by swings in the inflation rate than by monetary policy. In the short run, Brazil has an opportunity to adopt a more expansionary monetary policy stance while maintaining macro-economic equilibrium.

Above and beyond the specific situations existing in some economies, one of the noteworthy events observed thus far in 2003 is that more countries are implementing more expansionary monetary policies, including those that were overtaken by crises in 2001-2002 (especially Argentina, Uruguay and Venezuela)[17]. Among the economies for which the relevant information is available, only Costa Rica has adopted a neutral monetary policy position in 2003. In the particular case of the Dominican Republic, the more expansionary monetary policy implemented in the second quarter has been specifically linked to the injection of liquidity occasioned by the failure of the Banco Intercontinental (BANINTER). Everything else indicates that this economy will have to move towards a tighter monetary policy during the remainder of the year.

The expansionary orientation of monetary policy reflects the recovery of degrees of freedom for monetary management, but it also stems from the fact that private domestic expenditure has weakened in most of the region's economies. In all likelihood, 2003 will, with few exceptions, prove to be a bad year for consumption and, especially, private investment. The sharp adjustment in the trade balance that was mentioned earlier is directly associated with this probability. This is because the trade balance represents the difference not only between exports and imports, but also between GDP and domestic spending. A low-growth year (as 2003 is projected to be) in which a trade balance adjustment is made (as is also expected) is also a sign of a slump in domestic spending. This partially explains why monetary policy is taking a more expansionary line in most of the region.

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16 Bolivia was hit by a bank run in mid-2002 and in February 2003.

17 In the case of Venezuela, where fluctuations in the exchange rate have been associated with the political crisis in that country, an expansionary monetary policy has become viable in the short run because of the exchange controls that have been instituted.

4. Improved exchange-rate stability

Exchange-rate policy –the third policy tool to be analysed here– is being implemented within a relatively more tranquil framework in 2003, following the disruptions of 2002, especially in the MERCOSUR economies. The year 2002 began with Argentina's abandonment of its convertibility regime in the wake of the steep drop in economic activity seen throughout 2001 and the onset of a severe financial, political and social crisis. The subsequent events in the Argentine economy are well known and will be analysed in later sections of this edition of the *Economic Survey*, but it is worth noting that the sharp real depreciation, which then slackened but continued until June 2002, was followed by a moderate appreciation. Thus far in 2003, the Argentine peso has appreciated by 19% in real terms against the United States dollar and by 7% against the euro. This has made it possible to take partial, gradual steps towards dismantling the exchange controls introduced during the worst days of the crisis. Recently, however, Argentina has also introduced financial measures designed to avert a massive inflow of short-term capital which initially won praise from multilateral institutions. The purpose of these measures has been to curb the recent trend towards an appreciation of the Argentine peso. In the end, the idea is that the pace of the exchange rate should follow a real sector rationale rather than a financial one, thus avoiding past mistakes.

Somewhat later, in June 2002 (but clearly in response to the Argentine crisis), Uruguay discontinued its currency band when it, too, was at a critical juncture. Uruguay's exchange-rate regime was certainly not the pillar of its economic and financial system, as Argentina's convertibility regime had been, and the abandonment of this system, although traumatic, therefore did not have the systemic ramifications that were seen in its neighbour. Nevertheless, in this case too, the steep real depreciation of 2002 has been followed by a real appreciation (7% thus far in 2003) against the dollar. In the case of Brazil as well, a 40% depreciation against the dollar in 2002 has been followed by a 25% appreciation in 2003 to date.

In fact, during the first half of 2003, the currencies of 12 countries in the region –led by the four MERCOSUR economies– have appreciated against the dollar in real terms. These events have followed the logical sequence to be expected after the overshooting of these exchange rates in 2002. This has also been the consequence of reversing capital outflows in the most critical cases, of strengthening the countries' trade balances and, to a lesser extent, of the dollar's depreciation against the euro.

Countries exhibiting features that warrant special mention in 2003 include Haiti, Jamaica, the Dominican Republic and Venezuela. Haiti's currency has depreciated sharply as the country remains immersed in a domestic political crisis and continues to feel the effects of the partial suspension of financial facilities. Jamaica has also been hurt by the deterioration of its macroeconomic and especially fiscal policies in 2003, following the fairly stable exchange-rate conditions it enjoyed in 2002. The Dominican Republic's economy started out the second semester of 2002 with rising inflation and exchange rates. These upward trends were a consequence, in part, of the implementation of an expansionary economic policy despite the slowdown in export growth, but they were mainly attributable to the injection of liquidity received by the Banco Intercontinental (BANINTER) and its subsequent intervention. The Dominican economy is expected to undergo an adjustment process during the remainder of the year. Venezuela, meanwhile, has been adversely affected by the domestic political crisis in that country and by the strike of December 2002-January 2003. These disturbances, in conjunction with the abandonment of the country's currency band system the year before, have triggered a steep depreciation and mounting inflation together with a sharp drop in GDP and sizeable capital outflows. The introduction of exchange controls has afforded some respite during which the authorities have been able to peg the nominal exchange rate, but these measures distort economic signals and would be difficult to maintain in the long run.

The exchange-rate policies of the region's three dollarized economies can be analysed only in terms of the relationship between domestic and international inflation.[18] El Salvador's and Panama's domestic inflation rates have been aligned with international rates, and their real exchange rates have therefore exhibited no major fluctuations. In Ecuador, on the other hand, inflation has –albeit with some ups and downs– been

18 When a nominal exchange rate is fixed by institutional means, as in the dollarized economies of the region, the real exchange rate appreciates/depreciates when domestic inflation is higher/lower than external inflation.

slowing and has recently converged with international rates, thereby putting a stop to the trend towards a real appreciation that had been in evidence since the economy was dollarized. The cumulative real rate of appreciation has, however, been considerable. Although the debate surrounding Ecuador's macroeconomic situation continues, this oil-producing economy has invested in new oil exploration and transport projects, and these investments are expected to improve its balance of payments situation. In that case, the real appreciation derived from accumulated inflation would be more closely limited to a "Dutch disease" problem than to the financial sustainability of dollarization.[19]

Mexico, the Central American economies and Peru have enjoyed a relative degree of exchange-rate stability. In Mexico's case, following a protracted real appreciation, the peso has recently shown a tendency to depreciate, although this has not yet reversed the Mexican economy's apparent loss of competitiveness, as discussed earlier.

All in all, two main features are brought out by an analysis of exchange rates in the region. The first is that, despite the recent appreciation of exchange rates in some of the South American economies, almost all of them are ending up with more competitive real exchange rates that boost their exports and sectors that compete with imports. In the absence of external and/or fiscal engines of growth, the forward momentum being conveyed to the real sector by this increased competitiveness is opening up areas of opportunity more rapidly than in the past. In all of the South American economies whose currencies have depreciated substantially, the agricultural sector (and especially annual and semi-annual crops) are booming.

The other noteworthy development is that exchange-rate variations in South America are having spillover effects on trading partners within the region. For example, although Bolivia devalued its currency against the dollar in 2002, because of the steep depreciation of its trading partners' currencies (especially those of Argentina and Brazil), its real effective exchange rate actually appreciated.[20] By the same token, however, the appreciation of the Argentine peso and the Brazilian real in 2003 have translated into a real effective depreciation of over 11% for the boliviano. Paraguay's currency has appreciated by 14% in real terms against the dollar in the first half of 2003, but, because of the appreciation of the Argentine and Brazilian currencies, its real effective exchange rate has appreciated by just 4%. During the same period, Uruguay's currency has appreciated by 7% against the dollar in real terms, but its real effective exchange rate has depreciated (-4%). The Brazilian real, as mentioned earlier, appreciated by 25% against the dollar in real terms, but, given the appreciation of the Argentine peso and the euro, its real effective exchange rate has appreciated by only 20%. Along the same lines, the Argentine peso has appreciated by 19% against the dollar in real terms but by only 11% in effective terms. All of these cases reflect a reversal of the effects described by ECLAC in the *Preliminary Overview, 2002*.

The main lesson to be drawn from these developments concerns the interdependence of exchange-rate policies at the subregional level, which is increasing further as trade integration processes progress. The corollary of this is that, in order to carry those processes forward, the countries will need to take steps to strengthen their policy coordination and to forestall the adverse effects of the unilateral devaluations carried out in 2002.

19 "Dutch disease" refers to an appreciation of the exchange rate and a loss of international competitiveness by the economy as a whole caused by a boom in non-labour-intensive export enclaves.

20 The real effective exchange rate represents the average of a country's major trading partners' real bilateral exchange rates, weighted by each partner's share in total imports and exports.

C. The internal situation

1. Growth

As noted earlier, it is estimated that regional GDP will grow by 1.5% in 2003, which tops the 2002 rate (–0.6%) but trails the rate forecast six months ago (2.1%). Moreover, countries with rapid growth rates, which could still be found in the region up until 2000, continue to dwindle in number. This year it will be the Dominican Republic's turn, since it will have to embark on an adjustment process and is expected to post negative growth of –1.0%.

The flattening of the regional growth curve predicted for 2003 is attributable to the lack of either a vigorous international economy or reactivating forces within the region. The economies that will achieve the fastest relative growth, in a context of overall listlessness, are the ones that are emerging from recent crises, together with some of those that have successful export sectors.

Argentina will rank first in terms of growth in 2003 (5.5%), out of both the MERCOSUR countries and the region as a whole, with the fastest growth in the sectors that have benefited the most from the real devaluation of the peso. This rebound, however, comes after the steep slide experienced in 2001 and 2002; the country's per capita GDP in 2003 will be 17% low than its 1997 level. Uruguay will also bounce back from the low point it reached in 2002, but will still not experience positive growth in 2003 (–2.5%). In Paraguay, meanwhile, the new administration taking office in mid-August will face a number of pending challenges, including arrears in external debt payments and pressing fiscal problems. Paraguay will nevertheless record positive growth, led by a robust agricultural sector buoyed by favourable weather and exchange-rate conditions. Brazil will post growth of about 1.5% for the third straight year, also because of a burgeoning agricultural sector and expanding exports, albeit with sluggish domestic demand. The degrees of freedom which this economy has accumulated should enable it to achieve greater prosperity in the medium term. The South American giant shows signs of awakening in the near future.

The Andean Community plus Chile[21] will turn in a mixed performance. Venezuela will post the year's lowest growth rate (–13%), despite having begun a significant recovery in the second quarter of 2003. It will thus experience a sharp downturn for the second year in a row, largely because of its domestic political turmoil. Chile's growth will speed up to about 3.5% in 2003 thanks in large part to the strong performance of its export sectors. Like Brazil, it is gearing up for faster growth in the medium term. Ecuador will have a difficult year in 2003, but will continue to post positive growth, on the order of 1.5%. Peru, the region's fastest-growing economy in 2002 (5.3%), is expected to record a rate of 3.5% in 2003, based on a good export performance and an upturn in domestic demand. The figures show that trends in the Peruvian economy are relatively orderly on almost all fronts. Remarkably, this pattern is not associated with an improved capacity to reach political agreements that would enable it to tackle its structural challenges. Bolivia will grow by about 2.0%, compared to 2.7% in 2002. This country has successfully reduced the number of coca plantations and curbed smuggling activities. Naturally, these activities are not fully reflected in the official figures, with the result that the Bolivian economy "feels" as though it were retreating even though its growth rate is positive. Following the serious political problems of last February, the government, the more powerful social strata and representative social groups are working on a national strategy for progressing towards a brighter future. Colombia is the only Andean country whose economic prospects look better now than they did several months ago, and it is projected to grow by 2.5% in 2003. This country has taken action to address its structural fiscal problems, and took advantage of its recent situation of mild recession to achieve a more competitive exchange rate. It is one of the few economies that will increase its investment rate in 2003, thus beginning a recovery from the historic lows of recent years.

21 Despite certain features that set it apart, Chile is more similar to the Andean economies than to the MERCOSUR economies, with an export structure intensive in non-renewable natural resources.

Table I.1
LATIN AMERICA AND THE CARIBBEAN: GDP TRENDS AND PROJECTION, 2001-2003
(*Annual growth rates*)

	2001	2002	2003[a]
Latin America and the Caribbean	**0.4**	**-0.6**	**1.5**
Argentina	-4.4	-10.9	5.5
Bolivia	1.6	2.7	2.0
Brazil	1.5	1.4	1.5
Chile	3.2	2.1	3.5
Colombia	1.5	1.5	2.5
Costa Rica	1.2	2.6	4.5
Dominican Republic	3.0	4.3	-1.0
Ecuador	5.5	3.8	1.5
El Salvador	1.9	2.2	2.0
Guatemala	2.6	2.2	2.0
Haiti	-0.6	-0.5	0.0
Honduras	2.7	2.4	2.5
Mexico	-0.5	0.8	1.5
Nicaragua	3.2	0.7	1.5
Panama	0.4	0.8	2.0
Paraguay	2.4	-2.3	1.5
Peru	-0.1	5.3	3.5
Uruguay	-3.5	-10.7	-2.5
Venezuela	3.5	-9.0	-13.0
Subtotal for the English-speaking **Caribbean**	**2.2**	**1.7**	**2.5**

Source: ECLAC, on the basis of official data.
[a] Projections.

Of the economies of Central America plus those of Cuba, the Dominican Republic and Haiti, the most dynamic will be that of Costa Rica, which, having expanded at an average rate of 4.3% between 1998 and 2002, will grow by about 4.5% in 2003 (compared to 2.6% in 2002). This economy turned in a surprising performance in the first half of 2003, led by assembly activities in its free zones, communications and agriculture, which rebounded from its poor performance in 2002. Despite these positive factors, Costa Rica will have to undertake a structural fiscal adjustment in the short term. Honduras will grow by 2.5% in 2003; El Salvador, Guatemala and Panama, by 2.0%; and Nicaragua, by 1.5%. These are low rates that continue the low-growth trend begun in 2000-2001. Haiti will continue to experience difficulties and is expected to show zero growth in 2003, after two years of negative growth. Cuba's economy grew by 1.1% in 2002, despite a decline in tourism, unfavourable terms of trade and natural disasters. A marginal improvement on that rate is expected in 2003. Lastly, the Dominican Republic will record negative growth in 2003 (-1.0%), something that it has not done since 1990.

The reactivation of the Mexican economy has not yet materialized. Nonetheless, a slight expansion is expected for the year as a whole, and a growth rate of up to 1.5% is projected. This means that per capita GDP will be flat, after having shrunk during the two preceding years. The country's principal challenge in the medium term will be to boost its external competitiveness.

Growth in the English- and Dutch-speaking Caribbean will be led by Trinidad and Tobago. This oil-exporting economy has received large inflows of investment, grew by an average of 5.5% between 1998 and 2002 and is projected to grow by about 4% in 2003. This subregion will grow by about 2.5%, bolstered mainly by a recovery in tourism and, in some cases, a good year for agriculture.

2. Investment and saving

Latin America's gross fixed capital investment is expected to increase moderately in 2003 (1.0%), while its investment rate will remain at about 18% of GDP, measured in constant 1995 prices. This is comparable to the 1988 level, the lowest recorded in the 1980s, and is significantly lower than the average for the 1990s (19.5%). The low level of investment shows that the region as a whole is not increasing its medium-term growth capacity. This is not surprising, since investment, along with imports, is the real variable most strongly affected by business cycles. The highest investment growth rates will be in Argentina, Colombia, Costa Rica and Peru, as the first two countries recover from historic lows (experienced in 2002 in Argentina and in 1999-2000 in Colombia).

At the same time, it is important to note the response capacity that national saving will demonstrate this year. The fact that the current account of the balance of payments has reached a state of near-balance indicates that almost all of this year's investments will be financed with national savings. While this development is associated at present with slack domestic spending, it is also driven largely by a change of behaviour with respect to saving. To the extent that the region emerges from its current difficulties with higher saving rates, more competitive exchange rates and lower real interest rates, as has been the case up to now in most of the countries, it will have laid the groundwork for a more export- and investment-intensive recovery. If this proves to be the case, the recovery will be able to support higher medium-term growth rates. To achieve this outcome, however, some thorny economic policy challenges will have to be addressed. The structural adjustment of fiscal accounts, which is proceeding throughout the region, represents a step in this direction.

3. Inflation

Inflation in Latin America is expected to average 8.6% for the period December 2002 to December 2003. Thus, inflation will fall steeply after having shot up to 12.1% in 2002 (from 6.0% in 2001). Of the 20 countries considered here, the number with double-digit inflation will fall from seven in 2002 (Argentina, Brazil, Dominican Republic, Haiti, Paraguay, Uruguay and Venezuela) to only three in 2003 (Dominican Republic, Haiti and Venezuela). In other words, in 2003 this group will no longer include the four MERCOSUR economies, but will continue to include the economies with the highest nominal depreciation rates.

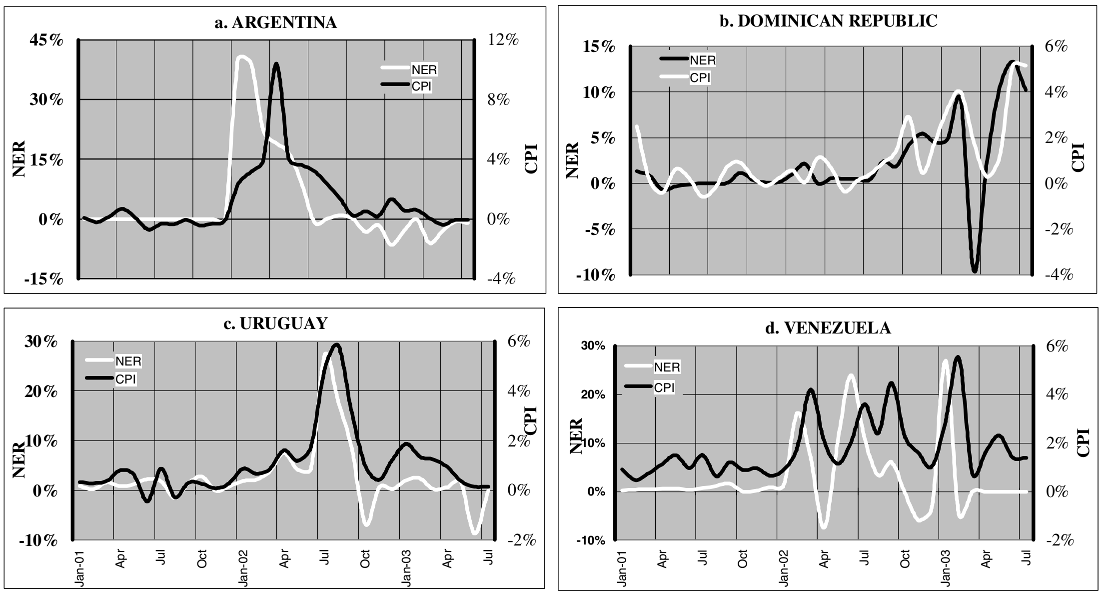
This clearly demonstrates that the recent fluctuations in inflation rates have been associated primarily with exchange-rate volatility. Figure I.3 shows monthly devaluation rates for the currencies of the four countries that accumulated the sharpest devaluation in 2002 and thus far in 2003, along with the corresponding monthly inflation rates. In the cases of Argentina and Uruguay, three relevant observations may be made. First, the acceleration and subsequent deceleration of inflation are associated with movements in the nominal exchange rate; second, the magnitude of changes in the exchange rate is greater than that of changes in inflation, so that a significant fraction of the changes in the nominal exchange rate translates into changes in the real exchange rate; and third, inflation is not persistent, indicating that the progress made in dismantling price indexation in these countries is having an effect. These three features of the relationship between the exchange rate and inflation are also observed in the cases of the Dominican Republic and Venezuela, albeit less clearly owing to the fluctuations in their exchange rates.

These observations do not hold in cases of moderate inflation and devaluation, such as that of Mexico, where inflation is expected to fall from 5.7% in 2002 to about 3% in 2003 despite the moderate devaluation of its currency this year. The relevant factor in this case is a narrowing of markups.

In short, the main conclusion for the bulk of the region is that the acceleration of inflation in 2002 and the slowdown in 2003 are phenomena primarily related to the exchange-rate.

As mentioned earlier, the biggest slowdown in inflation in 2003 is taking place in the four MERCOSUR economies. Argentina will make the most progress, with inflation of around 5% (compared to 41% in 2002). Brazil, Paraguay and Uruguay will post inflation of under 10% in 2003, after having recorded double-digit rates in 2002 (12.5%, 14.6% and 25.9%, respectively).

Figure I.3
CHANGES IN THE NOMINAL EXCHANGE RATE AND THE CONSUMER PRICE INDEX
(*Monthly percentage variations*)



Source: ECLAC, on the basis of official data.

The situation in the Andean countries will be mixed, with the highest inflation being observed in Venezuela (30%, as compared to 31.2% in 2002). In Colombia, inflation will approximate its 2002 rate (7%). Bolivia and Peru will post rates of between 2% and 3%, consolidating their low rates of recent years, while Chile's inflation will stay within the target range, at 3.5%. Since Ecuador has a dollarized economy, its inflation rate is especially relevant to its external competitiveness. Although it is finally achieving inflation rates that are consistent with international standards, its annual rate will exceed 6% as a result of the inflation accumulated in the first quarter and will not reverse the real appreciation which its currency has accumulated since dollarization was introduced.

Central America will keep its inflation at a rate similar to that of 2002. The highest rates will be found in Costa Rica (at about 9%) and Nicaragua (at about 7%, as compared to 4.0% in 2002). El Salvador and Panama, the two dollarized economies in this area, will again post inflation rates in line with international standards (about 3% in El Salvador and 1.5% in Panama). Guatemala and Honduras, meanwhile, will post inflation of about 6%.

The Dominican Republic is grappling with a complicated situation involving a depreciating currency and an upswing in inflation. The inflation rate is expected to triple this year, bordering on 30%. If the adjustment process is carried out quickly, the authorities may manage to rein in the depreciation of the exchange rate and bring monthly inflation down towards the end of the year. The situation in Haiti is even more complex, and will be reflected in significantly higher inflation that is hard to estimate for this year (having reached 14.8% in 2002).

Most of the English-speaking Caribbean countries will continue to post low inflation in 2003. The exceptions will be Suriname, where inflation sped up significantly last year, and Jamaica, which, as mentioned earlier, is faced with complex macroeconomic policy dilemmas.

4. Employment and wages

In 2002 the region's labour markets were heavily influenced by the contraction or slowdown in economic activity. The employment rate fell for the second year in a row, the generation of formal employment was weak and most new jobs were concentrated in low-productivity sectors. Urban unemployment increased by about one million people, and the unemployment rate reached a record high of 8.9% of the workforce.

Meanwhile, real wages followed the pattern of changes in inflation, and in 2002 fell by an average of 1.6%. The deterioration of working conditions was concentrated in countries suffering severe economic crises –especially within MERCOSUR– but the sluggishness of employment generation was a widespread phenomenon that also affected countries achieving moderate growth.[22]

In 2003, the labour situation is expected to improve slightly. In the first half of the year, Chile, Colombia, Peru and, especially, Argentina succeeded in increasing employment and reducing unemployment. However, the listlessness of the region's two biggest economies (Brazil and Mexico) has affected the regional average. This is why, for the region as a whole, unemployment in the first half of this year declined only moderately in relation to the same period of 2002, and no major changes are expected for the second half of the year.

While the unemployment rate for the year as a whole is likely to show little change, the increase in the labour supply –attributable to both demographic factors and a higher labour participation rate– will increase the number of urban unemployed by about 750,000 people, bringing the number of people in this situation to 13.6 million.[23]

Argentina's labour market indicators have shown steady improvement in 2003, although the year-on-year comparison of some variables is still negative for the first semester. Its labour situation became more volatile in the biennium 2002-2003; with a loss of formal employment that reached a year-on-year rate of over 10% in mid-2002, open unemployment rose to a new high of 21.5% in May. Owing largely to a massive public-sector employment programme, the expansion of informal-sector employment and the gradual stabilization of formal employment through an improvement in the competitiveness of tradable goods-producing sectors, Argentina's employment rate began to recover in the second half of 2002. Accordingly, in May 2003 the employment and unemployment rates reached levels similar to those recorded in May 2001. At the same time, reflecting trends in inflation, real wages plummeted for much of 2002, though they have stabilized since the end of that year. The labour situation in Uruguay and Venezuela, meanwhile, seems to have bottomed out but has yet to show any clear sign of an upturn.

In 2002, changes in real wages in the region were determined largely by the sign and magnitude of changes in the inflation rate, which, as shown earlier, mirrored changes in exchange rates. In one group of countries (representing the majority), declining inflation had the effect of pushing up real wages in the formal sector, while in the countries with the biggest increases in exchange rates and inflation (the MERCOSUR countries and Venezuela), the purchasing power of wages fell.

In 2003, nominal wages in that first group of countries have inched upward only slightly, in a context of sluggish economic activity and stalled average labour productivity. Since inflation has generally stayed relatively stable (and low) in these countries, real wages have shown little movement. In the other group of countries, a year-on-year comparison continues to show negative results. However, as their currencies appreciate and their inflation rates subside, as of mid-year these countries' real wages are stabilizing and are tending to recover at least partially, depending on the strength of economic recovery, especially in Argentina and Uruguay.

Overall, 2003 will be a better year than 2002 in terms of growth, employment, inflation and the situation of the financial and external accounts, although the basis for comparison is hardly a demanding one. These variables are expected to continue to make progress in 2004, albeit at a slower pace than might be desired. To a large extent, next year's performance will hinge on developments in the world economy, whose potential return to faster growth is still fraught with uncertainty.

22 The median growth rate of employment in the region was –1.5%.

23 In Brazil, a new methodology for measuring labour market variables shows higher magnitudes and rates of urban unemployment than previous measurements, but the old and new data are thus not comparable. Given Brazil's size, this is also true of regional figures that include information on Brazil derived from the old and new methodologies, respectively.

Chapter II

The regional economy in 2002-2003

Introduction

This chapter provides an analysis of the regional economy in terms of its main thematic areas.

(i) The external sector is analysed from the standpoint of the balance of payments and indicators such as commodity export prices, the terms of trade, goods and services trade, capital flows and foreign borrowing.

(ii) Economic policy is reviewed in its fiscal, exchange-rate and monetary dimensions.

(iii) Domestic performance is examined from several angles: sectoral supply, aggregate demand, saving as a financing source for investment, inflation, wages and employment.

A. The external sector

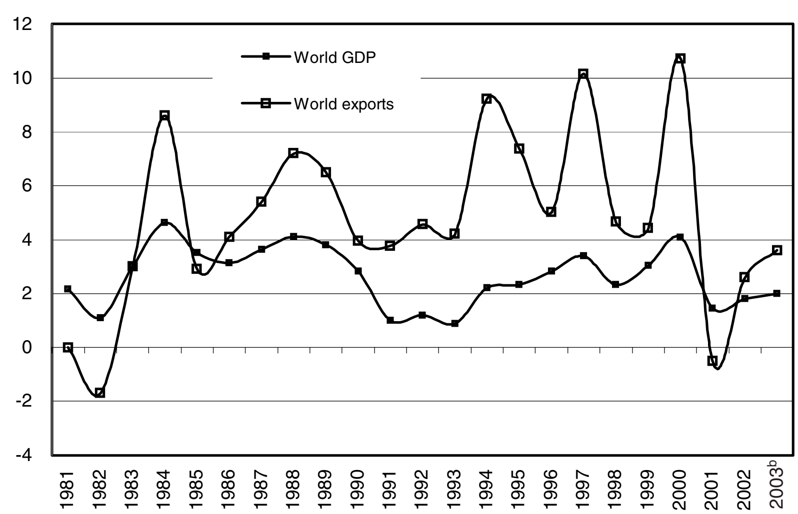
In 2002, Latin American and Caribbean imports suffered a massive contraction, and, for the first time in a decade, the balance of trade in goods and services posted a surplus, which significantly reduced the balance-of-payments deficit on current account. For 2003, the trade surplus is forecast to increase further, on the back of stronger exports, with imports recovering only slightly. Given the behaviour projected for the other accounts, the regional current account is likely to be virtually in balance. Foreign sales strengthened in 2002, especially in countries that made exchange-rate corrections during the year and thus became more competitive on the world market. In most cases, however, devaluations in 2002 were associated with major financial upheavals that affected several countries and caused large-scale capital flight. The region's net outward resource transfer amounted to US$ 40.4 billion, equivalent to 2.5% of GDP at current prices; in 2003 this is forecast to drop to US$ 15 billion, or 0.9% of GDP.

1. Slow growth of the world economy

Following a slowdown in the growth of world output and trade in 2001, a slight recovery was discernible in 2002, although rates of expansion remained below the average achieved during the past decade.[1] During the first quarter of the year, the United States seemed to be moving towards a more vigorous recovery, but economic growth was irregular thereafter, and only reached 2.4% for the year as a whole. Meanwhile, a near-recessionary climate prevailed throughout 2002 in the euro zone and Japan, which grew by 0.9% and 0.2% respectively (see figures II.1 and II.2).

The first quarter of 2003 was overshadowed by the armed conflict in Iraq, which heightened uncertainty throughout the world economy and caused a steep rise in the price of oil. Following the rapid conclusion of the war itself, most analysts expected worldwide economic activity to gather pace in the second part of the year, with growth continuing into 2003. These predictions were largely based on two assumptions, however: that the United States economy would grow faster than it had in 2002, and that oil prices would ease back. In fact, the slow progress of the United States economy in the first quarter of 2003 followed by a slight acceleration in the second (heavily influenced by increased military spending), together with preliminary figures from a range of indicators for the rest of the year, would suggest annual growth of little more than 2%.[2] The outlook could improve if the cut in federal fund interest rates (to 1%), announced by the United States Federal Reserve in June, in conjunction with the earlier fiscal stimulus package, were to exert an expansionary effect during the second half of the year. The euro zone has also been in the doldrums, with signs of recession and deflation visible in Germany. Even assuming a degree of recovery in the second half of the year, the outlook is for annual growth of about 1% for the European Union as a whole. In Japan, first-quarter figures revealed a slight strengthening of activity, suggesting a 1% expansion for the year overall, provided exports recover as expected. Projections made by the United Nations Department of Economic and Social Affairs see the world economy expanding by slightly over 2% in 2003, with total export growth of just under

Figure II.1
WORLD GROSS DOMESTIC PRODUCT AND EXPORTS
(*Annual rates of variation at constant prices*) [a]



Source: ECLAC, on the basis of figures from the World Trade Organization (WTO).
[a] Annual GDP growth rates are weighted according to each economy's share of nominal world GDP in 1990, expressed in dollars using market exchange rates.
[b] Projections made by the United Nations Department of Economic and Social Affairs.

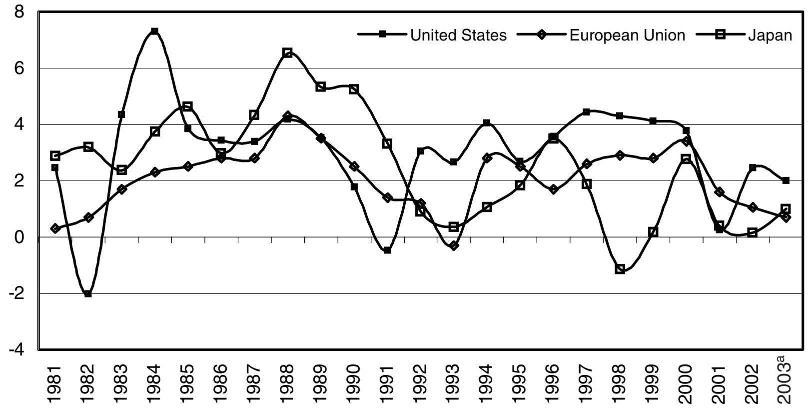
1 According to the World Trade Organization (WTO), global GDP grew in real terms at an annual average rate of 2.5% during the 1991-2000 decade, while worldwide merchandise exports expanded at 6.7% per year, albeit with wider fluctuations than in the case of GDP.

2 See L.R. Klein and S. Ozmucur, *Weekly update on the US economy and financial markets,* 4 August 2003.

Figure II.2

GROSS DOMESTIC PRODUCT OF THE UNITED STATES, JAPAN AND THE EUROPEAN UNION

(*Annual rates of variation at constant prices*) [a]



Source: ECLAC, on the basis of figures from the Bureau of Economic Analysis of the United States Department of Commerce, the Economic Study of Europe of the United Nations Economic Commission for Europe (ECE), the Statistical Office of the European Communities (EUROSTAT), and the Department of Statistics of the Ministry of Public Administration, Internal Affairs, Post and Telecommunications of Japan.

[a] Projections based on estimates from the Project Link quarterly model (for the United States and Japan), and the preliminary indicator of Observatoire français des conjonctures économiques (OFCE) in the case of the European Union.

4% –broadly similar to results in 2002.[3] Only more vigorous demand in the United States could produce the change in trend needed to climb out of the downswing that began in 2001.

The problems weighing on the world economy stem partly from uncertainties caused by geopolitical events, or others such as the outbreak of atypical pneumonia that affected a number of Asian countries; but they also reflect more deep-seated economic factors. These include low profitability, the existence of idle capacity in a number of industrial sectors (communications and information, the aeronautical and automotive industries) and falling stock-market indices. The steep slide in share prices is putting heavy pressure on financial-institution and enterprise balance sheets, and has also eroded family asset values, thereby discouraging consumption and investment.[4] In addition, the recent depreciation of the dollar against the euro, and to a lesser extent against the yen, makes it harder for United States imports to energize the world economy. Macroeconomic imbalances have also worsened in that country, and higher unemployment is dampening consumer demand. This panorama, while not one of outright recession, is far from displaying propitious conditions for restoring the global economy to a sustained growth path, as was expected following a short war in Iraq.

This general lack of momentum reduces net capital flows to developing countries. Projections by the Institute for International Finance (IFI) suggest that such flows will grow from US$ 110 billion in 2002 to US$ 139 billion in 2003; but this would still leave them 30% below their 2000 level.[5] Foreign direct investment (FDI) is forecast to shrink in 2003, yet it will still contribute about 80% of total net capital inflows. The Organisation for Economic Co-operation and Development (OECD) confirms this forecast and draws attention to the downward trend in mergers and acquisitions during the first five months of 2003.[6] According to the IFI projection on debt flows, bank borrowing is expected to be virtually non-existent, while non-bank debt (mainly bonds) is expected to grow from US$ 12.4 billion to US$ 25.1 billion.

3 See United Nations Department of Economic and Social Affairs, *World Economic and Social Survey*, 2003.

4 After posting an all-time high in March 2000, three years later the NASDAQ index had fallen by 73%. During the same period the Dow Jones and the Dow Jones Europe indices fell by 20% and 54% respectively. During the stock-market crash of 1929 the Dow Jones index fell by 48%, measured as the difference between its highest and lowest values in that year.

5 See Institute for International Finance (IFI), *Capital flows to emerging market economies*, 15 May 2003.

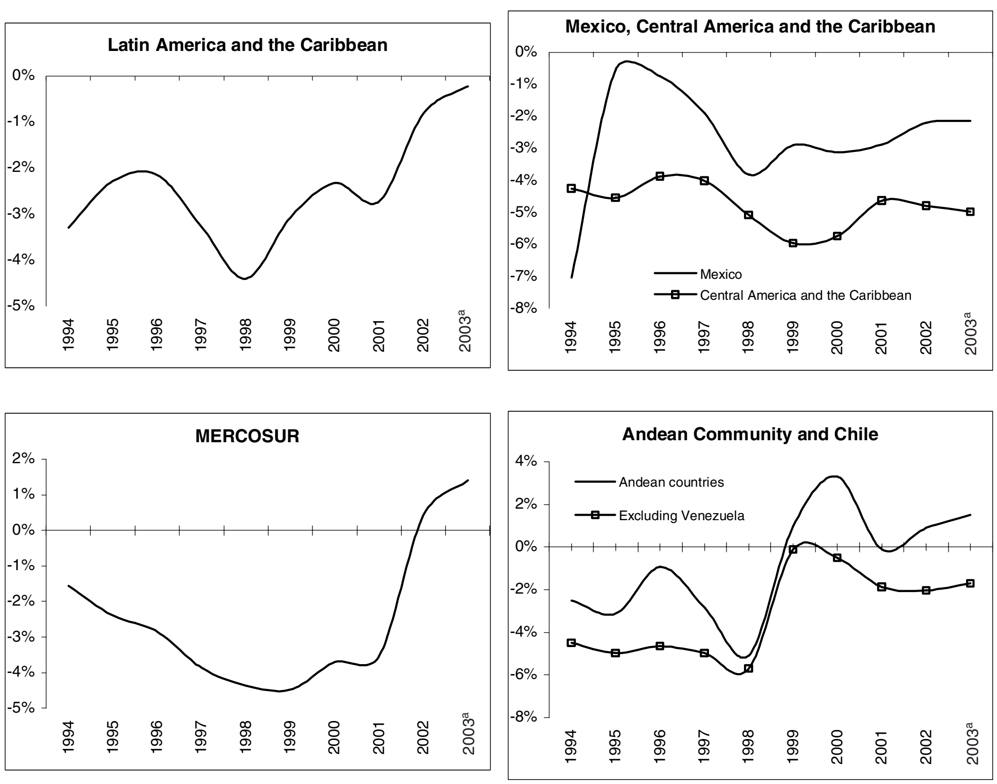
6 See OECD, *Trends and recent developments in foreign direct investment*, June 2003.

2. The balance of payments

Between 2001 and 2003 the balance of payments of Latin America and the Caribbean saw major changes. First and foremost, the current account deficit narrowed appreciably, from 2.7% of GDP in 2001 to 0.8% in 2002.[7] In 2003 a deficit of just 0.2% of GDP is forecast, which means the current account will be practically in balance.

As figures II.3 and II.4 illustrate, current account trends vary widely across the region, and were heavily influenced by large surpluses in Venezuela and the MERCOSUR countries (except Brazil) in 2002.[8] Projections suggest that these countries will maintain surpluses in 2003, while the current account deficit in Brazil will be practically nil. In contrast, Chile and the Andean Community countries (except Venezuela) posted current account deficits similar to those of 2001, although these are expected to narrow slightly in 2003. In Mexico, the current account deficit narrowed in 2002 but is expected to remain stable in 2003, whereas deficits widened in the Central American and Caribbean

Figure II.3
LATIN AMERICA AND THE CARIBBEAN: TREND OF THE CURRENT ACCOUNT OF THE BALANCE OF PAYMENTS
(*Percentages of GDP at current prices*)

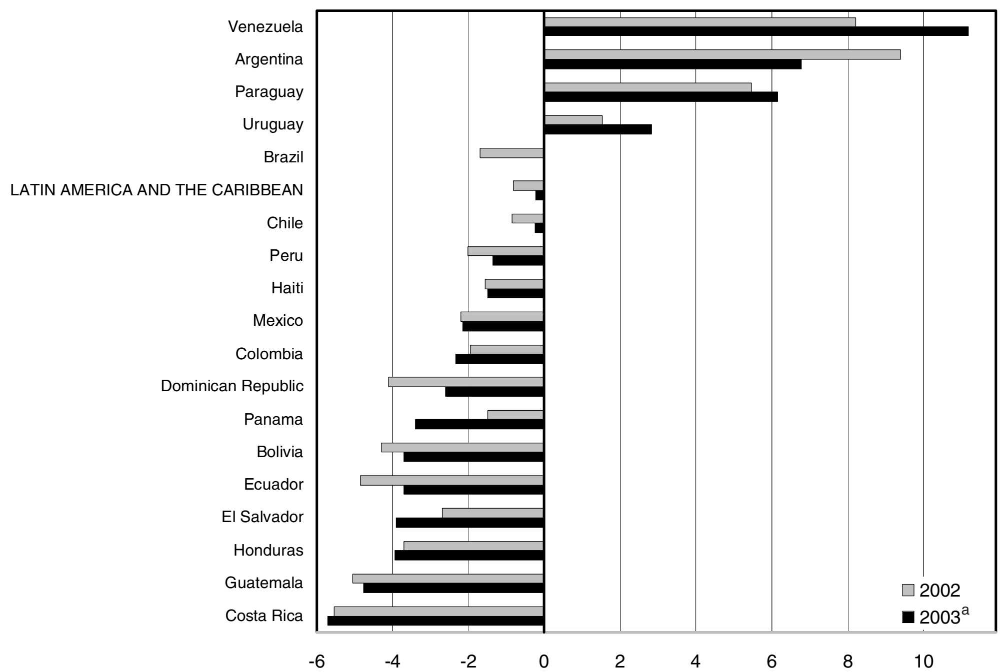


Source: ECLAC, on the basis of official figures.
[a] Projections.

7 Calculation of the current account balance in relation to GDP is based on officially published balance-of-payments figures. These balances (with the opposite sign) differ from external saving because the latter is calculated from national account figures in which balance-of-payments data are adjusted for this purpose. Another influence is external saving itself, which is the sum (with opposite sign) of the balances on the current and capital accounts –the latter as defined in the fifth edition of the *Balance of Payments Manual* of the International Monetary Fund (IMF).

8 Figure II.3 does not include Nicaragua, because the high relative size of its current account deficit seriously distorts the regional or subregional averages.

Figure II.4
LATIN AMERICA AND THE CARIBBEAN: CURRENT ACCOUNT BALANCE
(*Percentages of GDP*)



Source: ECLAC, on the basis of figures from official sources and the International Monetary Fund (IMF).
[a] Projections.

countries in 2002, and are set to expand further in 2003 except in the Dominican Republic and Guatemala.

In 2002 the region generated a surplus of US$ 24.3 billion in its merchandise trade, following a deficit of US$ 1.6 billion in the previous year (see table II.1); and for 2003, the surplus is projected to widen to about US$ 37.2 billion. The underlying factors differ from one year to the next: in 2002 there was a steep fall in imports (6.7%), caused mainly by the crisis facing the MERCOSUR countries and Venezuela. The import contraction explains 60% of the variation in the regional current account balance for that year, while merchandise exports grew by 0.8% (0.1% excluding oil). In contrast, for 2003, exports are projected to expand by about 4.4% (3.5% excluding oil), with imports staging only a slight recovery (0.8%). This means that the region's external sales will have gathered pace during the course of the biennium. In 2002, export buoyancy was confined to a group of countries in which investments to exploit natural resources reached maturity (e.g., Peru) or foreign sales reacted to exchange-rate corrections (as occurred in Brazil). In 2003, exports are expected to grow on a more widespread basis, but will also reflect the effects of devaluations –particularly in the MERCOSUR countries, but also in Chile and the Dominican Republic, among others. There are also cases that probably reflect supply-side influences, such as the oil pipeline in Ecuador coming on stream, and production strategies among firms established in Central American duty-free zones. Foreign sales by Mexico and Venezuela were particularly weak during the biennium –the first case resulting from an overvalued exchange rate and loss of competitiveness, and the second reflecting a severe institutional crisis.

Although net payments of interest and profits receded in 2002 for the first time since 1992, gross outflows in this category rose to US$ 50.7 billion –far outweighing the combined surplus in goods and services trade and current transfers, which amounted to US$ 37.2 billion. For 2003, net payments on the income account are projected to expand further to US$ 54.8 billion. In some countries, this is explained by larger profit remittances, stimulated by currency appreciation and the recovery of economic activity. In other cases, it is almost entirely the result of higher interest payments, reflecting the nominal debt expansion that occurred in 2002, since interest rates on external debt have actually

Table II.1
LATIN AMERICA AND THE CARIBBEAN: BALANCE OF PAYMENTS
(*Billions of dollars*)

	1994	1995	1996	1997	1998	1999	2000	2001	2002[a]	2003[b]
Current account	-51.6	-38.0	-38.9	-64.9	-87.3	-53.8	-45.3	-51.2	-13.4	-3.7
Balance on goods	-12.7	3.3	5.3	-11.9	-33.4	-5.7	4.4	-1.6	24.3	37.2
Exports Fob	188.5	229.5	257.3	286.4	283.2	299.1	358.3	343.5	346.4	361.7
Imports Fob	-201.2	-226.2	-252.1	-298.4	-316.6	-304.8	-353.9	-345.1	-322.1	-324.5
Balance on services	-15.6	-15.6	-15.5	-19.8	-20.7	-15.9	-16.9	-19.3	-14.0	-14.6
Income balance	-36.1	-40.8	-43.2	-48.3	-49.9	-51.5	-53.2	-54.5	-50.7	-54.8
Current transfers	12.8	15.1	14.5	15.1	16.7	19.2	20.4	24.2	26.9	28.5
Capital and financial account [c]	41.7	29.8	67.7	83.6	68.9	47.8	60.0	32.9	-14.2	...
Net FDI	24.4	25.8	40.3	57.0	60.6	79.6	67.8	68.7	39.0	...
Financial capital[d]	17.3	4.0	27.4	26.7	8.3	-31.7	-7.7	-35.8	-53.2	...
Overall balance	-9.9	-8.2	28.7	18.7	-18.5	-6.0	14.7	-18.4	-27.6	...
Reserve assets (variation)[e]	4.5	-23.1	-26.1	-15.8	9.6	6.3	-7.0	1.2	3.2	...
Other financing	5.5	31.3	-2.6	-2.9	8.9	-0.3	-7.7	17.2	24.5	...

Source: ECLAC, on the basis of figures from official sources and the International Monetary Fund (IMF).
[a] Preliminary figures.
[b] Projections.
[c] Includes errors and omissions.
[d] Refers to balances on the capital and financial account, less foreign direct investment, plus errors and omissions.
[e] A minus sign denotes an increase in reserve assets.

fallen.[9] Current transfers, mostly family remittances, continued to trend upward in 2002, and are expected to grow further in 2003 to reach a total of US$ 28.5 billion.

The balance on the capital and financial account in 2002 showed a net capital outflow of US$ 14.2 billion, following the US$ 32.9 billion inflow recorded in the previous year. This is the result of net inward FDI amounting to US$ 39.0 billion –about 57% of the figure recorded in 2001– and an outflow of financial capital (which covers all other capital flows, including errors and omissions) totalling US$ 53.2 billion, equivalent to 3.3% of regional GDP. Financial capital has been moving out of the region since 1999, but in 2002 the outflow grew to exceptional levels, clearly related to the ongoing crises in Argentina, Brazil, Uruguay and Venezuela.

The net outcome of current account flows combined with flows on the capital and financial account produced an overall balance-of-payments deficit of US$ 27.6 billion in 2002 (1.7% of regional GDP). The shortfall had to be met by drawing down reserves and making use of exceptional financing, such as credits from the International Monetary Fund (IMF), and, in some cases, by delaying external debt principal and interest payments.

3. The net resource transfer[10]

In 2003 total capital inflows are expected to amount to about US$ 40 billion.[11] With net profit and interest payments estimated at around US$ 55 billion, the region is likely to record a net resource transfer abroad of approximately US$ 15 billion (equivalent to 0.9% of GDP at current prices).

9 In view of the arrears that several countries have accumulated, especially Argentina, interest actually paid is likely to be less than interest accrued, which is the figure recorded in the income account. Countries with external liabilities in euros have also seen their debt increase given the real appreciation of that currency in recent months.

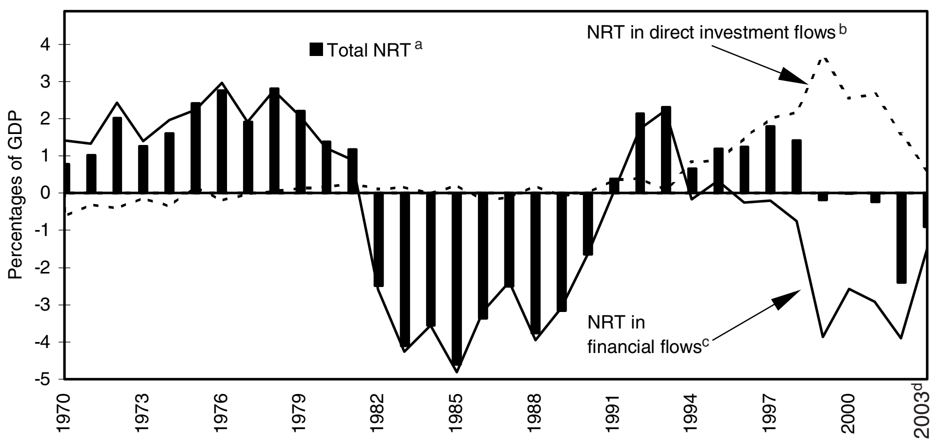
10 The net resource transfer (NRT) is calculated as the total net capital inflow, minus the balance on the income account (net profit and interest payments). The total net capital inflow corresponds to the balance of the capital and financial account, plus errors and omissions, plus loans and the use of IMF credits and exceptional financing. The direction of the region's net resource transfer began to change in 1999.

11 The total capital inflow corresponds to the sum of autonomous capital inflows, exceptional financing and IMF loans.

These results make 2002 the fifth consecutive year in which the region has recorded a net resource transfer abroad (see figure II.5); moreover, this year the outflow reached the unprecedented level of US$ 40.4 billion (2.5% of GDP), half of which is accounted for by results in Argentina. In contrast, direct investment inflows are expected to remain positive in 2003. Capital flows in this category prevented the overall transfer from being negative between 1999 and 2001, despite their clearly declining trend, which continued in 2002-2003. Future difficulties can be foreseen for the region in financing its substantial factor-service payments, if FDI inflows continue to decline at their current rate, profit remittances gradually increase and financial transfers remain negative (as is now happening for the eighth year in a row).

The pattern of net resource transfers from abroad is not homogeneous throughout the region (see figure II.6). The Central American and Caribbean countries have received external funding continuously since 1989, albeit at a decreasing rate since 1997. Mexico, meanwhile, has recorded positive transfers since overcoming its 1995 financial crisis. In contrast, in MERCOSUR, the Andean Community and Chile, transfers have been declining or overtly negative since 1996-1997. The balance-of-payments crisis that affected several of these countries in 2002 caused substantially larger outflows of financial capital than in the previous year, which was reflected in a negative resource transfer abroad equivalent to about 6% of GDP.

Figure II.5
LATIN AMERICA AND THE CARIBBEAN: NET RESOURCE TRANSFER
(*Percentages of GDP at current prices*)



Source: ECLAC, on the basis of official figures.

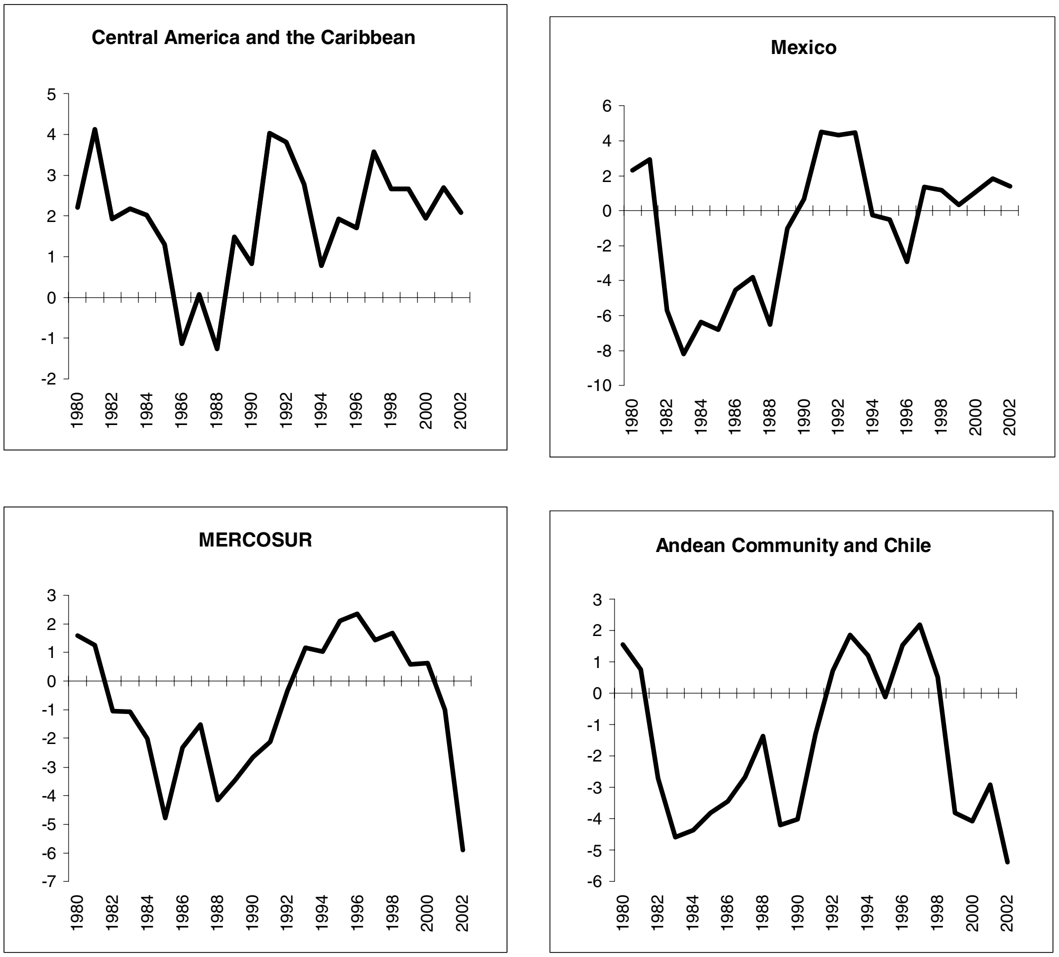
[a] The net resource transfer (NRT) is calculated as the total net capital inflow, minus the balance on the income account (net profit and interest payments). The total net capital inflow corresponds to the balance of the capital and financial account, plus errors and omissions, plus loans and the use of IMF credits and exceptional financing. Negative figures imply resource transfers abroad.

[b] Equivalent to net inward foreign direct investment (FDI), less net profit remittances.

[c] Equivalent to the net inflow of capital other than FDI, less net interest payments.

[d] Projections.

Figure II.6
LATIN AMERICA AND THE CARIBBEAN: NET RESOURCE TRANSFER BY SUBREGION
(*Percentages of GDP at current prices*)

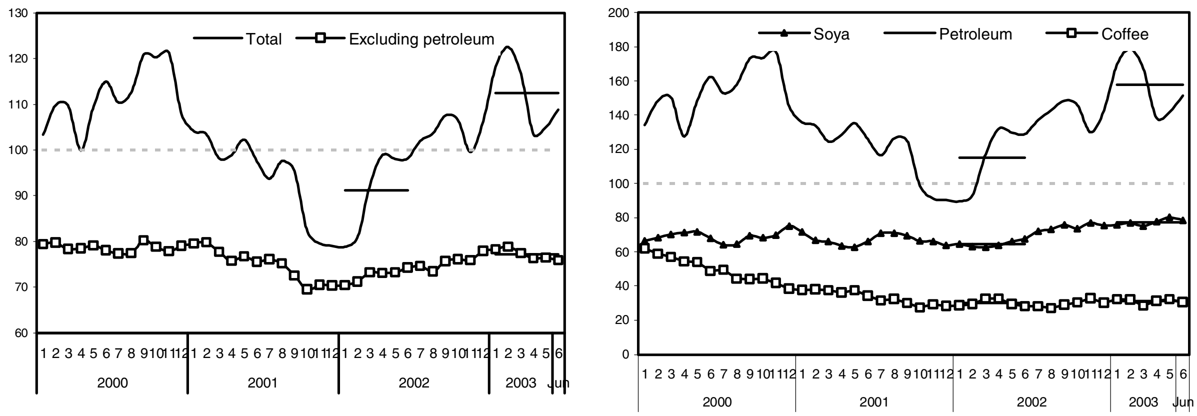


Source: ECLAC, on the basis of official figures.

4. Commodity prices

The weakness prevailing in the world economy since 2001 has had an adverse effect on the prices of commodities exported by Latin America and the Caribbean (see figure II.7). As the world economy slowed in 2001, the aggregate index of commodity prices fell sharply, pulled down mainly by the price of oil. Symmetrically, 2002 saw a marked recovery that extended into the first half of 2003, again basically reflecting the behaviour of hydrocarbons prices. The recent rise in oil prices is explained by a number of factors that have counteracted sluggish world demand for this product, which grew by just 0.5% in 2002. The Organization of the Petroleum Exporting Countries (OPEC) cut production levels by 6% in 2002, and this was compounded by uncertainty during the year concerning the possibility of armed conflict in Iraq, and various interruptions of oil production in Venezuela and Nigeria during the same period. The average per-barrel price of Tía Juana crude (which is included in the index) climbed by 11% from US$ 20.2 to US$ 22.4 in 2002, and in the first half of 2003 reached US$ 27.6 –38% above the level recorded during the same period of 2002. Any future easing of the price depends on the speed with which stocks are replenished in the United States; these stocks were at unusually low levels in mid-2003. Clearly the rapid conclusion of the war in Iraq has not had positive repercussions on this market, since a sustained fall in prices had been expected.

Figure II.7
LATIN AMERICA AND THE CARIBBEAN: EXPORT COMMODITY PRICES
(Index 1997 = 100) [a]



Source: ECLAC, on the basis of official figures.
[a] Price indices weighted by each product's share of the region's exports in 1995.

Excluding oil, commodity prices fell by 1.1% in 2002, but then rose by 6% in the first half of 2003 compared to the same period a year earlier. Nonetheless, their average level is still below that recorded in 2000. Generally speaking, the prices of non-oil commodities remained very weak in 2000-2003, trailing their 1997 levels by 25%. Falling prices affected the vast majority of commodities in 2002, albeit with important exceptions including maize, wheat, cacao, soya products, wool and fish meal. The price of soya products climbed by 20% during the first half of 2003, having risen in 2002 on the back of stronger world demand, particularly from China and India, assisted by production cuts in the United States. Nonetheless, prices remain far below the levels recorded in 1997. Soya prices are likely to remain strong in 2003, thanks to sustained demand and the fact that the area currently under cultivation in the United States is less than in 2002; but they will probably weaken in 2004 as worldwide production expands. Sugar, maize, wheat, cotton, wood pulp, tin and steel sheet displayed similar price trends (two-digit increases in the first half of 2003 while remaining at very low levels). After falling in 2002, the price of copper enjoyed a minor upturn in the first half of 2003, reflecting low inventory levels; but it remains 26% off the average recorded in 1997. The only non-oil products to register prices significantly higher than in 1997 are cacao and wool, worldwide production of which has declined in recent years. Following a 10% fall in 2002, the price of coffee rose slightly in the first half of 2003, in the wake of production cuts and the withholding of sales in several countries, but it remains 70% below its 1997 value. Banana prices, which were already very low, again fell steeply in the first half of 2003.

5. The terms of trade

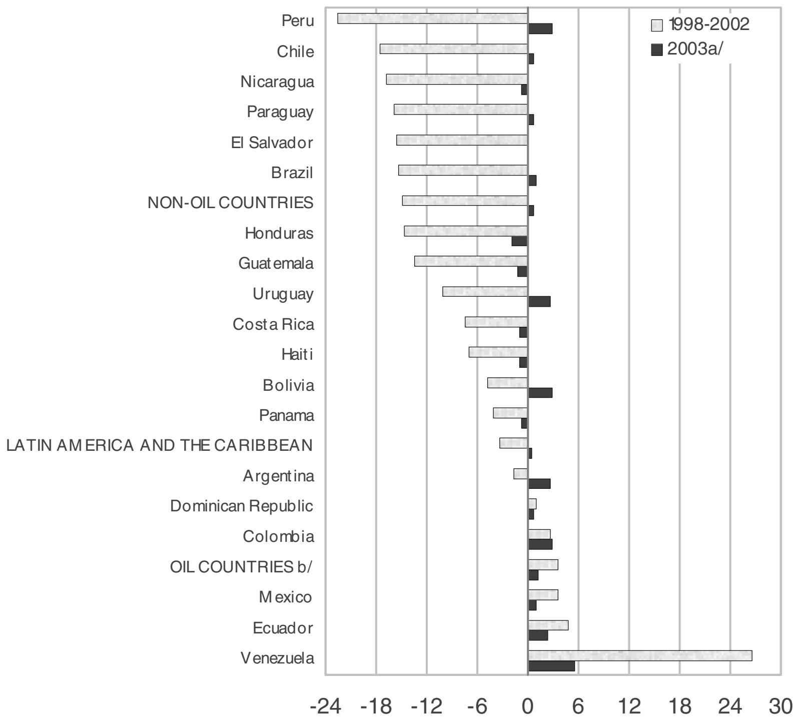
Unfavourable price trends among the region's export products, combined with a much more moderate decline in import prices, caused the terms of trade to worsen between 1998 and 2002 (see figure II.8).[12]

During this period, the non-oil economies accumulated a loss of 14.9%. Even when oil-exporting countries are included, the terms of trade for the region as a whole declined by 3.4%. On the other hand, the purchasing power of exports grew steadily over the same period (see figure II.9),[13] which means that the region has more than offset its terms-of-trade loss by exporting larger volumes.

Although this has boosted activity in the export sector, it also shows that the region's participation in

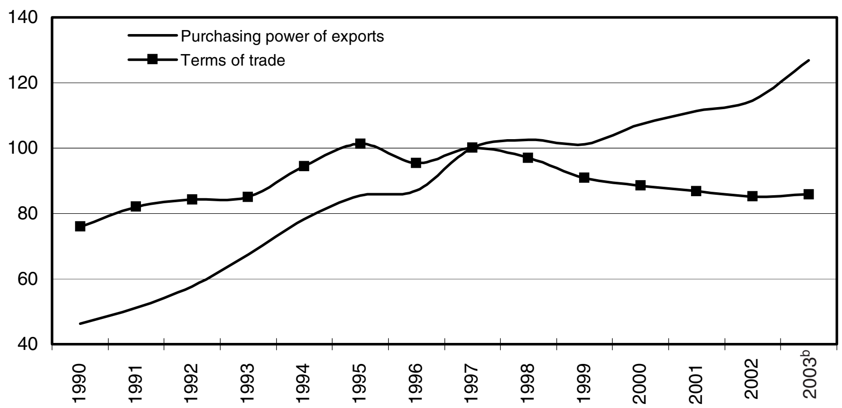
12 The terms of trade is the ratio between the export and import price indices.
13 The purchasing power of exports is the ratio between the indices of total export value and import prices: it tracks the purchasing power of external sales, which is affected not only by price trends but also by volumes exported.

Figure II.8
LATIN AMERICA AND THE CARIBBEAN: TERMS OF TRADE
(*Cumulative percentage variation for 1998-2002, and percentage variation in 2003*)



Source: ECLAC on the basis of official figures.
[a] Projections.
[b] Argentina, Colombia, Ecuador, Mexico and Venezuela.

Figure II.9
LATIN AMERICA AND THE CARIBBEAN: TERMS OF TRADE AND PURCHASING POWER OF EXPORTS OF NON-OIL COUNTRIES[a]
(*Index 1997=100*)



Source: ECLAC, on the basis of figures from the International Monetary Fund (IMF) and national sources.
[a] The purchasing power of exports is the ratio between the indices of merchandise export value and merchandise import prices.
[b] Projections.

the international economy has been based on selling larger quantities of goods at generally lower prices.

The countries worst hit by the fall in the terms of trade between 1998 and 2003 –with cumulative losses in excess of 10%– are Brazil, Chile, El Salvador, Guatemala, Honduras, Nicaragua, Paraguay and Peru. A slight easing of the deterioration is projected for 2003, which for the region as a whole could amount to 0.5%. In the case of oil countries, the gain is likely to be 1.2%, while non-oil countries stand to benefit by 0.8%. The small improvement forecast for the latter group is the result of price rises among certain export products in 2003, as discussed above.

6. Merchandise trade

The balance of merchandise trade in Latin America and the Caribbean turned positive in the first few months of 2002, and the year ended with a regional surplus of US$ 24.295 billion, following the deficit of US$ 1.611 billion recorded in 2001 (see figure II.10 and table II.2).[14] A substantially larger merchandise trade surplus is forecast for 2003 –about US$ 37.2 billion, equivalent to just over 2% of GDP. The positive balance in 2002 was the result of a 0.8% rise in exports and a 6.7% fall in imports, both in relation to their 2001 levels. Exports are forecast to grow by about 4.4% in 2003, while imports are set to strengthen marginally by 0.8% compared to the previous year's figure.

The surplus achieved in 2002 is largely explained by a steep decline in the value of imports in MERCOSUR countries, which had been shrinking since mid-2001; but sharp devaluations were responsible for restricting foreign purchases during 2002. The real exchange rate of the Argentine peso against the dollar rose by 2.5 times between December 2001 and December 2002,[15] while the Brazilian real depreciated by 40% in dollar terms over the same period, and by 54% between January and October 2002. Paraguay and Uruguay endured situations similar to those of their MERCOSUR trading partners, while imports collapsed in Venezuela as a result of the conflictive political and economic situation prevailing in the country during the year, compounded by devaluation of the bolívar. In Chile, foreign purchases also retreated, but to a lesser extent than in the other countries mentioned. In Mexico, imports grew slightly, following a 3.5% drop in 2001, whereas the Central American and Caribbean countries saw foreign purchases expand by 4%, especially in Costa Rica and Guatemala. The import growth projected for 2003 is likely to be strongly influenced by events in MERCOSUR, whose member countries can be expected to resume more normal levels of trade compared to the critical juncture reached in 2002. A decisive factor in this regard will be the recovery of economic activity in Argentina. In Mexico, on the other hand, foreign purchases seem to be flagging, reflecting the fragile state of its trade with the United States and the weakness of its domestic activity.

On the other side of the equation, although exports contributed less to the surplus in 2002, an incipient improvement could be discerned in the second half of the year among both non-oil and total foreign sales.

Export values in 2003 are projected to rise in 16 of the 19 countries considered –in five cases at two-digit rates (see figure II.11). Only in Mexico and Colombia will this growth be attributable exclusively to the effect of prices, particularly that of oil. The contribution made by the rise in hydrocarbons prices can certainly not be underestimated, however, since this accounted for about 12% of the region's surplus in 2002.[16] The higher price was positive for the merchandise trade balances of net exporters, namely Argentina, Colombia, Ecuador, Mexico and Venezuela. Non-oil exports have also performed strongly since the

14 As table II.2 is based on annual trade figures (fob) taken from the respective balance-of-payments data, whereas figure II.10 shows monthly data, there may be differences between the two sets of records. The monthly series are indicators of the trends of these variables.

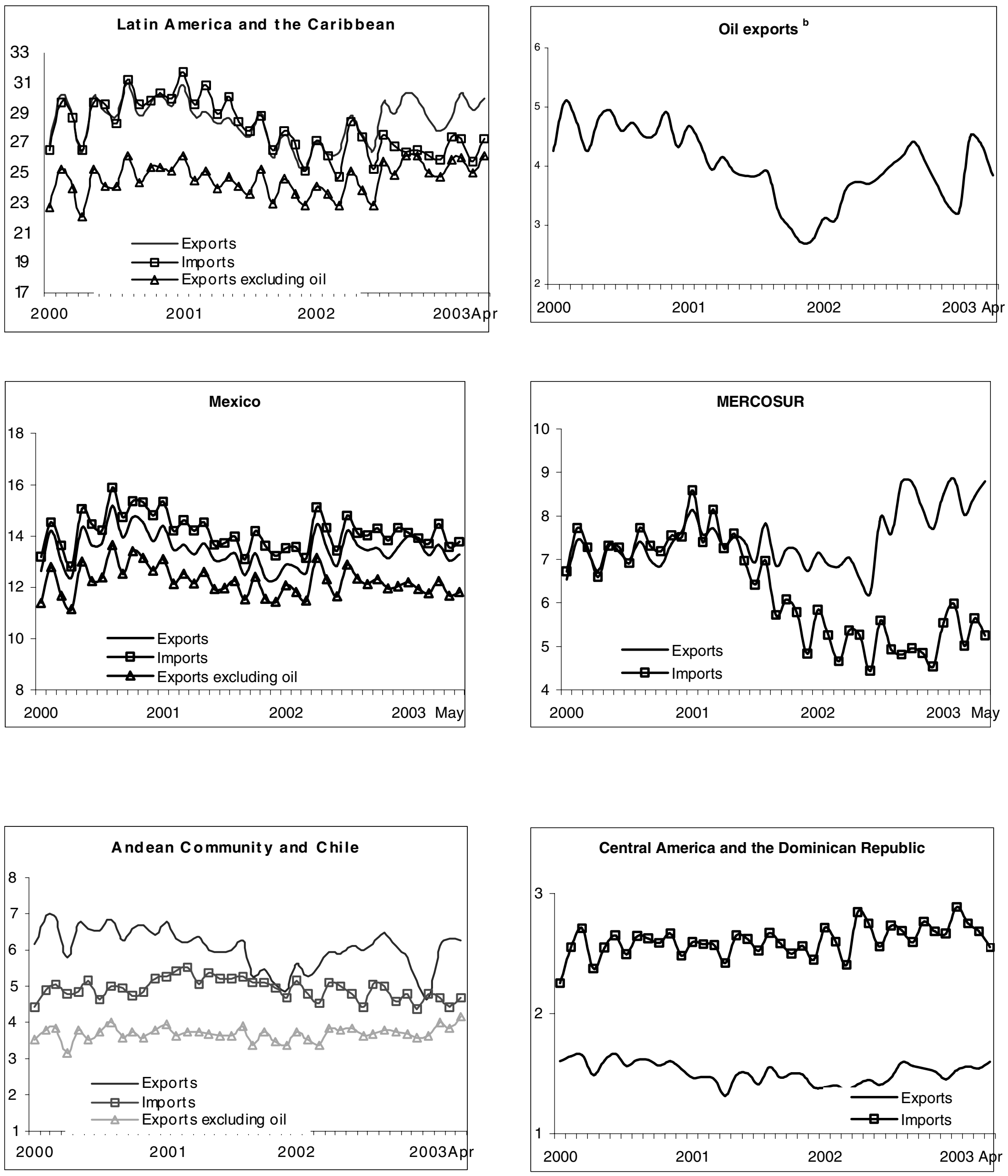
15 This means that in Argentina a given amount of dollars in December 2002 would buy 2.5 times what the same quantity of dollars would have bought twelve months earlier, in terms of a given basket of tradable and non-tradable goods.

16 The percentage of the merchandise trade surplus accounted for by the difference between net oil exports in 2002 and the same physical volume of exports valued at 2001 prices.

Figure II.10

LATIN AMERICA AND THE CARIBBEAN: MONTHLY TREND OF MERCHANDISE TRADE (FOB) [a]

(*Billions of dollars, deseasonalized figures*)



Source: ECLAC, on the basis of official monthly figures.

[a] Estimates: Honduras – December 2002 to April 2003; Bolivia, Dominican Republic, Guatemala and Nicaragua – April 2003. Figures for Guatemala, Honduras and Nicaragua do not include maquila activities.

[b] Argentina, Colombia, Ecuador, Mexico and Venezuela.

second half of 2002 and in 2003, thanks largely to a vigorous expansion of exports from MERCOSUR, and non-oil exports from the Andean Community (excluding Venezuela) and Chile. In the Central American and Caribbean subregion, Costa Rica produced outstanding export results.[17]

17 The monthly export series for this subregion is underestimated, since Guatemala, Honduras and Nicaragua do not report figures for the maquila sector. United States import records of goods purchased from those countries show a larger increase than that recorded in official national statistics, especially in 2003.

Table II.2
LATIN AMERICA AND THE CARIBBEAN: MERCHANDISE EXPORTS AND IMPORTS (FOB)

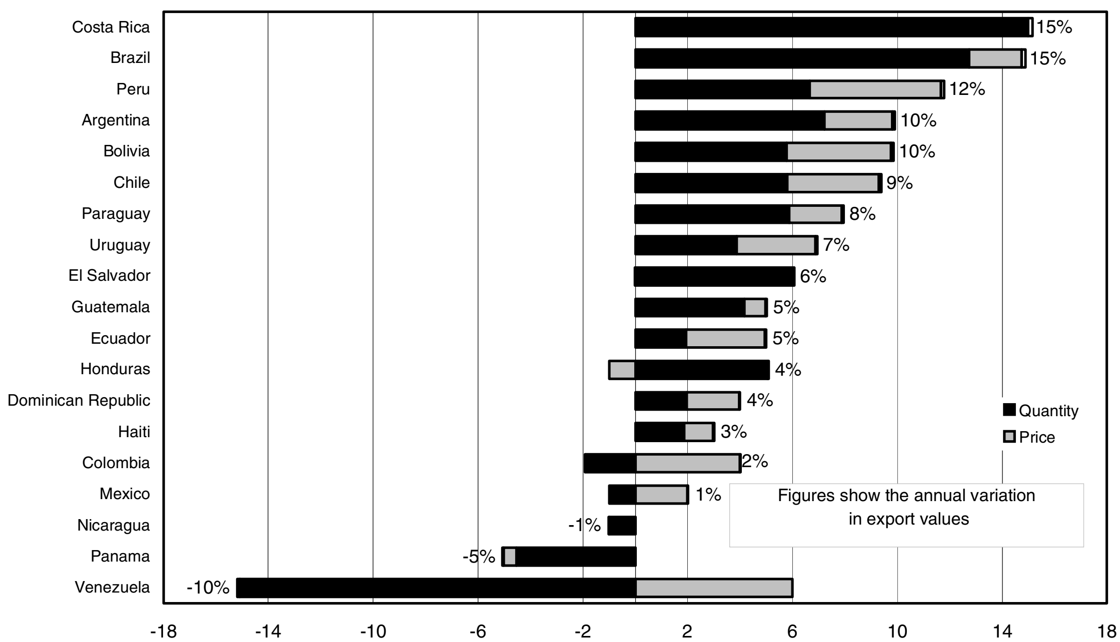
	2001			2002[a]			2003[b]		
	Exports	Imports	Balance	Exports	Imports	Balance	Exports	Imports	Balance
	(Millions of dollars)			(Millions of dollars)			(Millions of dollars)		
Latin America and the Caribbean	**343 467**	**345 077**	**-1 611**	**346 353**	**322 058**	**24 295**	**361 710**	**324 495**	**37 216**
Mexico	**158 443**	**168 396**	**-9 954**	**160 682**	**168 679**	**-7 997**	**162 289**	**167 835**	**-5 547**
MERCOSUR	**88 973**	**80 141**	**8 832**	**90 322**	**59 952**	**30 370**	**102 267**	**63 318**	**38 949**
Argentina	26 655	19 148	7 507	25 709	8 470	17 239	28 280	11 435	16 846
Brazil	58 223	55 572	2 651	60 362	47 219	13 143	69 416	47 455	21 961
Paraguay	1 952	2 507	-555	2 319	2 391	-71	2 505	2 462	43
Uruguay	2 144	2 915	-771	1 931	1 873	59	2 066	1 966	100
Andean Community and Chile	**71 152**	**59 923**	**11 229**	**71 053**	**55 338**	**15 715**	**71 732**	**54 562**	**17 170**
Bolivia	1 285	1 477	-193	1 310	1 532	-222	1 441	1 563	-122
Chile	18 466	16 411	2 054	18 340	15 827	2 513	20 082	17 013	3 069
Colombia	12 787	12 267	520	12 304	12 076	228	12 550	12 559	-9
Ecuador	4 781	5 179	-397	5 192	6 196	-1 004	5 452	6 196	-745
Peru	7 108	7 198	-90	7 688	7 426	261	8 610	8 021	590
Venezuela	26 726	17 391	9 335	26 219	12 280	13 939	23 597	9 210	14 387
Central America and the Caribbean	**24 898**	**36 616**	**-11 718**	**24 296**	**38 089**	**-13 793**	**25 422**	**38 779**	**-13 357**
Costa Rica	4 923	5 744	-821	5 277	6 825	-1 547	6 069	7 166	-1 097
El Salvador	2 891	4 796	-1 905	3 017	4 922	-1 906	3 198	5 316	-2 118
Guatemala	2 864	5 142	-2 278	2 629	5 578	-2 950	2 760	5 801	-3 041
Haiti	305	1 055	-750	274	980	-706	283	1 000	-717
Honduras	1 943	2 807	-865	1 930	2 804	-874	2 008	2 945	-937
Nicaragua	699	1 620	-921	702	1 636	-935	694	1 669	-975
Panama	5 996	6 672	-675	5 284	6 460	-1 176	5 020	6 266	-1 247
Dominican Republic	5 276	8 779	-3 503	5 183	8 883	-3 699	5 391	8 616	-3 225

	2002[a]			2003[b]		
	Annual variation (%)		Change in balance	Annual variation (%)		Change in balance
	Exports	Imports	(millions of dollars)	Exports	Imports	(millions of dollars)
Latin America and the Caribbean	**0.8**	**-6.7**	**25 905.5**	**4.4**	**0.8**	**12 920.7**
Mexico	**1.4**	**0.2**	**1 956.8**	**1.0**	**-0.5**	**2 450.2**
MERCOSUR	**1.5**	**-25.2**	**21 537.4**	**13.2**	**5.6**	**8 579.7**
Argentina	-3.5	-55.8	9 732.2	10.0	35.0	-393.6
Brazil	3.7	-15.0	10 492.0	15.0	0.5	8 818.0
Paraguay	18.8	-4.6	483.8	8.0	3.0	113.8
Uruguay	-9.9	-35.8	829.4	7.0	5.0	41.5
Andean Community and Chile	**-0.1**	**-7.7**	**4 485.8**	**1.0**	**-1.4**	**1 455.5**
Bolivia	2.0	3.7	-29.5	10.0	2.0	100.4
Chile	-0.7	-3.6	458.8	9.5	7.5	556.0
Colombia	-3.8	-1.6	-292.0	2.0	4.0	-237.0
Ecuador	8.6	19.6	-606.9	5.0	0.0	259.6
Peru	8.2	3.2	351.4	12.0	8.0	328.4
Venezuela	-1.9	-29.4	4 604.0	-10.0	-25.0	448.1
Central America and the Caribbean	**-2.4**	**4.0**	**-2 074.4**	**4.6**	**1.8**	**435.2**
Costa Rica	7.2	18.8	-725.9	15.0	5.0	450.4
El Salvador	4.4	2.6	-0.3	6.0	8.0	-212.8
Guatemala	-8.2	8.5	-671.9	5.0	4.0	-91.7
Haiti	-10.0	-7.1	44.0	3.0	2.0	-11.4
Honduras	-0.6	-0.1	-9.3	4.0	5.0	-63.0
Nicaragua	0.3	1.0	-13.7	-1.0	2.0	-39.7
Panama	-11.9	-3.2	-501.1	-5.0	-3.0	-70.4
Dominican Republic	-1.8	1.2	-196.1	4.0	-3.0	473.8

Source: ECLAC, on the basis of official figures.
[a] Preliminary figures.
[b] Projections.

Figure II.11

LATIN AMERICA AND THE CARIBBEAN: COMPOSITION OF PERCENTAGE VARIATION IN MERCHANDISE EXPORTS (FOB) BY UNIT PRICE AND QUANTITY, 2003 [a]



Source: ECLAC, on the basis of official figures.

[a] Projections.

a) Mexico, Central America and the Caribbean

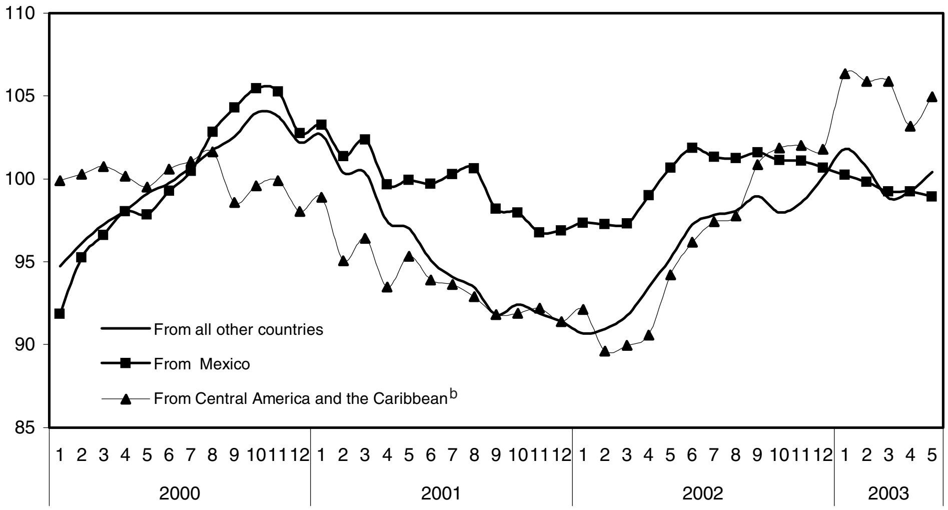
In Mexico, export performance differs sharply from patterns prevailing elsewhere in the region. Non-oil exports have declined steadily since mid-2002, broadly following their 2001 trend when the United States was in recession.

As shown in figure II.12, non-oil imports into the United States from Mexico fell steeply in 2001. Although there has been an upturn in the second quarter of 2002, the trend in the remainder of the year and first few months of 2003 has again been negative. In contrast, United States imports from Central America and the Caribbean, which had also declined in 2001, recovered even faster than purchases from the rest of the world in 2002.

The sluggish performance of Mexican exports, which represent about half of the regional total, is one of the salient features of the present conjuncture. It is worth recalling that Mexico's foreign sales enjoyed exponential growth during the 1990s, attaining a level of US$ 166 billion in 2000. This happened while the domestic economy was integrating with that of the United States, which absorbs 90% of the country's exports, approximately half of them produced under the maquila regime. The 2001 recession interrupted this growth trend, however; manufacturing exports stalled in 2002, and maquila exports grew by just 1.6%. The downswing intensified in the first half of 2003, when both activities reported reductions in relation to the same period a year earlier (of 2% and 2.6% respectively). Mexican imports, which are closely related to its export trade, grew by 0.5%, although capital goods purchases shrank by 7.2%.

There are several reasons for this lack of buoyancy. First of all, Mexico's competitive advantage has been eroded by an overvalued exchange rate. From 1997 to 2002, the real exchange rate of the peso against the dollar fell by 18% (appreciation); and despite a devaluation in 2003, it still remains close to its mid-2000 level. In addition, the maquila industry is facing competition from China and elsewhere, where wage levels are lower; and several firms have transferred their operations to those countries. Mexico has also partially implemented the rules of origin contained in its free trade treaty with the United States and Canada, which impose tariffs on maquila enterprises that use components from outside the area; this has particularly affected Japanese and Korean electronic assembly businesses. This loss of competitiveness could intensify further as a result of the free trade agreement the five Central American countries have signed with the United States.

Figure II.12
UNITED STATES: MONTHLY NON-OIL IMPORTS
(*Index 2000=100*) [a]



Source: ECLAC, on the basis of figures from the United States International Trade Commission (USITC).
[a] Three-monthly moving average of the respective deseasonalized series.
[b] Includes Costa Rica, Dominican Republic, El Salvador, Guatemala, Haiti, Honduras, Jamaica and Nicaragua.

In contrast to Mexico, trade between the Central American and Caribbean countries and the United States has been on the increase. In Costa Rica, the expansion has been dominated by the activities of Intel and other firms located in the duty-free zones. In 2002, Intel made large-scale imports related to the production of a new microchip, the production and export of which began only late in the year but proceeded vigorously in the first few months of 2003. In El Salvador, maquila activities now represent about 60% of total external sales and recently have been expanding strongly: in the first half of 2003 this sector grew by 10% in relation to the same period of 2002, having increased by 7% during the previous year. In the Dominican Republic, maquila activities account for about 80% of all exports. Although sales contracted in 2002, they recovered in the early months of 2003 following a currency devaluation; United States imports from the Dominican Republic grew by 11% in the first five months of 2003. This result is explained not only by free-zone activities, but also by stronger price trends among traditional products, such as sugar, coffee, cacao and others during this period, which have benefited all countries in the subregion.

b) Mercosur

As illustrated in figure II.10, the other salient feature of the region's trade has been vigorous growth in the value of exports from MERCOSUR countries in 2003. Although the 2002 devaluation of the Argentine peso did not immediately benefit that country's total exports (they actually decreased), foreign sales staged a clear recovery in 2003, exports of agricultural manufactures having previously expanded by 9% in 2000. The nucleus of this expansion is the soya complex (soybeans, oil and other subproducts), which has been boosted by rising world demand, production cutbacks in the United States and a consequent rise in prices. In Argentina and in Brazil, not only have areas of soya cultivation expanded, but technological improvements have made it possible to raise yields above those achieved in the United States, and in 2001 the combined harvest of these two countries exceeded that of the world's leading producer for the first time ever.[18] Exports from Argentina grew by 16% in the first half of 2003, and the expansion could reach 10% for the year as a whole, following a 3.5% decline in 2002. Peso devaluation enhanced the profitability of

18 In 2001, the United States crop accounted for 39% of world soya production, whereas Argentina and Brazil contributed 16% and 26%, respectively.

various activities, among which the most dynamic have again been in the soya complex, which has introduced a number of products at good prices in non-traditional markets such as China and India. The downside to this generally positive export performance was provided by Argentina's manufacturing industry, which showed no signs of recovery between 2002 and 2003. This largely reflects the weakness of the Brazilian market, which for many years has been the natural destination for products from this sector. Some firms have started to position themselves in alternative markets such as the European Union, Chile and the countries of the North American Free Trade Agreement (NAFTA).[19] In addition, the characteristics of the situation that followed the end of the convertibility regime –compressed imports, partial cessation of external debt payments, export boom and even an inflow of speculative capital– triggered an appreciation of the peso starting in July 2002, although the exchange rate remains well above the levels prevailing under the convertibility regime.[20] In conjunction with more buoyant activity in 2003, this appreciation provided a major stimulus to Argentine imports, which grew by 38% in the first six months of the year, including substantial increases in purchases of intermediate and capital goods.

Brazil's contribution to the export revival in MERCOSUR has been fundamental. In 2003, this country's foreign sales are expected to increase by about 15%, easily surpassing the 3.7% expansion of 2002. As in Argentina, soya and its subproducts have been key players, but sales have also increased in the iron and steel complex. The latter is responsible for 40% of the expansion achieved in 2002, whereas soya and its subproducts account for one third. Unlike Argentina, Brazil made an exchange-rate correction in 1999 which boosted profitability in the export sector. Although the exchange rate has since fluctuated sharply, it has remained consistently above its pre-1999 levels.[21] The steep devaluation recorded in 2002 stimulated exports still further, which in the first seven months of 2003 grew by 22% compared to the same period in the previous year. In the first six months, foreign sales from the soya complex expanded by 114%, iron and steel by 47%, and coffee by 39%, while automotive-industry sales recovered thanks to a revival of demand from Argentina (35%). As also occurred in Argentina, booming exports, combined with meagre expansion of the domestic market and imports (which are trending downward), are pushing up the value of the real, and this appreciation could detract from the vigour of exports in the final part of the year.

In the first five months of 2003, exports from Paraguay grew by 31% in relation to the same period a year earlier, led by cotton and soya. Sales of the latter product doubled, as a result of substantial increases in both price and volume. This export boom makes it likely that imports will also recover to some extent over the year as a whole. In Uruguay, export growth is still incipient, but foreign sales figures suggest a recovery in 2003 from the extremely low levels recorded in 2002.

c) The Andean countries

Exports from Chile and the Andean Community countries (except Venezuela) trended upward in 2003. Bolivia's foreign sales grew in 2002, driven by natural gas and soya products; the latter are expected to perform even more strongly in 2003, while exports of certain mineral products also look set to regain ground. In contrast, the country's imports are likely to remain flat, given the weakness of domestic activity. In Chile, total exports failed to increase in 2002 partly because of reduced sales of copper, the price of which has been in the doldrums in recent years. Projections for 2003, however, show significant export growth led by a slight recovery in copper, wood pulp and timber, supported by a variety of products in which the country has gained competitiveness in recent years, and which are sensitive to the devaluation of the peso. Imports can also be expected to recover strongly, having grown by 13% in the first six months compared to the same period a year earlier. In 2002, exports from Colombia were down by 3.8%; oil sales declined by 0.3% (lower volumes) while non-oil exports shrank by 4.3%. Recovery in 2003 is likely to be relatively modest and heavily dependent on the behaviour of oil prices; non-traditional exports declined in the first part of the year, and the uncertain situation in Venezuela has affected Colombia's external

19 In 2002, the slump in automobile sales in Brazil was partly offset by a preferential agreement in this sector signed with Mexico in 2001.

20 Between June 2002, when the devaluation reached its peak, and May 2003, the peso appreciated sharply and the real effective exchange rate fell by 23%. Nonetheless, if one compares June 2003 with December 2001 (the final month of the convertibility regime), the exchange rate has risen by 2.1 times.

21 The extent of the real's instability can be gauged from the following figures: the effective exchange rate rose by 32% between January and October 2001, then fell by 23% between the latter month and April 2002. After this it rose again by 60% between April and October 2002 in a climate of uncertainty induced by the elections.

sales generally. Imports soared in the first quarter, and this is bound to show through in the annual rate. The higher oil price contributed to export growth in Ecuador in 2002 and the first part of 2003. By the end of the year, the heavy crude oil pipeline is expected to come on stream, making it possible to increase the volume of oil sales; nonetheless, export growth for the year as a whole is likely to fall short of the 2002 figure. Imports are forecast to remain flat in 2003, reflecting the slowdown in domestic economic activity. In Peru, export growth in 2002 and 2003 was based on a major increase in shipments of certain minerals, particularly copper. Gold sales also increased in 2003, following a rise in price, and this metal now represents one fifth of the country's total foreign sales. Exports of fish meal and clothing have also grown. The exceptional circumstances experienced by Venezuela in 2002 and 2003 had major repercussions on its external trade. In 2002, total exports fell by 1.9%, and oil exports dropped by 1.2%; then in the first two months of 2003 the latter declined by about 20% compared to the same period a year earlier. The effect of this break in trend is such that, even assuming the path of normalization that began in March is maintained, total exports for the year as a whole are likely to be down by 10%.

7. Intraregional trade

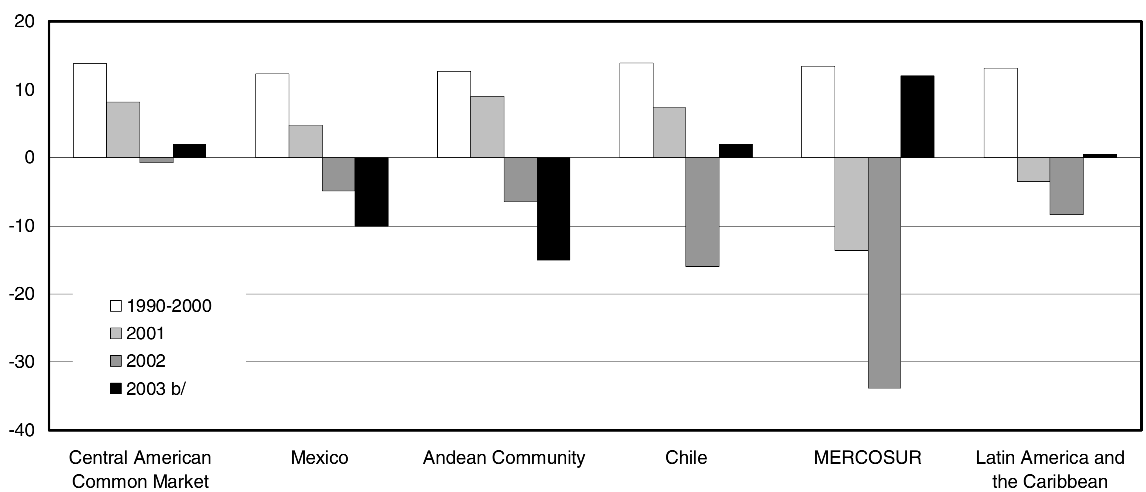
Slow growth region-wide and, in particular, outright contraction of economic activity in a number of economies caused trade within the region to shrink by 8% in 2002.

Although the crises in Argentina, Uruguay, Paraguay and Venezuela played a major role in reducing trade within the region, commercial exchange weakened in all trade groupings, and also in Mexico and Chile. Lack of buoyancy in the MERCOSUR countries had caused trade to shrink in 2001, in contrast to the prevailing trend of the past decade. In 2002, the intraregional share of the region's total trade fell slightly

Figure II.13

LATIN AMERICA AND THE CARIBBEAN: TRADE WITHIN THE REGION [a]

(*Annual rates of variation*)



Source: ECLAC, International Trade and Integration Division, on the basis of information from the respective countries.

[a] Intra-bloc exports for the Central American Common Market (CACM), the Andean Community and MERCOSUR. Exports to the rest of Latin America and the Caribbean in the cases of Mexico and Chile.

[b] Projections based on data for the first four months of the year for CACM, the Andean Community, Uruguay and Paraguay; in the cases of Argentina, Brazil, Chile and Mexico, data were available up to May 2003.

to about 16%. Projections for 2003 see a slight recovery in the regional total, with increases in MERCOSUR, Chile and CACM. In MERCOSUR, a key factor has been the growth of Argentine imports from Brazil and Chile; in contrast, Brazilian imports from Argentina remain weak – especially manufactured goods. In CACM, the growth in trade predicted for 2003 is explained by Costa Rican exports and Guatemalan imports. Trade between Mexico and the rest the region is likely to remain depressed, however, the decisive factor being the sluggishness of sales to Venezuela and Brazil, both of which represent important markets for Mexico within the region. Trade within the Andean Community is expected to shrink further in 2003, reflecting the import contraction in Venezuela and the negative effects of devaluations in Bolivia, Colombia and Venezuela.

8. Family remittances

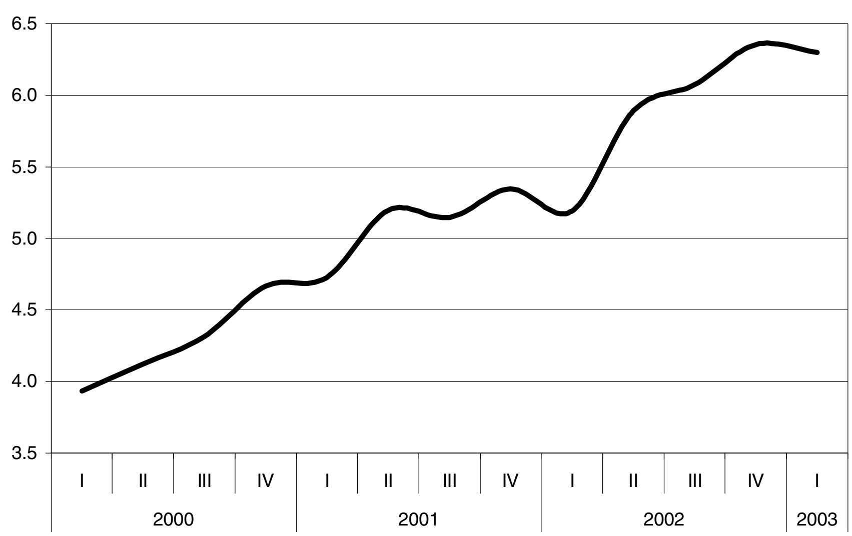
In recent years, workers' remittances have become one of the most dynamic components of the current account of the balance of payments in Latin America and the Caribbean. Flows of this type are recorded under current transfers.

In 2002, remittances grew by 15% to reach US$ 23.5 billion for the year; and they totalled US$ 6.3 billion in the first quarter of 2003, compared to US$ 3.9 billion in the same period of 2000. Although part of the growth can be attributed to improvements in record keeping and the financial transfer mechanisms used, flows of this type are becoming increasingly important for the region's external accounts. Their total in 2003 could approach US$ 25 billion, equivalent to about 85% of expected FDI inflows. Remittances represent a decisive income source for all the Central American countries (except Costa Rica), and for the Dominican Republic, where they represent about 10% of GDP. They are also essential for Mexico, which in 2002 received inflows in this category equivalent to 70% of total FDI during the year, and for Ecuador, where remittances represent about 6% of GDP. As can be seen in figure II.14, remittances inflows were smaller in 2001, consonant with the slowdown of economic activity in the United States, but they bounced back in 2002.

Figure II.14

LATIN AMERICA AND THE CARIBBEAN: NET WORKERS' REMITTANCES [a]

(*Billions of dollars*)



Source: ECLAC, on the basis of figures from official sources and the International Monetary Fund (IMF).

[a] Estimate. Only includes net recipient countries: Bolivia, Brazil, Colombia, Costa Rica, Dominican Republic, Ecuador, El Salvador, Guatemala, Haiti, Honduras, Jamaica, Mexico, Nicaragua, Paraguay, Peru and Uruguay.

9. The trend of autonomous capital flows

According to an estimate made in July, the total volume of autonomous capital flows into Latin America is likely to be around US$ 15 billion in 2003, in contrast to the US$ 14 billion outflow recorded in 2002.[22] This turn for the better seems to be based on FDI, even though inflows in this category have been trending downward continuously since 2000. Financial capital is expected to register a net outflow abroad as in 1999-2002, albeit this time on a smaller scale. Compensatory capital, including IMF credits and exceptional financing (which includes arrears in interest and amortization payments), are expected to approach US$ 25 billion. As a result, the total capital inflow into the region should come to around US$ 40 billion. This recovery helped to replenish international reserves in the first half of 2003 in countries running current-account deficits, while international interest rates have fallen to their lowest level of the last 40 years.

IMF support has been crucial in some countries, given recent difficulties in obtaining external financing. Between early 2002 and May 2003, credits from the Fund were mainly channelled to Brazil and Uruguay; Argentina did not receive any IMF funding in 2002, but made repayments amounting to US$ 800 million.[23] In January 2003, the country signed an agreement for US$ 1.4 billion to cover amortization payable to the Fund by April 2003. Other commitments are due to expire in August and are expected to be rescheduled in the framework of a new three-year agreement. Bolivia and Ecuador signed arrangements with IMF in the early months of 2003, and have made disbursements totalling US$ 55 million and US$ 42 million, respectively. Colombia, for its part, reached an agreement with the Fund in January and has credits approved totalling US$ 2.2 billion, but as of mid-2003 no disbursements had been made. In contrast, Paraguay held two rounds of negotiations with IMF in 2002, but neither of them came to fruition: the first, owing to the suspension of privatization of the phone company Compañía Paraguaya de Comunicaciones (COPACO), and the second, because of the delay in approving a fiscal reform package. In July 2003 new negotiations began, which will be concluded by the new government that took office in mid-August.

As regards autonomous capital inflows towards the region, despite a recovery in the rate of gross bond flotations in the first half of 2003, the negative external financing trends that began to appear in 1999 still persist (see table A-13 of the statistical appendix). Thus, the end of 2003 will complete a five-year period (1999-2003) in which the contribution of autonomous capital inflows to the region's development will have fallen to an average of 1.7% of GDP –no more than half their level of the preceding five years (1994-1998). The conditions leading to this result have been successive episodes of crisis and upheaval, beginning with the Asian crisis in mid-1997, and followed by the moratorium declared by the Russian Federation in August 1998, devaluation in Brazil in early 1999, crisis in Argentina, lack of growth in the industrialized economies since 2001, and turbulence, mainly in the MERCOSUR countries, in 2002.

Although net FDI is set to fall from US$ 39 billion in 2002 to US$ 30 billion in 2003, it will continue to be the main source of financing received by the region. Larger gross non-bank debt flows to the region (mainly bonds) are unlikely to compensate for the reduction in bank loans and other short-term capital, so the net debt flow is again likely to be negative. Given this situation, at least seven Latin American countries will continue to require compensatory financing, mainly in the form of IMF loans, to meet their factor-payment obligations (net interest and profit remittances). Net funding of this type is projected at about US$ 15 billion for 2003, similar to their average level during the 2001-2002 biennium.

In the first half of 2003, a number of factors (including the successful handover of power in Brazil) helped improve financial conditions in the region, following their sharp deterioration in 2002. This generated a somewhat more favourable climate for investments. When commenting on the uncertainty generated by the elections in Brazil and its effect in widening sovereign spreads, in late 2002 ECLAC claimed that this represented an overreaction by the financial market, exacerbated by the influence of a number of analyses made by international financial intermediaries regarding the sustainability of external

22 Autonomous capital inflows correspond to the sum of FDI, equity investments, bank and non-bank loans (mainly bonds), official flows (apart from IMF credits), and errors and omissions in the balance of payments.

23 During that period, Brazil and Uruguay drew on IMF credits totalling US$ 16 billion and nearly US$ 2 billion respectively.

public debt.[24] In some Latin American countries, external debt spreads and exchange rates are closely related, so when sovereign spreads begin to trend upward, the local-currency value of public debt denominated in foreign currency also tends to rise. This worsens indicators of the public-debt burden, which in turn encourages spreads to widen further. The overreaction of the financial market in the second half of 2002 was confirmed when spreads on Brazilian sovereign debt eased back to around 750 basis points (bps) in July 2003, having soared to 2,500 bps the previous September.

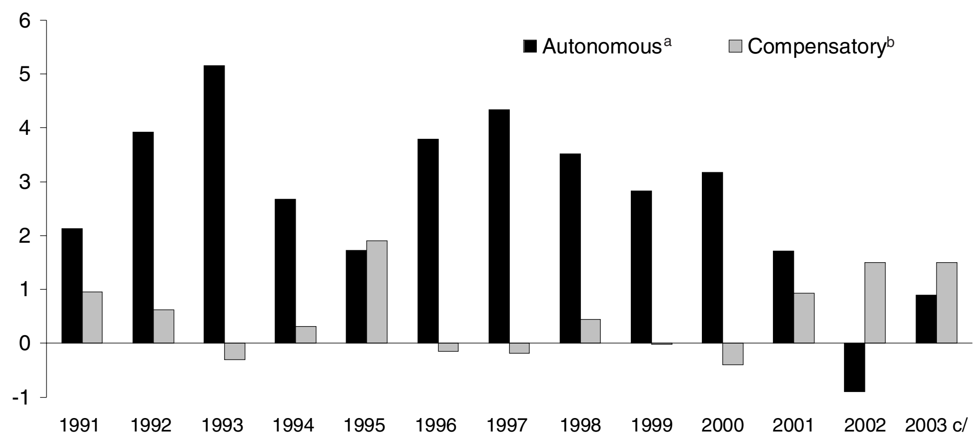
Another positive factor has been the inclusion of collective action clauses (CACs) in sovereign bond issues, which will help solve disputes between governments and investors. These clauses in the bond contracts enable issuing governments and a qualified majority of bondholders to take decisions that commit all creditors of a given issue.[25] The specified majority can impose a restructuring agreement on the remaining creditors either before or after non-performance. Thus CACs afford greater certainty to investors, and to the government in its capacity as issuer, and they facilitate the process of external-debt restructuring should this be necessary. The governments of Mexico and Brazil adopted this scheme in their 2003 bond issues, and the corresponding flotations were both oversubscribed. The government of Uruguay also included CACs in the debt swap carried out in May 2003

Nonetheless, external financing problems persist. Some countries in the region have absorbed large amounts of external funding in relation to their GDP, particularly through bond flotations. In some cases governments have used the proceeds to finance current expenditure, without any benefit to productive sectors. On this point, ECLAC has argued that "...contagion of optimism leads many agents to underestimate the risks of channelling resources into economies or companies whose indicators, looked at objectively, are not entirely favourable."[26] It is worrying that experiences of misuse of external funding are being repeated, since they raise the cost of external borrowing and its servicing.

Figure II.15

LATIN AMERICA AND THE CARIBBEAN: TOTAL NET CAPITAL INFLOW, BY COMPONENT

(*Percentages of gross domestic product at current prices*)



Source: ECLAC, on the basis of figures from official sources and the International Monetary Fund (IMF).
[a] Balance of the capital and financial account, plus errors and omissions.
[b] Includes loans and the use of IMF credits, and exceptional financing.
[c] Projections.

24 See ECLAC, *Preliminary Overview of the Economies of Latin America and the Caribbean, 2002* (LC/G.2196-P), Santiago, Chile. United Nations publication, Sales No. E.02.II.G.126, December 2002, p. 10. The sovereign spread is the risk premium on public external-debt securities. It is measured as the difference between the rate of return on sovereign bonds traded internationally and the rate on equivalent bonds issued by the United States Treasury Department; 100 basis points (bps) is equivalent to 1% interest per year.

25 See International Monetary Fund, *IMF Survey*, 2 June 2003.

26 See ECLAC, *A decade of light and shadow. Latin America and the Caribbean in the 1990s*, Libros de la CEPAL series No. 76 (LC/G.2205-P), Santiago, Chile. United Nations publication, Sales No. E.03.II.G.79, July 2003, p. 83.

Another problem stems from an inflow of speculative capital (hot money) attracted by the upturn in prices on the region's main stock markets; such inflows fuelled currency appreciation in a number of Latin American countries in the first few months of 2003. On this point, the ECLAC secretariat has been arguing since the early 1990s that transitory capital flows seeking to exploit the spread between domestic and external interest rates over the short term should be avoided. Reserve requirements have been proposed as a policy tool to discourage inflows of this type, by forcing foreign investors to keep their capital in the country for a certain period of time, or pay a tax for withdrawal before the established deadline. Specifically in order to restrain the steady appreciation of the local currency, the Argentine government issued a regulation in June requiring non-FDI capital to remain in the country for six months following its date of entry; the regulation also requires foreign-currency withdrawals to be registered with the central bank, and the economic authorities can lengthen or shorten the permanency period of the capital in question.

10. Foreign direct investment (FDI)

Since 2000, FDI flows into the region have suffered a gradual but substantial decline, even though they continue to be the region's main source of external financing (see table A-16 of the statistical appendix). In 2002, FDI totalled nearly US$ 39 billion –below the average of US$ 67 billion recorded in the five-year period 1997-2001, but still above the annual average received in 1992-1996. Data from 13 Latin American countries for the first few months of 2003 suggests that FDI entering the region during the year as a whole will again be down from its previous-year level, this time by about 30%, bringing the total amount to approximately US$ 30 billion.[27] In Brazil, net FDI slumped from US$ 8.584 billion in the first half of 2002 to US$ 2.844 billion in the same period of 2003. Nonetheless, the central bank predicts a recovery in the second half of the year and is projecting an FDI inflow of US$ 10 billion for the year as a whole. In Argentina, FDI was practically non-existent in the first few months of 2003, in a continuation of the downward trend that began in 2001. Venezuela saw investment outflows (amounting to US$ 617 million) in the first three months of the year, for the first time since the fourth quarter of 1994, thereby confirming the downturn that began to appear in 2002.

The forces underlying the dwindling trend of FDI include the fact that the privatization process has run its course in many countries, and foreign residents have been acquiring fewer domestic assets in the private sector. A number of transnational groups have also scaled down their expansion strategies to a significant degree, having acquired enterprises in various sectors in Latin America (including many privately owned businesses) during an exceptionally active period of international mergers and acquisitions. The decline of FDI in 2002 was also affected by specific factors in each country, linked to recession, greater political instability or uncertainty caused by changes in the rules of the game, as happened in Argentina.

Among countries in which FDI remained buoyant, about 30% of inflows represented profit reinvestment. Official projections for 2003 see Mexico maintaining FDI at the US$ 13 billion level it has registered since 1994. Other countries likely to continue the positive trend of recent years include Bolivia, Ecuador and Peru, where major investments are expected in the hydrocarbons subsector. In Chile and Colombia, FDI declined in the first quarter of 2003, but only in comparison to the high level attained in the same period of 2002; both countries have authorized investment projects which should generate an upturn in the next few quarters.

27 The 13 countries referred to are Argentina, Bolivia, Brazil, Chile, Colombia, Costa Rica, Dominican Republic, Ecuador, El Salvador, Mexico, Peru, Uruguay and Venezuela.

11. Credit conditions and the new external financing

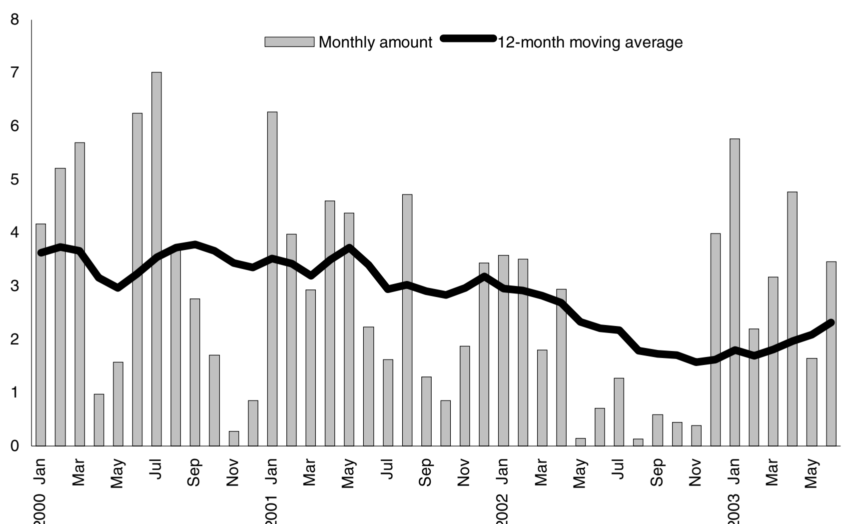
Following a very lean period for bond flotations lasting from May to November 2002, fund flows of this type gathered pace between December that year and June 2003, as revealed by the figures for bond placements in nine of the region's countries. In the first half of 2003, bond issues totalled US$ 20.6 billion (excluding the bond swap made by Uruguay in May), which compares favourably with the US$ 13 billion recorded in the first half of 2002. Gross flotations on international bond markets in 2002 totalled US$ 18.215 billion –just over half the figure recorded in 2001 (see table A-17 of the statistical appendix). These operations consisted largely of sovereign issues, made mainly by Brazil, Colombia, Mexico and Uruguay, whose governments used the proceeds almost entirely for loan repayment or debt swaps. In addition to these placements, others were made by Chile, Costa Rica, El Salvador, Jamaica and Peru –the latter for the first time since 1928. In these cases, the proceeds were used mainly to refinance existing external liabilities.

In recent years, borrowing in the form of bonds has increasingly replaced commercial bank loans. At the same time a number of countries (Chile and Mexico, among others) have been pursuing a systematic policy to improve their maturity profile, prepaying current loans or replacing expired debt with new borrowing under better conditions. Other countries (especially in Central America) have been replacing domestic debt with external borrowing, in some cases on a large scale. In the first half of 2003, nine Latin American and Caribbean governments accounted for 60% of all bond placements; these include Mexico, which became the region's main borrower, and Chile, in response to the more favourable conditions being offered. In addition, bond issues by the government of Brazil in April and June marked that country's return to international financial markets following a year-long absence, and secured a large part of the government's financing needs for 2003.

As happened in 2002, non-sovereign debt flotations (40%) were also made by firms based in the region, including Petróleo Brasileiro (PETROBRAS) and Petróleos Mexicanos (PEMEX), in addition to a number of Brazilian banks and Chilean firms.

Following the pattern of previous years, nine of the Latin American and Caribbean countries that issued sovereign bonds used the proceeds partly to repay expired debts and finance their fiscal deficits. In Chile

Figure II.16
LATIN AMERICA AND THE CARIBBEAN: INTERNATIONAL BOND ISSUES
(*Billions of dollars*)



Source: ECLAC, on the basis of figures up to June 2003 from Merrill Lynch.

and Mexico proceeds were also used to prepay existing loans, while in Costa Rica, Dominican Republic, El Salvador and Peru, they were also used to replace domestic debt with external borrowing and take advantage of better credit conditions. In the Dominican Republic, bond proceeds will also be used to build up international reserves. In Brazil, Mexico and Peru in recent years, available funds have been used to buy back Brady bonds, in an operation that has made it possible to retrieve the collateral on those bonds, thus generating a saving for the government, in addition to taking advantage of improved credit conditions. In mid-2003 Mexico concluded the process of buying back all its Brady bonds (US$ 35 billion) issued in 1990 in the wake of the 1980s external-debt crisis.

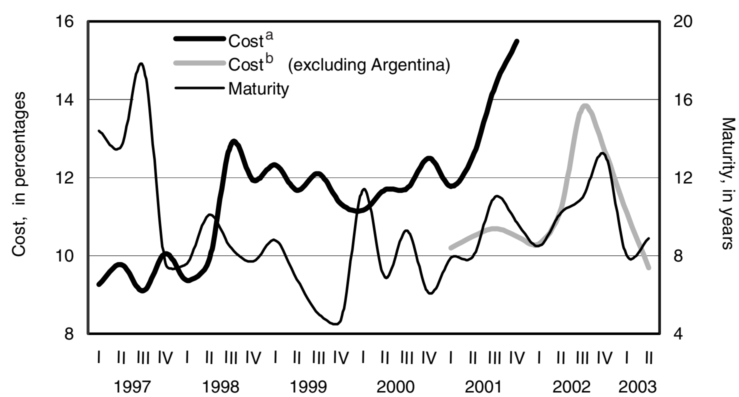
Having deteriorated in mid-2002, external financing conditions staged a substantial recovery late in the year and in the first half of 2003. The average cost of external financing on new issues by the region's governments had fallen to 10% per year by mid-2003 after approaching 14% in the third quarter of 2002 (similar to the level reached in August 1998 when the Russian Federation declared a moratorium). The mid-2003 rate was close to the level prevailing in early 2001, but still

Table II.3
LATIN AMERICA AND THE CARIBBEAN: SELECTED SOVEREIGN BOND ISSUES [a]
(*First half of 2003*)

	Amount (millions of dollars)	Issue Date	Maturity (years)	Spread [b] (basis points)	Yield (percentage)
Brazil [c]	1 250	17/06/03	10	810	11.45
Chile	1 000	15/01/03	10	134	4.84
Colombia	635	28/01/03	30	530	9.47
Costa Rica	250	31/01/03	10	358	6.99
El Salvador	350	24/03/03	20	…	7.75[d]
Mexico [c]	2 000	16/01/03	10	236	5.83
Peru	750	06/02/03	12	536	8.86
Dominican Republic	600	23/01/03	10	388	7.26
Uruguay [c e]	1 004	29/05/03	12	780	11.32

Source: ECLAC, on the basis of data from Bloomberg.
[a] Sovereign bond issues with maturities of 10 years or longer. [b] Adjusted spread excluding options.
[c] Includes collective action clauses. [d] Coupon rate. [e]Principal bond of external debt swap.

Figure II.17
LATIN AMERICA AND THE CARIBBEAN: COST AND MATURITY OF INTERNATIONAL BOND ISSUES



Source: ECLAC, on the basis of figures from J.P. Morgan and Merrill Lynch.
[a] Sum of the average spread between rates on bond placements and the yield on long-term bonds issued by the United States Treasury Department. The spread corresponds to the figure estimated in the eurobond index for Latin America (*Latin Eurobond Index, LEI*).
[b] LEI recalculated using November 2001weightings.

Figure II.18-A

LATIN AMERICA AND THE CARIBBEAN: SOVEREIGN BOND SPREADS (EMBI) [a]

(*Basis points over yields on United States treasury bonds*)

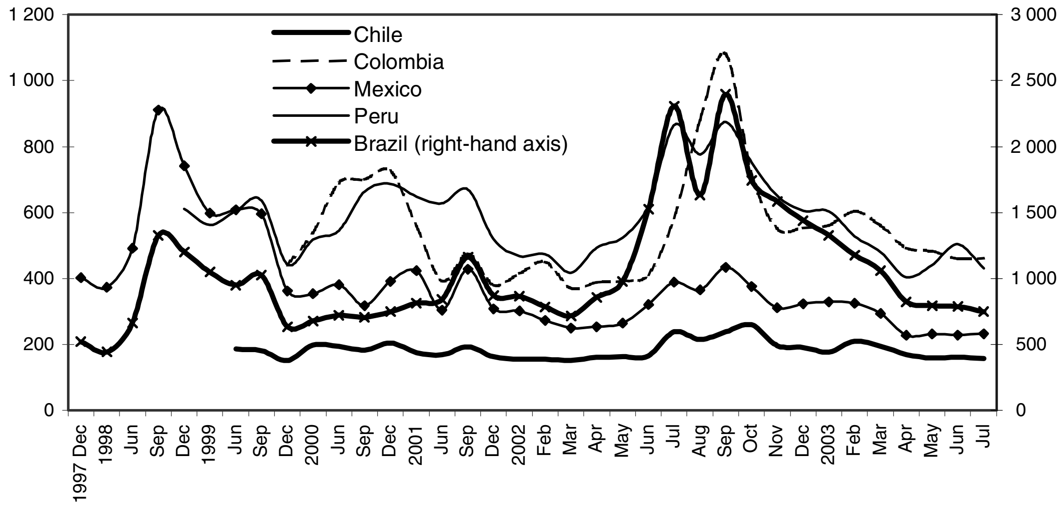
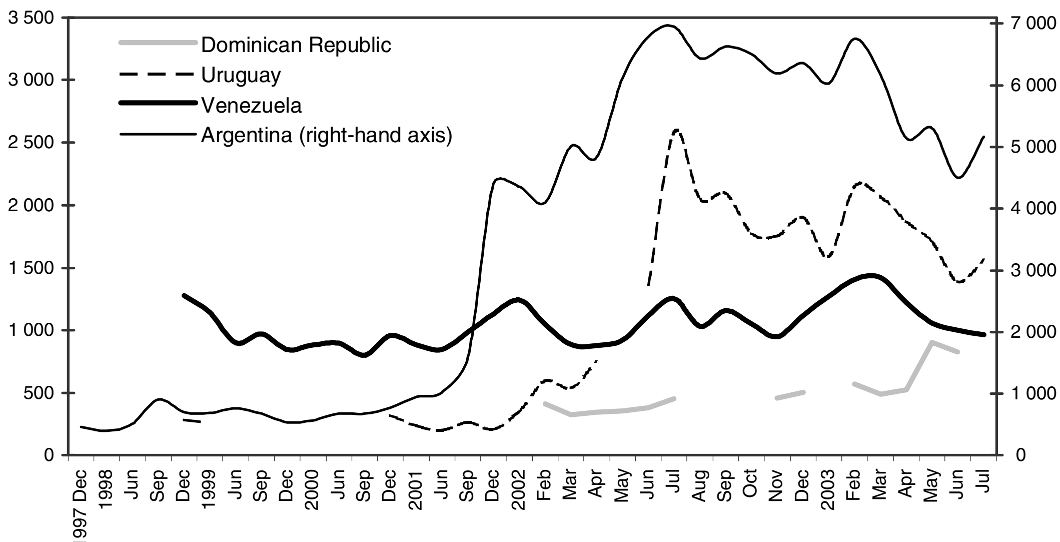


Figure II.18-B



Source: ECLAC, on the basis of figures from J.P. Morgan.

[a] Emerging Markets Bond Index (EMBI). Argentina: ELI PARL index; Brazil: ELI PRBL index; Mexico: ELI PMXL index; Peru: ELI PPRL index; Venezuela: ELI PVNL index; Uruguay: YTM (Bid) on normal global sovereign bond maturing in 2008; Chile: YTM (Ask) on sovereign bond maturing in 2009; Colombia: YTW on global sovereign bond maturing in 2009; Dominican Republic: YTM (Bid) on normal global sovereign bond maturing in 2006.

above that of early 1997. The reduction reflects the smaller spreads the countries of the region are having to pay, since the yield on 10-year United States treasury bonds remained stable at around 4% per year between October 2002 and June 2003.

With investors displaying greater risk aversion, sovereign spreads widened generally in Latin America and the Caribbean between June and September 2002, with the regional average rising above 1,000 basis points. Bonds issued by Argentina, Brazil and Uruguay were worst hit by this surge, as their spreads grew to levels that meant the virtual closure of the voluntary market. Starting in October, however, spreads began to narrow, also on a widespread basis, and this process was still continuing in mid-2003. Nonetheless, levels still remained high in Argentina, Uruguay and Venezuela. In the Dominican Republic, meanwhile, the spread doubled during the first half of 2003 as result of the domestic banking crisis, to reach 830 bps. Thus, in mid-June average sovereign bond spreads in the region were fluctuating around 600 bps, substantially lower than the 900-point level they had reached in mid-2002.

It needs to be said that markets continue to differentiate between countries according to creditworthiness, so in some cases interest rates remain onerous. As regards maturities, in the first half of 2003 these were broadly unchanged from their levels of the recent past, with terms tending to stabilize around nine years –still far below the average of 15 years that prevailed before the Asian crisis. In recent months, nearly all bond issues have been made in dollars, partly because of the substantial recent appreciation of the euro against that currency.

12. The region's external debt

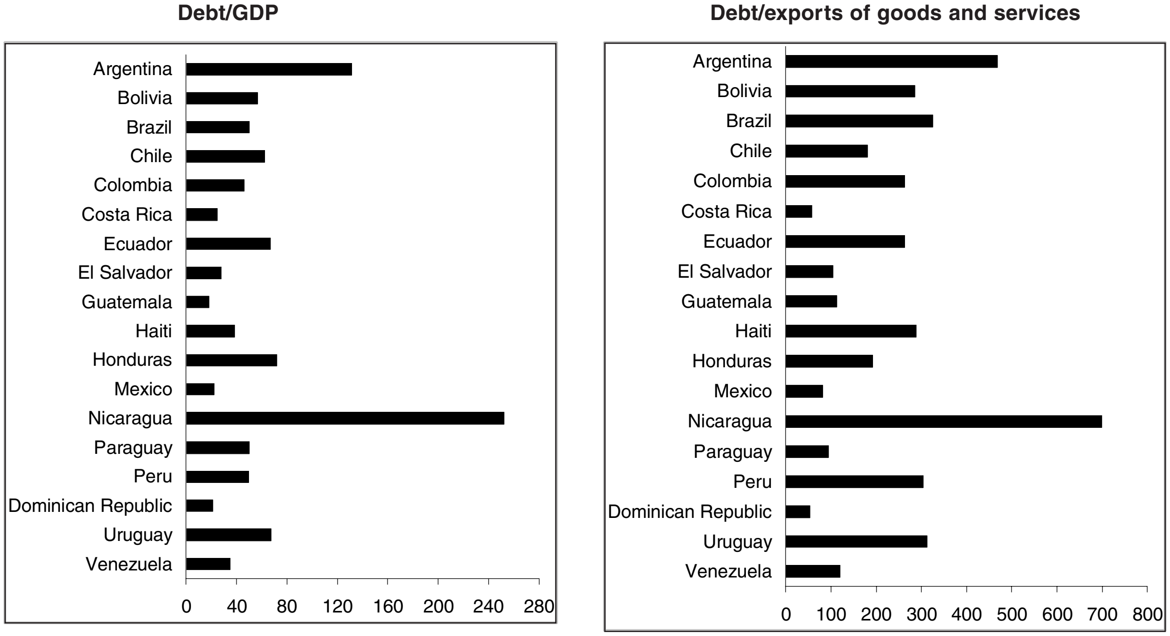
The gross disbursed external debt of Latin America and the Caribbean amounted to US$ 727 billion in December 2002 –practically the same as a year earlier, when it had grown by 2% (see table A-18 of the statistical appendix). In 2003, in contrast, external liabilities are expected to rise to the US$ 745 billion range, thereby returning to their 2000 levels. In most countries, this increase is explained almost entirely by heavier government borrowing from multilateral agencies, although in some cases it is also caused by arrears in amortization and interest payments. In a few countries, debt growth reflects additional borrowing by the private sector. Given the problems faced by Latin American and Caribbean countries in obtaining external financing, in 2002 most countries recorded large variations in their external liabilities, and there were even nominal reductions in eight cases. Estimates made by the Bank for International Settlements (BIS) show that bank debt retreated most sharply in 2002, as the regional aggregate shrank by nearly 5% in nominal terms. This was partly offset by stronger non-bank borrowing (mainly in the form of bonds). In some countries, however, external liabilities grew significantly. Uruguay's foreign debt grew by 42% because of exceptional commitments acquired with multilateral agencies, mainly IMF; in El Salvador, external obligations increased by 27% in the wake of its aggressive policy to convert domestic debt into external borrowing (bonds), in order to reduce short-term financial pressures; and in Ecuador there was a 13% increase, reflecting increased private-sector borrowing. Countries displaying a moderate increase in external liabilities included Chile (mainly private borrowing), Costa Rica (conversion of domestic into external debt) and the Dominican Republic (increased government liabilities).

In over half the countries of Latin America and the Caribbean (mostly those with economies that are more open than the regional average) the two traditional debt-burden indicators have remained within prudent ranges. The eight most heavily indebted countries include Bolivia, Brazil and Peru, which displayed debt/export ratios as high as 300%. Nonetheless, it is positive to note that in Brazil and Peru these indicators have been improving systematically since 1999. In contrast, both ratios deteriorated in Ecuador, and particularly in Uruguay.

Despite accumulating US$ 4.3 billion in overdue interest on its public debt, in 2002 Argentina reduced its overall external debt burden by 4%, as a result of net payments to multilateral agencies and the partial payment of private-sector debts. The government declared a unilateral moratorium on its debt with private-sector creditors in late 2001, but has continued to honour its commitments towards multilateral agencies. The country now needs to reschedule amortization and overdue interest payments on its external public debt under conditions that include substantial discounts, longer maturities and interest rates that make it possible to service medium- and long-term obligations on a sustainable basis. The government is expected to announce a proposal for an external debt swap in September, which will include bond refinancing amounting to over US$ 50 billion.

In the case of private-sector external debt, several Argentine firms are trying to exploit a recent amendment to the local bankruptcy law in order to simplify debt work-out procedures. These firms have presented restructuring proposals under the *acuerdo preventivo extrajudicial* mechanism, which enables debtors to reach an out-of-court settlement with the approval of just two

Figure II.19
LATIN AMERICA AND THE CARIBBEAN: INDICATORS OF TOTAL GROSS EXTERNAL DEBT, 2002[a]
(*Percentages*)



Source: ECLAC, on the basis of official figures.
[a] Preliminary estimates.

thirds of their creditors. In 2002, the government amended the domestic bankruptcy law to make such agreements applicable to all creditors rather than just those committing to the procedure under new agreements. A telecommunications firm with overdue financial debts of around US$ 3.2 billion set a precedent in this regard by proposing to use the restructuring agreement to exchange older debt for new borrowing at a discount of about 50%.

In late 2002, the government of Nicaragua reached an agreement with IMF in which fulfilment of the proposed programme will make the country eligible for international financial cooperation once again and enable it to reach the "culmination point" in the framework of the Heavily Indebted Poor Countries (HIPC) Initiative, thereby affording it external debt relief. Honduras will also be able to join the HIPC Initiative, with similar results, provided it meets the targets stipulated in its new agreement with the Fund.

The Uruguayan government agreed on a "market-friendly" sovereign debt swap with its creditors in May 2003, with IMF support. The terms of the deal involve a five-year extension of sovereign bond maturities, while maintaining the original currency of the contract with no reduction of principal or interest. The proposal was aimed at creditors holding bonds with a total par value of US$ 5.2 billion, of which US$ 3.5 billion corresponded to external and the remainder to domestic bonds. By May, the vast majority of the respective creditors had accepted the proposal, thereby reducing debt-service pressure for the next few years. Multilateral lending agencies did not participate in this agreement, however.

B. Economic policy

1. Fiscal policy

Fiscal policy management in 2002-2003 was implemented in difficult macroeconomic circumstances, both domestically and internationally; in some cases, sluggish economic growth in the United States and deteriorating terms of trade in the non-oil economies made the situation even worse. In the most indebted countries, the salient features have been capital-market volatility, worsening international financial conditions and the constraints that public sectors have consequently had to cope with.

As was pointed out in *Preliminary Overview of the Economies of Latin America and the Caribbean, 2002*, in this particular situation most of the region's economies lost degrees of freedom for fiscal-policy management, despite pursuing very different courses in general. This is illustrated by the fact that most governments are implementing or negotiating programmes with IMF that include fiscal-austerity measures that could deepen the effects of the business cycle.[28] Moreover, macroeconomic circumstances have directly or indirectly affected fiscal revenues in nearly all countries and increased the demand for assistance policies.

Fiscal policy is increasingly at the forefront of agendas in the countries of the region, whose governments in 2003 are striving to implement a variety of policies to strengthen fiscal results, either through programmes to curtail primary expenditures or by raising tax pressure (through reforms or administrative improvements). Although fiscal management would normally call for expansionary measures in the present circumstances, few countries managed their fiscal accounts in previous years so as to allow greater room for current fiscal-policy manoeuvre. Debate over the use of this type of instrument began to intensify following the onset of the South-East Asian crisis; for, in many countries of the region, a situation of fiscal balance was a prerequisite for introducing such measures, and this had to be achieved in the midst of a recession. In the few countries that implemented countercyclical policy by design (Chile is the most obvious example), the length of the current recession raises doubts as to whether the surpluses accumulated to cope with the crisis will prove sufficient.

Moreover, the various structural reforms implemented during the 1990s have failed to provide governments with more solvent public sectors or to resolve problems arising from high levels of past borrowing. On the contrary, in many cases these have merely served to put off necessary reforms, creating situations of temporary solvency by taking advantage of large capital inflows (in some cases arising from privatization); others have aggravated existing fiscal imbalances (pension reforms in certain countries), reduced revenue (economic liberalization accompanied by tariff reductions), or intensified pressure for higher levels of expenditure (decentralization).

a) General fiscal-policy trends

Given the institutional diversity in the organization of the countries making up the region, it is hard to find a single indicator that reflects the overall fiscal situation. Nonetheless, as a first approach to fiscal trends in recent years, this analysis will focus on central-government accounts.[29] The overall deficit at that level shows a minimal improvement between 2001 and 2002, narrowing from 3.3% to 2.6% of GDP (as a simple average),[30] while the average primary deficit eased from 0.7% to 0.1% of GDP. In both cases the deficits recorded in 2001 were the largest of the last 10 years (see table II.4).

28 In the region there are countries that have ongoing arrangements with IMF (Brazil), others in which arrangements were signed in 2002 (Ecuador, Nicaragua, Uruguay), and lastly countries where agreements will come to an end in 2003 (Bolivia, Guatemala). In the midst of its crisis, Argentina managed to sign a short-term deal, in the hope that the new government would negotiate a medium-term agreement, also in 2003.

29 Later, to evaluate the differences in tax-pressure and debt levels, data from other jurisdictional levels will be considered.

30 Throughout this chapter, references to the average situation in the region relate to the simple average, thus avoiding the use of indicators likely to be dominated by results in the largest economies.

Table II.4
LATIN AMERICA AND THE CARIBBEAN: CENTRAL GOVERNMENT FISCAL INDICATORS
(*Percentages of gross domestic product, at current prices*)

	Total revenue		Primary expenditure		Interest payments		Total expenditure		Primary balance		Overall balance	
	2001	2002[a]	2001	2002[a]	2001	2002[a]	2001	2002[a]	2001	2002[a]	2001	2002[a]
Latin America and the Caribbean [b]	**17.6**	**17.9**	**18.3**	**17.9**	**2.6**	**2.6**	**20.9**	**20.5**	**-0.7**	**-0.1**	**-3.3**	**-2.6**
Argentina	14.4	14.4	14.2	12.6	4.0	2.0	18.2	14.6	0.2	1.8	-3.8	-0.3
Bolivia	20.8	20.6	25.6	26.2	2.3	2.5	27.9	28.7	-4.8	-5.6	-7.1	-8.1
Brazil	18.9	20.1	16.9	17.8	3.3	2.7	20.2	20.4	1.9	2.3	-1.4	-0.3
Chile	23.2	22.7	23.0	23.3	0.5	0.3	23.5	23.6	0.2	-0.5	-0.3	-0.8
Colombia	14.5	15.0	15.9	16.0	4.0	3.9	19.8	19.9	-1.4	-1.0	-5.3	-4.9
Costa Rica	13.5	13.3	12.4	13.3	4.0	4.3	16.4	17.6	1.1	0.0	-2.9	-4.3
Ecuador	21.4	21.9	18.2	18.8	5.2	3.9	23.4	22.8	3.2	3.1	-2.0	-0.9
El Salvador	12.0	12.6	14.3	14.1	1.3	1.6	15.6	15.7	-2.3	-1.6	-3.6	-3.1
Guatemala	11.1	11.4	11.6	11.1	1.4	1.2	12.9	12.4	-0.5	0.3	-1.9	-1.0
Haiti	7.5	8.4	9.9	11.1	0.3	0.1	10.1	11.2	-2.4	-2.7	-2.7	-2.9
Honduras	19.9	19.4	23.8	22.9	2.1	1.8	26.0	24.7	-3.9	-3.4	-6.0	-5.3
Mexico	18.2	18.1	16.0	17.4	2.9	2.6	18.9	19.9	2.2	0.8	-0.7	-1.8
Nicaragua	27.4	31.1	35.0	28.5	3.8	4.7	38.8	33.1	-7.6	2.6	-11.4	-2.1
Panama	18.9	16.8	16.2	14.6	4.5	4.1	20.7	18.7	2.7	2.2	-1.8	-1.9
Paraguay	21.5	20.3	20.7	21.1	1.3	1.5	22.0	22.6	0.8	-0.8	-0.5	-2.3
Peru	14.5	14.5	15.1	14.7	2.2	2.0	17.3	16.7	-0.7	-0.2	-2.9	-2.2
Dominican Republic	16.7	17.1	15.5	15.9	0.8	1.1	16.3	17.0	1.2	1.2	0.4	0.1
Uruguay	19.8	20.1	21.7	20.8	2.5	4.0	24.2	24.8	-1.9	-0.6	-4.4	-4.7
Venezuela	20.2	21.9	21.7	20.9	2.8	4.5	24.5	25.4	-1.4	1.0	-4.2	-3.5

Source: ECLAC, on the basis of official figures.
[a] Preliminary figures.
[b] Simple average.

Even that minor achievement was heavily influenced by the exceptional results achieved in Nicaragua, where the fiscal adjustment imposed by the new authorities was so great that it had a major effect on the average direction of change among the countries of the region (Nicaragua's primary balance improved by more than 10 percentage points of GDP between 2001 and 2002). Figure II.20, which displays the average situation of the region's central governments *excluding* Nicaragua, reveals that the situation did not alter significantly in 2002: the primary balance weakened slightly while the global balance posted a small improvement, thanks to a reduction in debt interest in the fiscal accounts of Argentina and Ecuador.[31] After fluctuating in a range of 1.1% to 1.8% of GDP between 1992 and 1997, the overall deficit had deteriorated to 2.8% of GDP by 2001.[32] The overall panorama in 2002 should be seen as a continuation of the previous critical conjuncture.

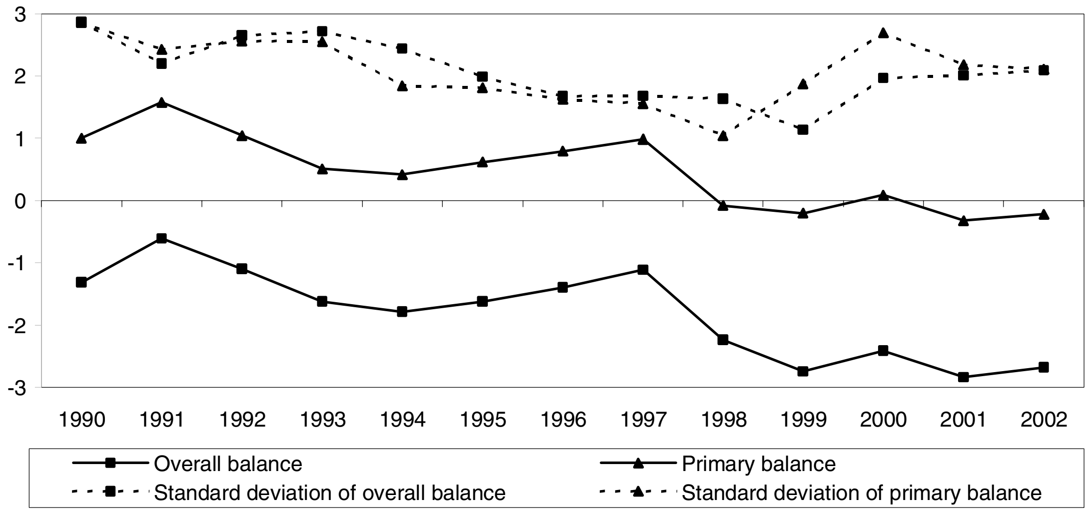
No improvement can be expected in the general panorama for 2003. Apart from a few individual cases, the countries of the region are striving to consolidate a more solid fiscal situation, and are generally negotiating with multilateral financial organizations to introduce new fiscal programmes or renew those already under way. A few countries do not fit this pattern, either because they do not require it (Chile) or because their political situation has put them in a condition that makes negotiation difficult (Honduras).

The figure above also illustrates two additional features of the behaviour of the region's public accounts. First, the widening gap between the two accounting aggregates confirms the growing burden of debt interest during crisis periods –caused largely by the higher rates

31 Unlike the other the countries of the region, for Argentina in 2002 interest actually paid was calculated rather than interest accrued. This reflects the partial moratorium on debt service declared by the government, on which a renegotiation process is expected to begin in late 2003. In Ecuador, on the other hand, the smaller weight of interest payments is explained by a significant revaluation of output in current dollar terms.

32 The average central government primary result varied between 0.4% and 1.0% of GDP between 1992 and 1997, before slipping to -0.3% of GDP in 2001.

Figure II.20
LATIN AMERICA AND THE CARIBBEAN: CENTRAL GOVERNMENT PRIMARY AND OVERALL RESULTS [a]
(*Percentages of GDP at current prices*)



Source: ECLAC, on the basis of official figures.
[a] Simple averages, excluding Nicaragua.

that borrowing countries have to pay in such circumstances, and the effects of currency devaluation.[33]

The second feature relates to the trend of the standard deviation of the two series. The average situation discussed above is the net outcome of widely diverging situations, and standard deviations can provide a first approximation to the extent of the disparities. In general, the dispersion of results has tended to decrease when the average situation has improved (specifically up to 1998), and to increase during the ensuing crisis. At the most critical junctures it is predictable that economies in the vanguard of the process suffer a more pronounced deterioration in their fiscal results, which serves to widen overall dispersion (countries such as Argentina, Bolivia, Nicaragua, Uruguay and Venezuela would fit this description in the regional situation of recent years). At the same time, countries less affected by the crisis display a more stable behaviour pattern, in some cases reinforced by the use of countercyclical instruments (Chile). Since 2000, the deterioration of the primary balance has coincided with a reduction in its standard deviation; but the dispersion in *overall* results is growing, which reflects the different influence exerted on the interest each government pays on its debt.

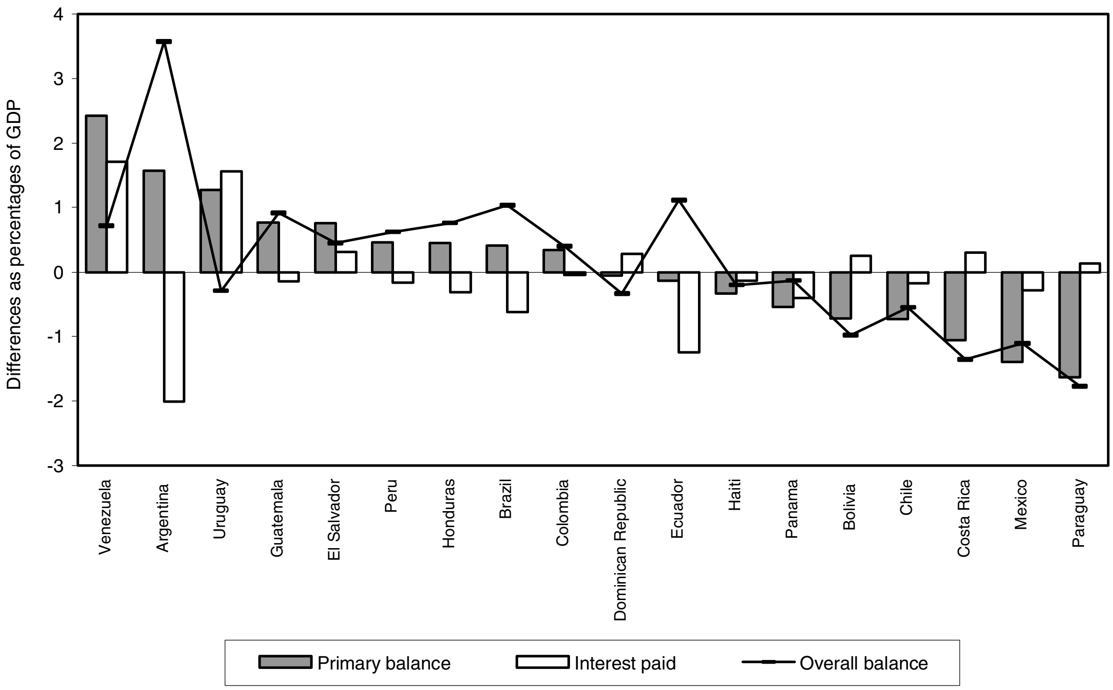
b) Fiscal results by groups of countries

In order to identify the fiscal trend in each country of the region during 2001-2002, figure II.21 shows how overall and primary results and central-government interest payments changed between 2001 and 2002, ranked by the magnitude of the variation in the respective primary results. Once again, Nicaragua is excluded from the calculation, because its results improved to such an extent that including them in the figure would make it impossible to adequately differentiate between the other countries using the same scale.

The invariability of the average, as mentioned above, reflects the fact that in half the countries the overall and primary results improved while in the other half they worsened. There are two countries whose results varied in opposite directions in 2002. One is Ecuador, whose central-government primary balance deteriorated while the overall result improved, thanks to significantly lower interest payments resulting from debt reduction and GDP growth measured in current dollars. The opposite case is Uruguay, which, despite achieving a larger primary surplus, saw its overall result worsen because that increase was outpaced by the growth of interest

33 Data for 2002 were affected by a number of special cases, as already mentioned, and are an exception to this observation.

Figure II.21
LATIN AMERICA AND THE CARIBBEAN: CENTRAL GOVERNMENT PRIMARY AND OVERALL RESULTS [a]
(*Differences between indicators for 2001 and 2002*)[b]



Source: ECLAC, on the basis of official figures.
[a] Excludes Nicaragua.
[b] See table II.4.

payments. In Argentina, meanwhile, specific aspects of these two cases conspired to produce the largest overall central-government surplus in the entire region after Nicaragua. Like its neighbour Uruguay, Argentina achieved a considerable improvement on its primary balance; but, given the partial moratorium on debt service, its accounts also registered significantly lower interest payments. In this case all central-government accounting aggregates displayed reductions. Among the remaining countries, there is an equal number of improving and deteriorating primary and overall results, as shown in table II.5.

When analysing whether the changes in the 2002 results were achieved with a larger or smaller State presence (measured by central-government primary expenditure as a percentage of GDP), four groups of countries can be distinguished in addition to the three special cases mentioned above. Of the eight countries that achieved better results in 2002, Brazil and Colombia increased their primary expenditure, while the State presence declined in the other six (El Salvador, Guatemala, Honduras, Nicaragua, Peru and Venezuela). Among the other eight countries, where results deteriorated, primary expenditure grew in six cases (Bolivia, Chile, Costa Rica, Dominican Republic, Mexico and Paraguay) and decreased in just two (Haiti and Panama).[34]

The situation described in the foregoing classification and the accompanying figures relates exclusively to events over the last two years. To put the regional fiscal-policy panorama during the past year into historical perspective, figure II.22 combines information on the primary balance for 2002 with a synthetic indicator of the fiscal situation in the past, in this case consisting of the debt/GDP ratio. When the regional averages of these two indicators are plotted on a graph, the four groups of countries can be located in quadrants representing increased or reduced fiscal solvency, both now (ratio between primary balance and GDP) and in the past (level of public debt as a percentage of GDP). Two extreme cases (Argentina and

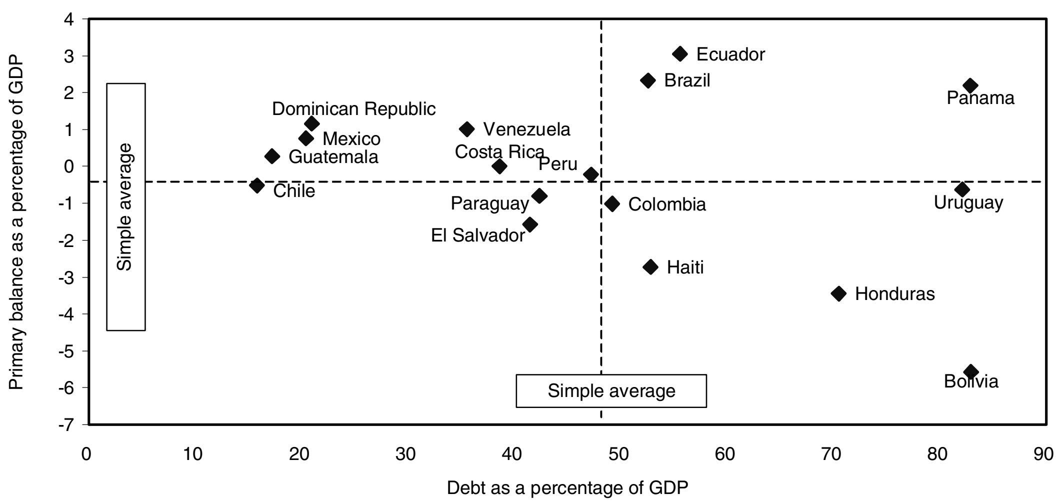
34 Subject to the proviso on the calculation of debt interest mentioned above, Argentina should be included in this last group.

Table II.5
CENTRAL GOVERNMENT: DIRECTION OF CHANGE IN FISCAL AGGREGATES, 2001-2002

Country	Income	Primary expenditure	Interest	Total expenditure	Primary balance	Overall balance
Argentina	-	-	-	-	+	+
Bolivia	-	+	+	+	-	-
Brazil	+	+	-	+	+	+
Chile	-	+	-	+	-	-
Colombia	+	+	-	+	+	+
Costa Rica	-	+	+	+	-	-
Ecuador	+	+	-	-	-	+
El Salvador	+	-	+	+	+	+
Guatemala	+	-	-	-	+	+
Haiti	+	+	-	+	-	-
Honduras	-	-	-	-	+	+
Mexico	-	+	-	+	-	-
Nicaragua	+	-	+	-	+	+
Panama	-	-	-	-	-	-
Paraguay	-	+	+	+	-	-
Peru	+	-	-	-	+	+
Dominican Republic	+	+	+	+	-	-
Uruguay	+	-	+	+	+	-
Venezuela	+	-	+	+	+	+

Source: ECLAC, on the basis of official figures.

Figure II.22
LATIN AMERICA AND THE CARIBBEAN: DEBT AND PRIMARY BALANCE [a]



Source: ECLAC, on the basis of official figures.
[a] Simple averages, excluding Argentina and Nicaragua.

Nicaragua) have been excluded because of their very high borrowing levels, to avoid bias in the classification of the remaining economies, since the figures used are simple averages.[8] It is worth noting that of the countries displaying higher debt-to-GDP ratios, three achieved primary surpluses in excess of 2% of GDP in 2002 (Brazil, Ecuador and Panama), while another three posted very large primary deficits (Haiti, Honduras and Bolivia).

In short, when variations in the central-government fiscal aggregates in 2002 are combined with the level of

35 If Argentina and Nicaragua had been included in the calculation, they would have been among the countries with above-average debt/GDP and primary-surplus/GDP ratios, along with Brazil, Ecuador and Panama. In Argentina, GDP fell abruptly in dollar terms as a result of the moratorium, devaluation and debt renegotiation, and there was a simultaneous increase in the debt/GDP ratio. In Nicaragua, this quotient is related to the level of output, for which the calculation methodology is currently under review.

public borrowing as a percentage of the respective GDP, the public-finance situation of the region's countries can be divided into four categories, as shown in table II.6:

i) Countries with below-average debt/GDP ratios whose primary balances improved in 2002. These are El Salvador, Guatemala, Peru and Venezuela, all of which achieved better results with lower levels of primary expenditure than in the previous year;
ii) Countries with below-average debt/GDP ratios whose primary balances deteriorated in 2002. These include Chile, Costa Rica, Dominican Republic, Mexico, and Paraguay, where primary expenditure was down from the previous year's level;
iii) Countries with above-average debt/GDP ratios and improved primary balances in 2002. There are four members of this group: Brazil and Colombia, where primary expenditure increased, and Honduras and Uruguay, where it decreased;
iv) Countries with above-average debt/GDP ratios whose primary balances worsened. This group includes Panama, even though it cut back its primary expenditures, along with Bolivia, Ecuador and Haiti, where primary expenditures grew in 2002.

A number of distinctive patterns can be discerned in the fiscal behaviour of countries in the different subregions and integration groupings. In 2002 and 2003, the MERCOSUR countries suffered most directly from the deterioration of international and local financial conditions. In 2002, all of these countries experienced steep currency devaluations and significant changes in their relative prices. The Argentine crisis and its contagion to neighbouring countries –compounded by conflictive political situations (Argentina and Paraguay), the change of government in Brazil, onerous financial costs and high country-risk premiums– marked all these economies. In addition, fiscal-policy design was tightly constrained by the macroeconomic crisis itself, which resulted in continuous negotiation of arrangements with IMF.

In the case of Argentina, the severe curtailment of primary expenditure is the outcome of a drastic change in the economy's relative prices, involving significant cuts in real wages and social-security benefits. Much of the fiscal improvement achieved is the result of a withholding scheme applied to exports, whereby the Treasury obtains a portion of the funds generated by the extraordinarily high value of foreign currency and its consequent effect on exporters' earnings. The maintenance of this source of funds will clearly depend on macroeconomic conditions, which are bound to be different in the future. The domestic fiscal situation has also benefited from a peculiar form of the Olivera-Tanzi effect. The inflationary surge in early 2002 generated real revenue losses that were recouped a few months later when the pace of inflation slowed sharply. Nonetheless, as many of the prices paid by the public sector remained practically frozen, including wages and social-security benefits, a fiscal surplus was achieved as a result of the higher real value of taxes compared to the prices paid by the public sector. Minimum pension entitlements were raised only slightly in mid-2003, by far less than cumulative inflation since the

Table II.6
LATIN AMERICA AND THE CARIBBEAN: CLASSIFICATION OF COUNTRIES BY PRESENT AND PAST FISCAL SITUATION, AND VARIATIONS IN 2002

		Below-average debt/GDP ratio	**Above-average debt/GDP ratio**
Improved primary balance in 2002	Increase in primary expenditure		Brazil Colombia
	Decrease in primary expenditure	El Salvador Guatemala Peru Venezuela	Honduras Uruguay
Deterioration in primary balance in 2002	Increase in primary expenditure	Chile Costa Rica Dominican Republic Mexico Paraguay	Bolivia Ecuador Haiti
	Decrease in primary expenditure		Panama

Source: ECLAC, on the basis of official figures.

end of 2001. Although the additional funds were partly used to finance a major assistance programme to tackle the social crisis, a large portion helped form the primary surplus described above.[36]

Public accounts in Uruguay also display a remarkable increase in the primary balance, as a result of cuts in primary expenditure across the board. The basic difference that distinguishes it from the Argentine case is that the latter also managed to reduce its total expenditures significantly by partially suspending debt service. In Brazil, on the other hand, fiscal improvement in 2002 reflected more buoyant revenue, induced by fiscal reform and improvements to tax administration. Since these measures involved exceptional payments that are unlikely to be repeated in 2003, the government's goal of achieving a larger primary surplus this year is founded on a more austere expenditure policy. Lastly, in Paraguay, the fiscal situation worsened steadily as income fell abruptly. Uruguay aims to strengthen its fiscal situation in 2003 to lay the foundation for a sustainable fiscal programme in the medium term. To achieve this, it is projecting a reduction in the real level of expenditure, supported by a slight upturn in receipts.[37]

It is also worth mentioning the importance of social security in this group of countries, since they have the region's most mature pension systems. Argentina and Uruguay are each facing problems characteristic of their different social-security reforms. In 2003 debate is expected in Brazil and Paraguay over the reform alternatives promoted by their new governments – especially, in Brazil's case, in relation to changes made to the pension regime covering public-sector workers. In Paraguay, half of the fiscal deficit stems from the financial shortfall in the country's social-security institute.

This section concludes by considering the effects of provincial- and state-government finances on the consolidated results achieved in Argentina and Brazil in recent years. Use of central government statistics makes it hard to gain insight into the accounts of countries with more deep-rooted federal traditions. Nonetheless, primary results have improved in both cases. The particular type of fiscal adjustment undertaken in Argentina, based on a change in relative prices, significantly increased room for fiscal manoeuvre by provincial governments whose budgets are largely used to pay workers in the education, health and security systems, and finance their own public administration. Moreover, in an agreement signed between the provinces and the nation, the central government undertook to renegotiate a large proportion of provincial debt, thereby significantly reducing the debt service payable by the corresponding provincial authorities.

The Andean group of countries, including Chile, displays more variety. Three of its members improved their primary balances in 2002 (Colombia, Peru and Venezuela), while another three suffered deteriorations (Bolivia, Chile and Ecuador). Peru was clearly one of the countries that proved best able to cope with the regional macroeconomic and fiscal turbulence. Nonetheless, fiscal-policy debate in that country revolves around factors of political uncertainty, albeit on a smaller scale than those affecting Venezuela or Colombia. In addition, the fiscal consequences of certain reforms introduced in the 1990s need to be highlighted in some cases. In Bolivia, for example, pension reform has been the main cause of imbalance, although other expenditures also grew while income retreated. Results in Colombia and Peru were also affected by the expenditure implications of their decentralization policies. In the first case, the surplus of the decentralized public sector (about 2% of GDP in 2002) partially offset a deficit of over 6% of GDP registered by the central government. Peru, meanwhile, is currently implementing an ambitious programme of reforms aimed at gradually decentralizing central government activities by creating new regions, in a process that is intended to be fiscally neutral.[38]

In this group of countries close attention needs to be paid to developments in the mining and hydrocarbons subsectors, the State's participation in these areas and the various methods employed to extract fiscal revenues from the corresponding activities. In Ecuador, for example, investment in the hydrocarbons area (in addition to current public expenditure, especially wage payments and social-security benefits) has acted as an engine of economic growth, and the fiscal results achieved in 2002 were founded partly on high oil prices. Another case worth mentioning is Venezuela, where the strike hit oil production, with knock-on effects on overall economic activity and fiscal revenues. A fiscal improvement can be expected in 2003, although its extent will depend on what happens to oil production.

36 The Unemployed Male and Female Heads of Household Plan was implemented in 2002, and distributed subsidies equivalent to 0.74% of GDP. An increase in these subsidies has been budgeted for 2003.

37 Nominal expenditures are expected to increase by just half the rate of inflation.

38 Peru also aims to increase its primary surplus (essentially by expanding its tax base) and establish a path for debt reduction.

Lastly, fiscal-policy design in Chile also warrants close inspection, since it includes a structural surplus rule that has enabled public finance to play a major stabilizing role in recent years by cushioning the effects of external shocks on domestic expenditure. An innovation made in the 2003 budget process consisted of involving experts from outside the government in estimating potential GDP and the price of copper for the coming year. This forces the authorities to abide by a fiscal rule that is becoming less and less discretionary. An improvement is also expected for this year as a result of more robust growth and an upturn in the price of copper, which is likely to reduce the central-government accounting deficit.

The economic slowdown in the United States has been felt most strongly in the subregion comprising Mexico and Central America. In addition, slower growth in nearly all the countries in this group, except Costa Rica, has brought pre-existing problems to the fore. Prospects for 2003 are not very promising, and fiscal policy in these countries is tending towards greater austerity.

As mentioned above, the case of Nicaragua needs to be considered separately. In complicated macroeconomic circumstances in which economic activity slowed for the third straight year, the government that took office in early 2002 has had to deal with a very complex fiscal situation. In 2001, public accounts deteriorated sharply, leading to a loss of international reserves; nonetheless, the new administration managed to reduce the central-government primary deficit by over 10 percentage points of GDP. Factors contributing to this result included increased grants (2.2% of GDP) and tax revenues (1.2% of GDP), supported by reduced expenditure on goods and services and fixed capital formation (2.6% of GDP) and lower current and capital transfers (3.9% of GDP). The adjustment was partly responsible for the slowdown in economic activity and for the delay in agreeing on a new three-year arrangement with IMF, which was not finalized until late 2002. In the Dominican Republic, on the other hand, public expenditure was increased in order to boost economic growth in the first half of 2002, but the government was forced to change policy direction towards the end of that year, when other macroeconomic imbalances began to surface.

Grants play a major role in central-government accounts in this subgrouping. Among the countries for which relevant information is available, income in this category declined in El Salvador and Guatemala, but staged a remarkable recovery in Nicaragua.

In Mexico, the economic-policy goal for 2002 was to maintain the fundamental balances through fiscal discipline against a backdrop of economic stagnation, but slow output growth prevented this from being achieved. The deficit widened to 1.2% of GDP, compared to an official target of 0.7%, with much of the divergence stemming from the cost of reforms to the rural credit system. The aim in 2003 is to keep public expenditure on a tight rein and take steps to increase revenues.

In Costa Rica the Legislative Assembly approved a fiscal contingency plan in December 2002 aimed at generating additional revenue equivalent to 1% of GDP in 2003, in order to fulfil a fiscal-deficit reduction programme. At the same time, expenditures were cut both at the central level and in the decentralized sector. In Guatemala, fiscal policies are being tightened in order to further reduce the accumulated deficit. In Panama, the authorities are striving to meet the targets contained in the Fiscal Responsibility Act passed in 2002.[39]

Tighter fiscal policies have also been proposed in the Dominican Republic, Haiti and Honduras, although these three countries face more complex situations. In Haiti, political crisis, rumours of a change of monetary regime, foreign-currency flight and arrears in meeting commitments with multilateral lending agencies have combined to heighten the uncertainty. In Honduras also, uncertainty persists over the future of the economy and the chances of success for the government's fiscal policy. The government failed to reach an agreement with IMF, so its deficit reduction programme is based on a tax reform passed in April 2003 (the Financial Balance and Social Protection Act), which is expected to yield additional funds equivalent to 1% of GDP. The Dominican Republic also redoubled its fiscal austerity drive in the midst of uncertainty and a banking crisis, with a view to reaching an agreement with the Fund. Nonetheless, income stalled and by mid-2003 Congress had not yet approved the fiscal reform bill.[40]

c) Structural reform and fiscal policy in the region

As shown throughout this chapter, in nearly all the countries fiscal policy has been dominated in recent years by the explicit goal of balancing public accounts. Pursuit of that goal in a recessionary setting, compounded by extreme capital-market volatility, has meant that the fiscal policies designed in each country have generally proved inadequate to overcome the macroeconomic crisis.

39 This legislation establishes a commitment to achieve a non-financial public-sector deficit of less than 2% of GDP.

40 To deal with the crisis in the country's second-largest bank, the monetary authorities placed it under administration and are thought to have provided funding equivalent to 15% of GDP.

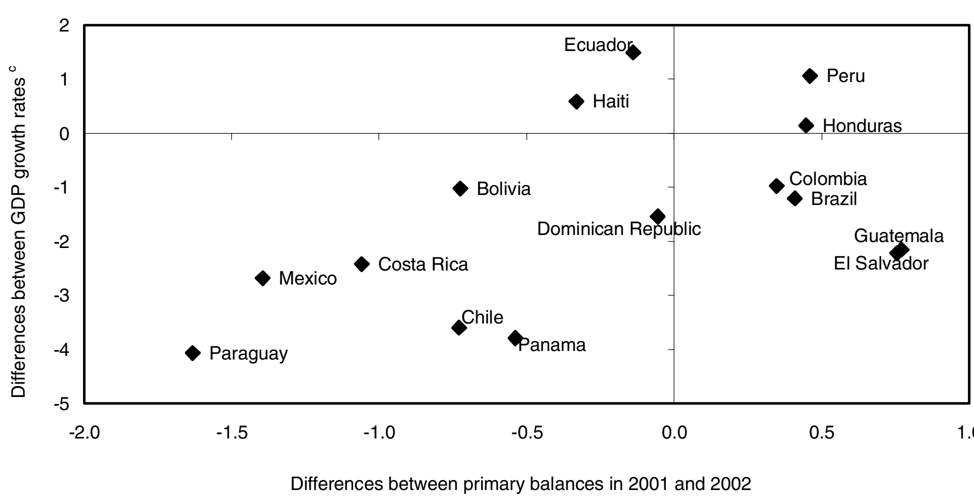
It is difficult to assess a country's fiscal-policy stance in relation to the business cycle by considering results alone.[41] Each economy's medium-term growth rate is different, so it does not suffice to evaluate fiscal policy on the basis of higher or lower absolute growth.[42] To evaluate this feature more thoroughly, figure II.23 considers the difference between each country's primary results in 2002 and 2001 and between its GDP growth in 2002 and its average growth during the 1990s. Various patterns can be distinguished when reviewing results in 2002.

Peru and Honduras have pursued countercyclical fiscal programmes, as evidenced by the improvement in their primary results at a time when their economies grew faster than their average growth during the 1990s. The results obtained in Chile and Costa Rica can also be classified as countercyclical, since fiscal policy took account of the need to boost the economy; so too can the results achieved by Bolivia, Dominican Republic, Mexico, Panama and Paraguay. In each of these countries, primary results were inferior to those of the previous year, while the respective economies grew more slowly than their average rate over the past decade.[43]

Ecuador's growth rate in 2002 was above its 1990s average, and its primary results were inferior to those of 2001, thereby indicating somewhat procyclical behaviour.[44] The same could be said of Brazil, Colombia, El Salvador and Guatemala, where slower growth rates were accompanied by improved primary results. These latter cases partly reflect typical attempts by the countries of the region to break out of critical conjunctures by means of rigorous fiscal adjustment processes.

Figure II.23 does not consider the cases of Argentina, Nicaragua, Uruguay or Venezuela. Nicaragua is excluded because its primary balance improved too much to be interpreted in terms of countercyclical public finance. Argentina, Uruguay and Venezuela are not included because they represent a sample of situations that have characterized the region in the recent past. In 2002, these economies faced extremely serious problems in which GDP shrank by about 10%; as a result of the financial constraints characteristic of such crises, they achieved significant improvements in their primary results.

Figure II.23
LATIN AMERICA AND THE CARIBBEAN: PRIMARY BALANCE AND ECONOMIC GROWTH[a]
(*Percentages of GDP at current prices*)



Source: ECLAC, on the basis of official figures.
[a] Percentages of gross domestic product in local currency at current prices.
[b] Average annual growth rates, on the basis of figures expressed in dollars at constant 1995 prices.
[c] Refers to differences between GDP growth in 2002 and annual average growth for the period 1991-2000.

41 Identification of an economy's cyclical phase at a given point in time is a matter of ex-ante speculation, and subsequent verification may require the initial judgement to be revised.

42 Chile, for example, which does have an explicitly designed countercyclical fiscal policy, has a potential growth trend far higher than those of other countries in the region.

43 In the case of the Dominican Republic, the primary result was only inferior to the 2001 figure.

44 In figure II.23, Haiti appears alongside Ecuador not because it grew faster in 2002 than in the 1990s, but because its activity level fell by less (0.2% in 2002 compared to an average decline of 0.8% for the decade).

Apart from the results obtained, one of the key features of the fiscal-policy reforms debated and implemented in the region in recent years concerns the introduction of macrofiscal rules of various kinds and the recognition of the need to mitigate the effects of future recessionary shocks by adopting countercyclical fiscal policies.[45]

The structural surplus rule implemented by the Chilean government has already been discussed; but several other countries in the region have introduced fiscal responsibility laws aimed at establishing macrofiscal frameworks to help manage the cycle. Examples include legislation passed in Brazil and Panama and, more recently, in Ecuador, which in January 2003 issued regulations for the Fiscal Accountability, Stabilization and Transparency Act; and also in Peru, where a fiscal prudence and transparency bill has been sent to Congress.

Four constraints on the effects of this type of reform need to be mentioned. First, in some countries the rules were not introduced with the aim of building a more disciplined and solvent fiscal structure in the medium term, but instead merely to show signs of such discipline. Argentina is a case in point, where legislation of this type was unable to ward off the effects of the crisis.[46] Second, in most cases, these rules were debated or adopted after the post-1998 economic slowdown had occurred and not during the preceding boom. Third, this crisis has lasted longer than could have been foreseen when the countercyclical funds were created. Finally, it is important to mention that most of the tax reforms implemented in the region have increased the structural share of valued added tax (VAT), thereby accentuating the procyclical nature of public finances.[47]

That is precisely the orientation of many of the tax reforms currently being debated or implemented in the region. Brazil is in the process of converting an old tax, levied in cascade form on different productive activities (thereby distorting allocational efficiency), into VAT. In Paraguay and Venezuela, VAT rates have been increased, and exemptions have also been eliminated in the latter. Other countries such as Bolivia and Uruguay are taking what are expected to be permanent steps to modernize their tax administrations (Uruguay is combining improved tax administration with an expansion of the VAT base). Nonetheless, there are also countries where tax reform has become habitual in the face of recurrent needs to strengthen fiscal outcomes. In Nicaragua, the Tax Base Expansion Act is the sixth tax reform implemented in the last seven years, while Argentina, Costa Rica, Peru and Venezuela are all planning to levy exceptional taxes.[48]

Lastly, fiscal policy in Latin America and the Caribbean includes other reforms introduced by various countries that could have medium-term effects on fiscal solvency. Questions have already been raised about the effect of pension reforms and the decentralization of public spending in a number of countries.[49] A special case of structural reforms likely to have negative medium-term fiscal effects consists of the trade agreements already signed or being negotiated by Chile and the Central American countries. In the case of Chile, these treaties will imply a fiscal-revenue loss on the order

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45 The most obvious forerunners in this type of debate are the various types of stabilization fund introduced in a number of Latin American and Caribbean countries. Some of these aim to cushion fluctuations in fiscal revenues obtained from the hydrocarbons sector, such as the Macroeconomic Stabilization Investment Fund created in Venezuela in 1998; the Oil Income Stabilization Fund established in Mexico in 2000 and the Oil Stabilization Fund set up in Colombia in 1995. Chile has had the Copper Compensation Fund (FCC) since 1987. The resources of all these funds have been depleted in recent years. See ILPES, *Fondos de estabilización*, Santiago, Chile, 2002, unpublished.

46 In Argentina, in the months leading up to the elections and change of government in 1999, Congress adopted the Fiscal Responsibility Act, which established a timetable for achieving fiscal balance at the national government level over a three-year period, in order to issue an institutionally credible signal of a commitment to gradually reduce fiscal imbalances. Subsequently, given the difficulties that the Argentine economy had to face in 2000, the timetable was extended to five years and the plan was expanded to encompass provincial governments. Finally, in 2002, when the irreversible nature of the crisis could no longer be denied, the government attempted to gain credibility by announcing a zero-deficit rule that would take effect immediately. This is an illustrative case of the way in which the rule becomes perverted and is used merely as a signal.

47 Table II.7, which provides data on tax pressure in each country, illustrates the importance of taxation in general, and VAT in particular, for consumption practically everywhere.

48 In Argentina and Venezuela these include taxes of various types levied on bank debits.

49 To cite a number of examples, in Brazil reform of the pension regime covering public-sector workers is currently under debate; in Ecuador, reform of the social-security system in 2001 increased contributions and raised the retirement age, and also made it possible to opt for a private funded system which has not yet been regulated; in Bolivia the main cause of the fiscal deficit is the social-security deficit generated by the 1997 reform, which amounted to 5% of GDP; in Argentina, the social-security reform carried out in 1994 explains much of the fiscal deficit of recent years; in Uruguay, despite the reform implemented, pension expenditure is growing constantly and has now reached a level of 16% of GDP, equivalent to half of total operating expenditures; in Panama, the Social Security Fund posted a deficit in 2002 for the first time since its creation. For an analysis of the fiscal cost of some of the region's pension reforms, see C. Mesa-Lago, *Estudio comparativo de los costos fiscales en la transición de ocho reformas de pensiones en América Latina*, Financiamiento del Desarrollo series, No. 93 (LC/L.1344-P), Santiago, Chile, Development Finance Unit, Economic Commission for Latin America and the Caribbean (ECLAC). United Nations publication, Sales No. S.00.II.G.29, 2000.

Table II.7
LATIN AMERICA AND THE CARIBBEAN: PUBLIC DEBT AND TAX PRESSURE, 2002[a]
(*Percentages of gross domestic product, at current prices*)

	Public Debt	Total tax revenue	Social security contri-butions	Total tax revenue minus social security contributions	Taxes on income, capital and property	Taxes on goods and services			Taxes on foreign trade	Other taxes
						Total	VAT[b]	Other		
	(1)	(2)	(3)	(4)=(2)-(3) (4)=(5)+(6)+(9)+(10)	(5)	(6)=(7)+(8)	(7)	(8)	(9)	(10)
Latin America and the Caribbean [c]	**67.0**	**17.2**	**3.1**	**14.1**	**4.3**	**7.6**	**5.1**	**2.5**	**1.7**	**0.5**
Argentina	134.4	19.8	2.8	17.0	5.8	9.1	6.9	2.2	1.7	0.5
Bolivia	82.9	15.0	1.7	13.3	5.3	6.8	6.1	0.7	1.1	0.1
Brazil	52.6	35.9	13.7	22.2	8.1	9.9	7.9	2.0	0.6	3.5
Chile [d]	15.8	20.5	1.5	18.9	7.0	10.7	8.4	2.4	1.0	0.2
Colombia	49.2	17.4	4.0	13.4	6.6	5.7	5.3	0.5	1.0	0.0
Costa Rica [d]	38.6	19.3	6.4	13.0	3.5	8.5	4.9	3.6	1.0	0.0
Ecuador [f]	55.6	13.7	2.2	11.5	2.7	6.9	6.3	0.6	1.8	0.1
El Salvador [d e]	41.5	12.5	1.8	10.7	3.3	6.3	5.9	0.5	1.1	0.0
Guatemala [e]	17.2	10.8	0.3	10.6	2.8	6.1	4.7	1.3	1.3	0.4
Haiti [e]	52.8	8.4	0.0	8.4	1.7	3.2	2.6	0.6	2.2	1.2
Honduras [d e]	70.5	16.5	0.5	16.0	3.7	10.3	5.5	4.8	2.0	0.0
Mexico [g]	20.4	16.9	1.5	15.4	5.3	9.2	3.5	5.6	0.6	0.3
Nicaragua [e h]	329.9	28.1	5.4	22.7	4.5	10.0	4.2	5.9	7.0	1.2
Panama [g]	82.9	16.6	5.0	11.6	5.5	3.5	1.5	2.0	2.0	0.6
Paraguay [e]	42.4	10.5	1.0	9.5	1.7	6.0	4.0	2.0	1.6	0.1
Peru [d e]	47.2	13.9	1.7	12.2	3.0	7.0	4.9	2.1	1.3	0.9
Dominican Republic [e]	20.9	16.6	0.6	16.0	4.5	7.7	4.2	3.5	3.6	0.2
Uruguay [e f]	82.1	23.5	7.8	15.7	3.6	11.8	5.6	6.2	0.2	0.1
Venezuela [e]	35.6	10.2	0.6	9.6	3.5	5.1	4.1	0.9	1.0	0.0

Source: ECLAC, on the basis of official figures.
[a] Preliminary figures.
[b] Corresponds to central government.
[c] Simple averages.
[d] Debt balances correspond to central government. In the other countries they correspond to the public sector.
[e] Data on revenue correspond to central government. In the other countries they correspond to general government.
[f] Data on revenue correspond to 2001.
[g] Data on revenue correspond to 2000.
[h] Consideration of data on Nicaragua should bear in mind that a review of the country's national accounts is currently under way.

of US$ 430 million per year as from 2004, which is to be covered by temporary increases in VAT rates starting in mid-2003.

d) Fiscal policy in the Caribbean countries

In 2002, the countries of the Organisation of Eastern Caribbean States (OECS) registered an improvement in their aggregate fiscal situation, as the net outcome of surpluses achieved by some governments (Anguilla and Montserrat), deficit reductions achieved by others (Antigua and Barbuda, Dominica and Saint Lucia) and deteriorations elsewhere (Grenada, Saint Kitts and Nevis and Saint Vincent and the Grenadines).[50] The distinctive feature of the group as a whole was that the aggregate improvement was achieved thanks to the behaviour of income and expenditure on the capital account. In some cases, this reflected the conclusion of public investment projects (Anguilla, Antigua and Barbuda and Montserrat); in others, it was caused by slower progress in ongoing

50 See the section on the Caribbean.

civil works (Dominica). Infrastructure expenditures grew, however, in Grenada, Saint Lucia, Saint Kitts and Nevis and Saint Vincent and the Grenadines. Current expenditure was contained in Anguilla, Dominica and Saint Lucia, while current revenues expanded in Antigua and Barbuda, Saint Vincent and the Grenadines and Saint Lucia. For 2003, most of these countries expect public investment to pick up without adversely affecting the fiscal situation.

In contrast to these experiences, it is impossible to find a common denominator in the fiscal behaviour of the remainder of the Caribbean countries, although income trends were decisive in most cases. Revenue growth in Belize and Guyana made them the only countries to improve their fiscal results. On the other hand, faltering revenue produced wider deficits in the Bahamas and Jamaica, and eroded the surplus in Trinidad and Tobago. Suriname and Barbados saw their fiscal situations deteriorate, mainly because of growth in the various expenditure components. Income levels are expected to recover in most of these countries in 2003, while expenditure is set to expand in Belize, Guyana and Trinidad and Tobago.

2. Exchange-rate policy

a) General trends

In 2002, the regional pattern of foreign-exchange policy was marked by changes of exchange-rate regime in three countries. In January, Argentina abandoned the currency-board system that had prevailed since 1991 and allowed the peso to float. This took place against the backdrop of a collapsing real economy, a public debt-service moratorium and general financial crisis. Second, and following a run on bank deposits related to the Argentine crisis, in June 2002 Uruguay abolished its crawling-band regime and also floated its currency. In February that year, Venezuela had also replaced its currency-band system with a free-flotation regime; nonetheless, twelve months later, following the strike that brought the country to a standstill between December 2002 and January 2003, the government fixed the exchange rate against the dollar once again and imposed strict currency controls. This system remains in force at the time of writing.

Exchange-rate trends in the region in 2002 were dominated by currency depreciations against the dollar in the MERCOSUR countries and Venezuela.[51] The Colombian, Dominican Republic and Haitian currencies also depreciated significantly during the year, while the other countries generally also experienced moderate declines.

In the first half of 2003, the exchange-rate panorama in the region changed dramatically. In 12 countries, led by the four full MERCOSUR partners, the real exchange rate appreciated against the dollar, while moderate real depreciations of under 3% were posted in all the other countries except the Dominican Republic (14.7%), Jamaica (11.3%) and Venezuela (6.1%).

In 13 countries, domestic currencies depreciated more (or appreciated less) against the dollar than in real effective terms.[52] The wide gap between the two indices in some countries, mainly MERCOSUR members (Paraguay, Uruguay, Bolivia), reflected the knock-on effect of depreciations in Argentina and Brazil on the currencies of their most important trading partners. Ecuador's effective exchange rate was also affected by currency depreciations among its Latin American partners; for, having adopted the dollar as its currency

51 The nominal exchange rate with respect to a foreign currency is defined as the number of units of the domestic currency that have to be given in exchange for one unit of the foreign currency in question at a given moment in time. A local currency depreciates/appreciates nominally when, in the current period, more/fewer units of that currency must be given up to obtain one unit of the foreign currency than was the case in the reference period. The real bilateral exchange-rate index against a foreign currency (such as the dollar) is calculated by deflating the nominal exchange rate by the ratio between the domestic and foreign-country inflation rates (in the case of the dollar, the foreign country is the United States). A currency depreciates/appreciates in real terms when the real bilateral exchange-rate index rises/falls.

52 A country's real effective exchange rate index is calculated by weighting its real bilateral exchange rate indices with each of its trading partners by their shares in the country's total trade flows in terms of exports or imports. This chapter uses the average real effective exchange rate for exports and imports. A currency depreciates/appreciates in real effective terms when the respective index rises/falls.

in 2000, Ecuador can no longer adjust its nominal parity in response to changes in its trading partners' dollar exchange rates. Real effective exchange rates remained volatile in 2003, with depreciations occurring in 14 countries. As in 2002, this dichotomy between the behaviour of parities against the dollar and the trend of trade-weighted exchange rates reflects the large volume of trade that several of the region's countries maintain with partners whose currencies appreciated sharply against the dollar, such as Argentina, Brazil and the European Union. Capital inflows from investors seeking higher returns than those offered in industrial-country markets are one of the factors driving currency appreciation in Argentina and Brazil.

Prospects for the remainder of 2003 point to greater stability on foreign-exchange markets, since the largest imbalances recorded in the region in 2002 (particularly in MERCOSUR) seem to be have been reduced. Nonetheless, doubts persist over exchange-rate trends in the Dominican Republic and Venezuela, for country-specific reasons in each case. Effective exchange rates were higher in June 2003 than in December 2001 almost region-wide (except in Ecuador, Guatemala and Trinidad and Tobago), and substantially higher in the MERCOSUR countries and Venezuela.

b) National cases

Although there was a variety of exchange-rate patterns across Latin America and the Caribbean in 2002 and 2003, several groups of countries can be distinguished according to the behaviour of their currencies' real exchange rates against the dollar in 2002.

The MERCOSUR countries and Bolivia (an associate member that maintains major commercial ties with Argentina and Brazil) constitute a first group, having posted the region's largest real depreciations during that year.

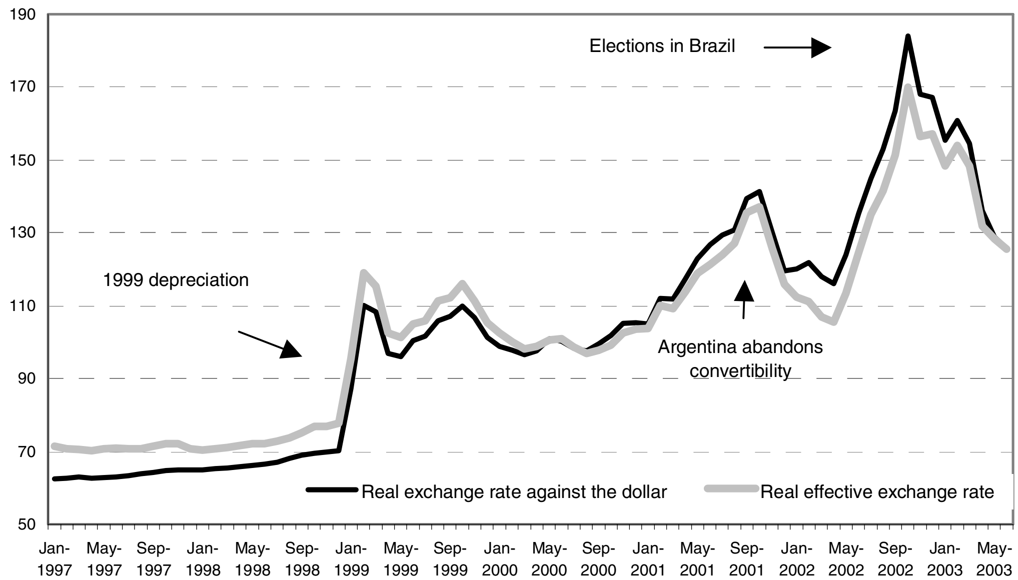
From October 2001 until April 2002, Brazil's currency (the real) appreciated nominally as country risk fell, but the appreciation was even greater in real effective terms from January 2002 onward, given the depreciation of the Argentine peso. Between April and October 2002, the Brazilian real suffered considerable nominal, real and effective depreciations, reflecting uncertainty surrounding the national elections, the heavy burden of domestic public debt combined with the moratorium on public debt service in Argentina, and reduced capital flows from abroad. Once the elections were out of the way, country risk fell steeply in response to the economic-policy signals emanating from the new government and the achievement of substantial trade and fiscal surpluses, all of which was accompanied by high interest rates in the framework of the inflation-targeting policy implemented by the central bank. These factors helped to strengthen the Brazilian currency against the dollar between October 2002 and June 2003. Nonetheless, given the steep previous depreciation, Brazil registered a real depreciation of 39.7% against the dollar for 2002 as a whole. In 2003 so far, Brazil's currency has appreciated by 24.7% in real terms against the dollar, although the real effective appreciation is only 20.1%, since both the Argentine peso and the euro have also strengthened nominally against the dollar.

In January 2002, Argentina abandoned the currency board system and allowed the peso to float, against a backdrop of heavy capital outflows and political and social crisis, following the moratorium declared on sovereign debt payments and the freezing of bank deposits.[53] After the real effective exchange rate had reached a 10-year low in December 2001, the peso depreciated steeply in the first half of 2002, but then began to strengthen from the third quarter onward, as the monetary situation in the country was gradually brought under control and the trade surpluses resulting from reduced imports associated with the crisis pushed the nominal exchange rate downward again. As a result, the year ended with a rise in the real effective exchange rate of 137.7%. In 2003, the Argentine peso has continued to strengthen despite a partial relaxation of controls on foreign currency outflows and periodic interventions by the central bank, against a backdrop of substantial trade surpluses and short-term capital inflows in the second quarter. Although this involved real appreciations against the dollar (19%) and the euro (7.1%), the rapid appreciation of the Brazilian real over the same period limited the Argentine currency's effective appreciation to 10.9%.

Uruguay suffered a run on bank deposits in the first half of 2002, which led to a faster pace of devaluation in the framework of the crawling-band system and a widening of the band. Nonetheless, the scale of the crisis forced the government to put the peso into a float in June 2002, after which it depreciated steeply against a backdrop of uncertainty and banking crisis. By the end of 2002 the Uruguayan peso had depreciated by 57.3% in real terms against the dollar, and by 32% in effective terms given the concurrent depreciations in Argentina and Brazil. The currency continued to weaken nominally

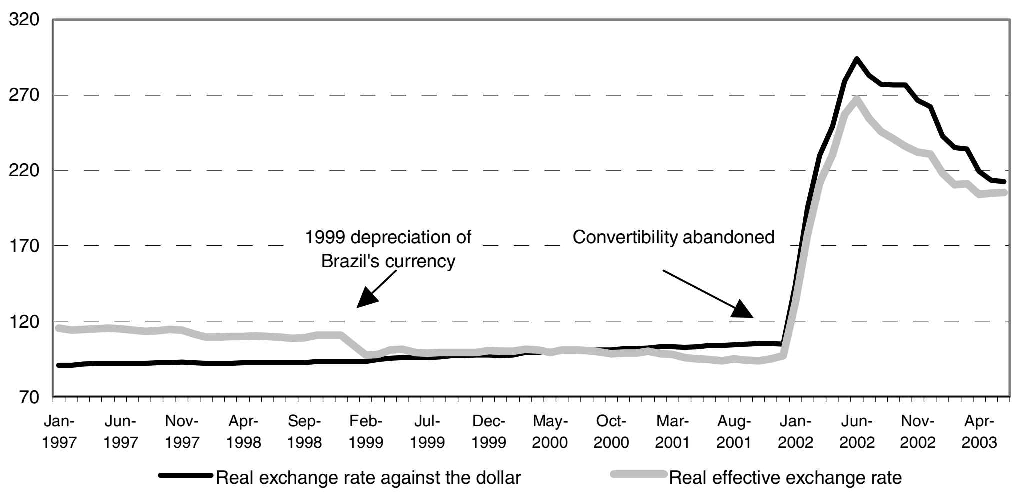
53 A dual foreign-exchange system was implemented for a brief period; this involved an exchange rate of 1.4 pesos per dollar for commercial transactions and a floating exchange rate (albeit with restrictions) for all other transactions.

Figure II.24
REAL EXCHANGE RATES IN BRAZIL
(*Indices 2000=100*)



Source: ECLAC, on the basis of official figures.

Figure II.25
REAL EXCHANGE RATES IN ARGENTINA
(*Indices 2000=100*)



Source: ECLAC, on the basis of official figures.

until June 2003, when an upturn in expectations and a foreign debt swap offering longer maturities caused it to strengthen. Thus far in 2003 the peso has appreciated by 6.7% in real terms against the dollar, but as the currencies of Argentina, Brazil and the European Union (euro) have all appreciated against the dollar by larger amounts, the Uruguayan peso has recorded a real effective depreciation of 4.3%.

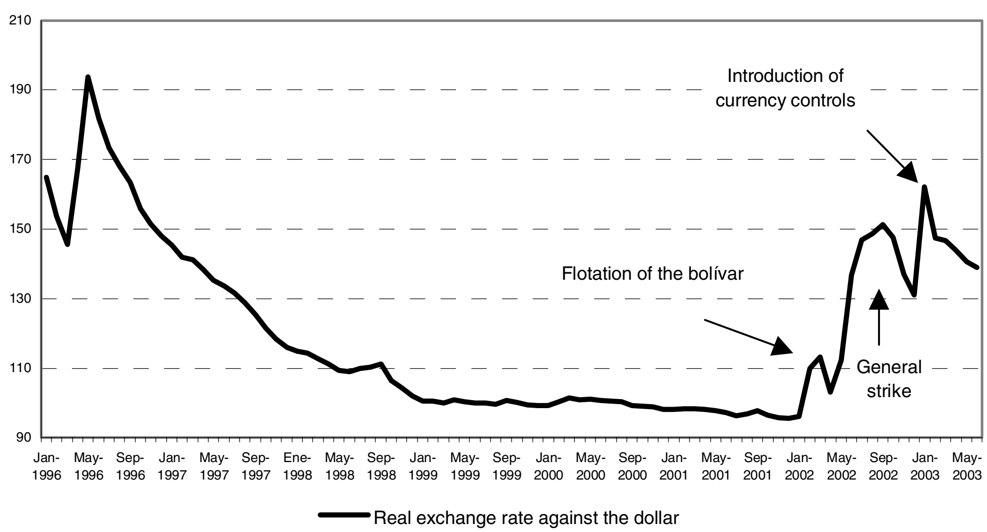
In Paraguay the central bank took steps to stabilize the guaraní in a situation overshadowed by official intervention in the country's third largest domestic bank, compounded by contagion from the exchange-rate turbulence prevailing in Argentina and Brazil. Nonetheless, real depreciation against the dollar (33.7%) and a real appreciation against both the Argentine peso (46.5%) and the Brazilian real (4.3%) resulted in a real effective depreciation of the guaraní of 8.1%. In 2003 to date, the Paraguayan currency has strengthened nominally against the dollar to generate a real appreciation of 14.4%, thanks particularly to the buoyancy of soya exports. Nonetheless, since the Argentine and Brazilian currencies both appreciated against the dollar to a greater extent, the real effective appreciation of the guaraní was limited to 3.8%.

In the case of Bolivia, depreciations against the dollar among its trading partners led the central bank to devalue the boliviano with respect to the United States currency, which resulted in a real devaluation of 9.5% for 2002 as a whole. In the first half of 2003, currency appreciation in Brazil and Argentina slowed the boliviano's nominal devaluation against the dollar; but it still depreciated by 11.4% in real effective terms, raising the real effective exchange rate to its highest level since 1995.

A second group consists of non-MERCOSUR countries whose currencies also depreciated sharply in 2002. These include the Dominican Republic, Haiti and Venezuela, each of which display different exchange-rate patterns linked essentially to domestic phenomena.[54] Jamaica can also be included in this group, for although its currency only depreciated by 1.2% against the dollar in 2002, it has weakened by 11.3% in 2003 thus far, in the wake of deteriorating macroeconomic results (particularly its fiscal situation).

Until February 2002, Venezuela's central bank strove to restrain capital flight by raising interest rates, in an unsuccessful attempt to prop up the crawling-band regime. In February, the latter was replaced by flotation, after which interbank interest rates fell steeply; but demand for dollars in a context of political turbulence caused the bolívar to continue depreciating rapidly in the first half of the year. The general strike of December 2002 marked another turning point and led to a nominal depreciation of 26.9% between December 2002 and January 2003. As a result, by the end of 2002 the bolívar had depreciated by 37.1% against the dollar in real terms. In February 2003, the government introduced exchange controls and fixed the nominal exchange rate below the currently prevailing parity. This led to the emergence of a parallel foreign-exchange market in which the domestic currency traded at rates above the official level. Fixing the exchange rate in an inflationary context led to a real appreciation of the bolívar starting in February 2003. It should be noted that the State is the leading exporter in Venezuela (Petróleos de Venezuela, S.A.), while the private sector is a net importer; so exchange-rate fluctuations have significant fiscal implications in addition to effects on private disposable income.

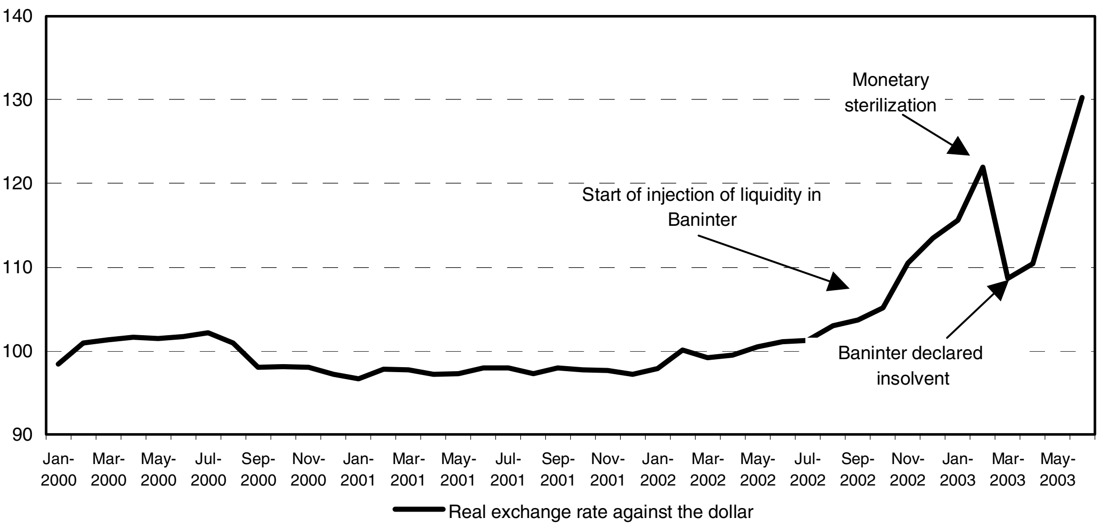
Figure II.26
REAL EXCHANGE RATES IN VENEZUELA
(*Indices 2000=100*)



Source: ECLAC, on the basis of official figures.

54 In Haiti, the real exchange rate against the dollar depreciated by 26.9% in 2002, before appreciating by 20.8% in real terms in the first half of 2003.

Figure II.27
REAL EXCHANGE RATES IN THE DOMINICAN REPUBLIC
(*Indices 2000=100*)



Source: ECLAC, on the basis of official figures.

In the Dominican Republic monetary policy was kept tight during the first half of 2002 in order to counteract the exchange-rate effect of higher public spending, in the midst of weak external demand and rising inflation. In the third quarter, the central bank began to inject liquidity into Banco Intercontinental (Baninter), the country's second-largest domestic bank, which caused an expansion of the monetary base and built up pressure for a devaluation of the peso. This contributed to a 16.7% real depreciation against the dollar in 2002 and boosted the inflation rate in the final quarter of the year. In April 2003, the central bank took control of Baninter, and an audit of its accounts in May revealed that it had been rendered insolvent by fraud on an unprecedented scale. This triggered an even steeper slide in the nominal value of the peso, despite improvements in the balance of payments and efforts to control fiscal spending. The size of the quasi-fiscal deficit generated by the Baninter liquidity transfusion, compounded by worsening expectations, caused a sharp nominal depreciation between April and June 2003, taking the real depreciation against the dollar for the first half of 2003 to 14.7%, despite the inflationary upsurge.

Colombia also experienced significant currency depreciation in 2002; but, unlike the previous group, managed to keep crisis at bay. The peso depreciated in real terms against the dollar as from April, in a low-interest-rate environment compounded by market concerns over fiscal accounts, heightened uncertainty in the region and a downturn in exports to Venezuela. Under these conditions, country risk soared to a peak in September 2002 before falling back in the wake of President Uribe's stated commitment to strengthen public accounts. By the end of the year the real depreciation against the dollar amounted to 16.7%, as the pace of inflation eased. In early 2003, renewed inflationary pressures led the central bank to tighten monetary policy, which, supported by the arrangement signed with IMF in January, caused the Colombian peso to appreciate nominally beginning in March. In 2003 to date it has strengthened by 3.3% in real terms against the dollar.

A third group includes economies whose currencies did not depreciate significantly in relation to the dollar in 2002 and 2003. Both Chile and Peru saw little change in their real exchange rates, while the Mexican peso depreciated moderately, breaking the trend of real appreciation that had lasted since 1995.

Expansionary monetary policy, regional crisis and deteriorating terms of trade conspired to devalue the Chilean peso by 4.5% in real terms against the dollar during 2002. In the first half of 2003, this exchange rate barely altered (0.4% in real terms), but real depreciations against the Argentine peso (23.9%) and the euro (15.1%) were mainly responsible for the real effective depreciation of 7.5% recorded in the first half of the year.

In Peru the exchange rate remained steady in the first six months of 2002, but uncertainty in the region during the third quarter caused a nominal depreciation, which pushed the exchange rate to a new high in September. Pressure on the local currency eased thereafter as interest rates were lowered, and 2002 ended with a real depreciation of 3.2% in dollar terms. For most of the first half of 2003, the exchange rate remained below its levels of the final quarter of 2002, which, combined with low inflation, generated a real appreciation against the dollar of 1.2%.

In Mexico, the peso depreciated from April 2002 onward, matching the change of direction in the tight monetary policy prevailing in the first quarter and after the real exchange rate had fallen to a 10-year low. The trend was reinforced in the second half of 2002 by economic slowdown in the United States and an erosion of expectations, while the depreciation began to have inflationary consequences. This led to monetary tightening which moderated the nominal depreciation, although fluctuations persisted, and by the end of 2002 the peso had depreciated by 7.8% in real terms against the dollar. From December 2002 to February 2003, the Mexican currency continued to depreciate sharply, partly because of external factors such as concerns about impending war in Iraq and the trend of the dollar. From March onward, monetary tightening and the unfolding of the Iraq conflict helped the peso to strengthen in real terms against the dollar until May. As a result the Mexican currency appreciated by 2.9% in real terms against the United States currency in the first half of 2003, and in June its real parity was just 1.6% above its level of November 1994, on the eve of the “tequila crisis”.

Other countries whose currencies depreciated to some degree against the dollar in 2002 were Honduras (0.7%), Costa Rica (3.4%) and Nicaragua (4.4%). Up to the second quarter of 2003, real dollar exchange rates in these countries had not departed significantly from their levels in the final quarter of 2002.

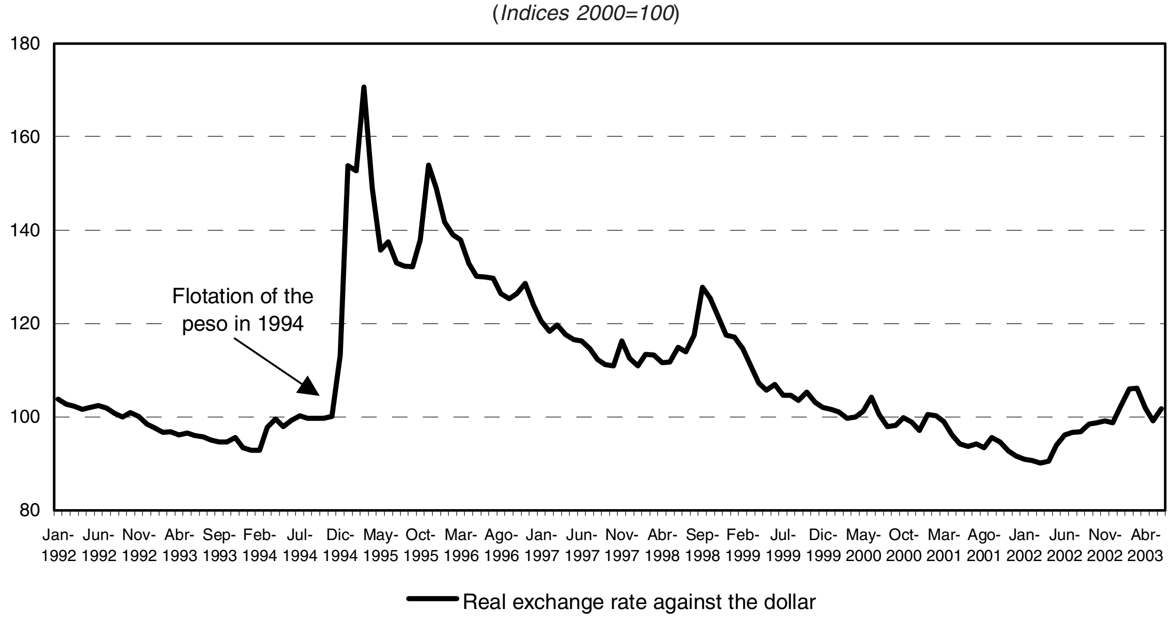
The fourth group consists of countries whose currencies appreciated in real terms during 2002, namely Guatemala and Trinidad and Tobago.

The Guatemalan quetzal has been strengthening in real terms since 2000, mainly because of inflation, and in 2002 the appreciation against the dollar amounted to 7.4%. The nominal depreciation that has occurred since the end of the year produced a slight real depreciation (1.3%) against the dollar in the first half of 2003.

In Trinidad and Tobago, exports and investment in the hydrocarbons subsector fuelled a nominal appreciation of the local currency until August 2002. As this was followed by a virtually symmetrical nominal depreciation, partly reflecting seasonal factors, by December 2002 the nominal exchange rate was broadly unchanged from its level of twelve months earlier, although inflation had generated a real appreciation of 2% against the dollar. In the first half of 2003 there was a further small real appreciation against the United States currency.

The fifth group consists of economies that have adopted the dollar as their currency of legal tender. There

Figure II.28
REAL EXCHANGE RATES IN MEXICO
(*Indices 2000=100*)



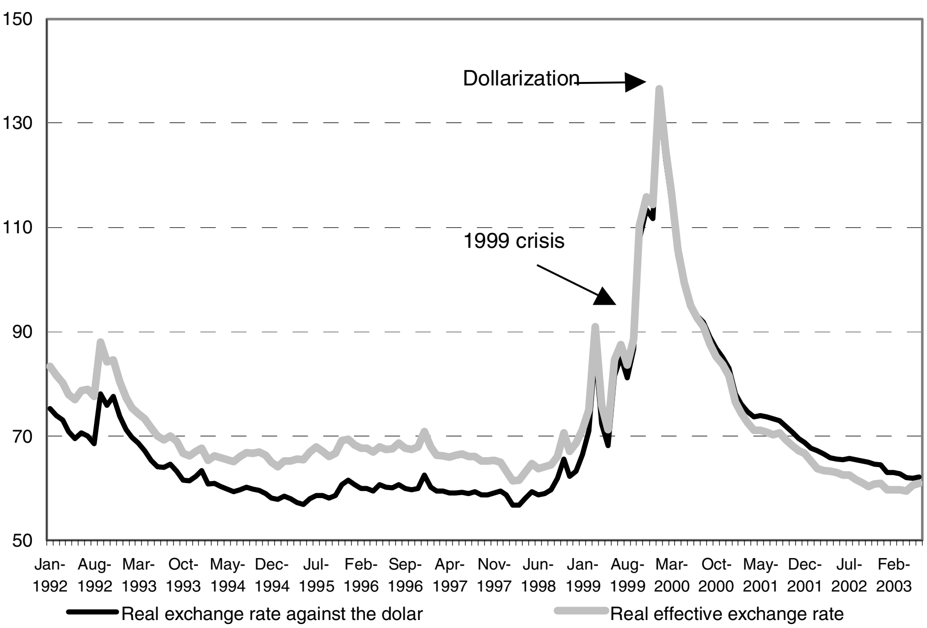
Source: ECLAC, on the basis of official figures.

are two distinct cases: Panama and El Salvador on the one hand, and Ecuador on the other.

Panama and El Salvador maintained inflation rates close to those of the United States in 2002 and 2003, and their real exchange rates have hardly varied in dollar terms.

In Ecuador, the real exchange rate against the dollar has fallen continually (meaning that the currency has appreciated) since dollarization was made official in January 2000. As the domestic inflation rate has gradually declined, currency appreciation has also slowed. Nonetheless, inflation in 2002 (9.4%) was considerably higher than in the United States, so the real exchange rate appreciated against the dollar by 6.3%. As this rate outpaced the ones observed in some of Ecuador's Latin American trading partners, the result was an effective appreciation of 8.5% during the period. In the first half of 2003, the real exchange rate appreciated in dollar terms by 3.6%, because, despite continuing to trend lower, domestic inflation continued to outstrip its counterpart in the United States. In June 2003, the real exchange rate against the dollar was slightly below the average recorded between January 1992 and December 1998 (i.e., appreciation), although above the minimum for that period. In April 2003, the real effective exchange rate fell to a 10-year low, but from then until June it rose (depreciated) slightly.

Figure II.29
REAL EXCHANGE RATES IN ECUADOR
(*Indices 2000=100*)



Source: ECLAC, on the basis of official figures.

3. Monetary policy

a) General trends

In a situation where most of the region's economies are either stalled or at best growing very slowly, the monetary authorities in several Latin American and Caribbean countries have focused on lowering the interest rates under their control in order to boost economic recovery. In 2003 this proved possible even in countries that raised interest rates to absorb currency-market pressures the previous year. There are exceptions, however, where other factors were in play that prevented the adoption of expansionary monetary policies in 2003, particularly Brazil and the English-speaking Caribbean. In addition, a number of countries, such as Mexico and

Colombia, have wavered between the goal of supporting economic revival and the risk of being unable to meet their inflation targets.

Inflation targeting has become the preferred monetary-policy regime in the region and has now been adopted in most countries where economic conditions have allowed; the respective monetary authorities in these countries have tended to use an intervention interest rate as their operating mechanism. The behaviour of interest rates most directly controlled by central banks generally shows that the latter have tried to support economic recovery. The result in terms of credit expansion and the growth of monetary aggregates has been more complex, however, depending on a series of factors, including the level of private-sector borrowing, expectations regarding demand and profitability trends, perceptions in the banking sector of the risk of increased lending to this sector and the level of trust in economic prospects and policies.

To analyse the interest-rate policy implemented by the monetary authorities, figure II.30 displays interbank rates, deposit and lending rates, spreads and inflation for 12 countries, in deseasonalized and smoothed time series running from early 2001 until the most recent available date (in some countries there is no interbank rate).[55] The analysis is complemented by additional data on the conditions under which monetary policy has unfolded in the different countries.

Effective control of the interest rate as a policy tool applied by the monetary authority has a significant and relatively immediate effect on deposit rates, which is then also transmitted to lending rates. In Chile, for example, movements in the interbank rate are fully reflected in the deposit rate almost instantaneously, so the path of the two series barely diverges, while the lending rate shadows the other rates with a large but virtually constant spread.

b) National cases

The analysis makes it possible to distinguish several groups. The first comprises the MERCOSUR countries, which faced very critical situations in late 2001 and 2002, but whose behaviour patterns since the crisis have varied.

In Brazil, devaluation and price increases accelerated (from very low levels) in the second half of 2002 in response to the approaching presidential elections and the uncertainty they caused both domestically and internationally. The reference interest rate (SELIC) climbed from 18% in September 2002 to 26% in February 2003. This caused deposit and lending rates to rise, while the spread between them remained very stable (see figure II.30); the process continued into 2003. The Brazilian real appreciated in 2003 and inflation gradually eased from its late-2002 peak, thereby raising real interest rates. Monetary policy began to be relaxed in July, when the SELIC interest rate was lowered to 24.5%. The credit arrangement signed with IMF in September 2002 set an annual inflation target of 6.5% for December that year, but this proved impossible to fulfil. Once the new government had taken office in January, the inflation target for 2003 was raised to 8.5%, on the grounds that “steeper inflation reduction paths entail excessive loss of output growth”.[56]

In Argentina, loss of bank deposits and capital flight led to a substantial rise in interbank rates from mid-2001 onward, before the convertibility regime was formally abandoned. In December 2001, the government’s inability to staunch the haemorrhage of bank deposits and international reserves forced it to impose strict controls on the withdrawal of funds from the banking system (a policy known as the *corralito*). Then in early 2002, dollar deposits were converted into pesos and their maturities were rescheduled (giving rise to the *corralón*). Nonetheless, deposits continued to leak out of the system in a substantial flow as a result of legal rulings, and this forced the central bank to grant substantial rediscounts to the banking system and kept the currency market under pressure. Starting in the second quarter of 2002, tensions on the monetary front finally began to ease. The central bank issued treasury bills at high interest rates, which revived demand for financial assets in pesos, while foreign-exchange-market interventions and the large trade surplus succeeded in restraining currency depreciation. The interbank interest rate peaked in the second quarter of 2002, and a few months later deposit and lending rates also levelled off; the latter had reached 80% per year for prime borrowers. From that moment onward, both interest rates and inflation began a descent that had taken them by mid-2003 to similar, if not lower, levels than those prevailing in early 2001.

Progressive normalization in the monetary and exchange-rate domains made it possible to lift the *corralito* in late 2002 and then liberate rescheduled

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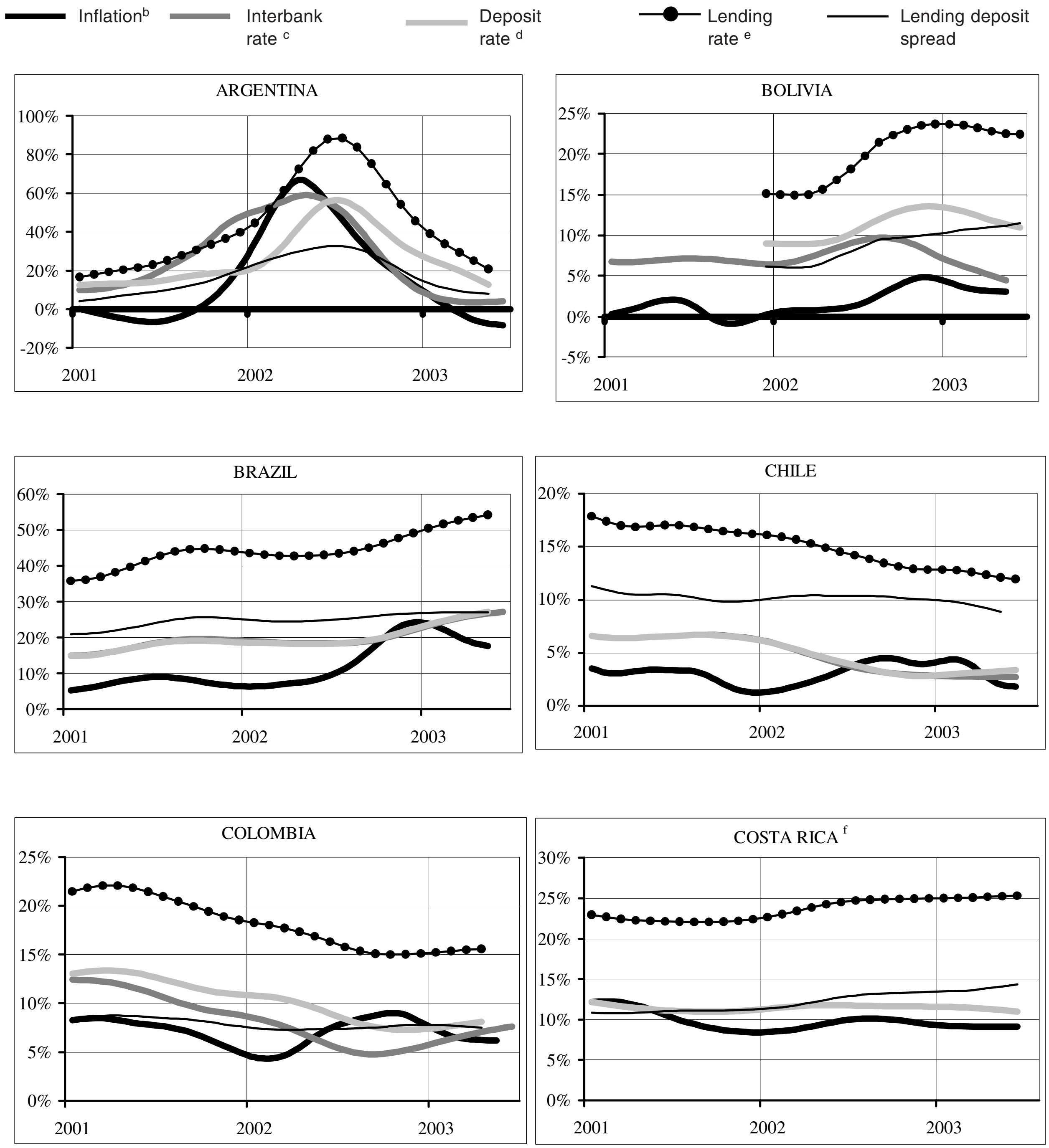
55 The Hodrick-Prescott filter was used to smooth the time series, with a smoothing parameter (l=10) such that the smoothed curve closely follows fluctuations in the original series.

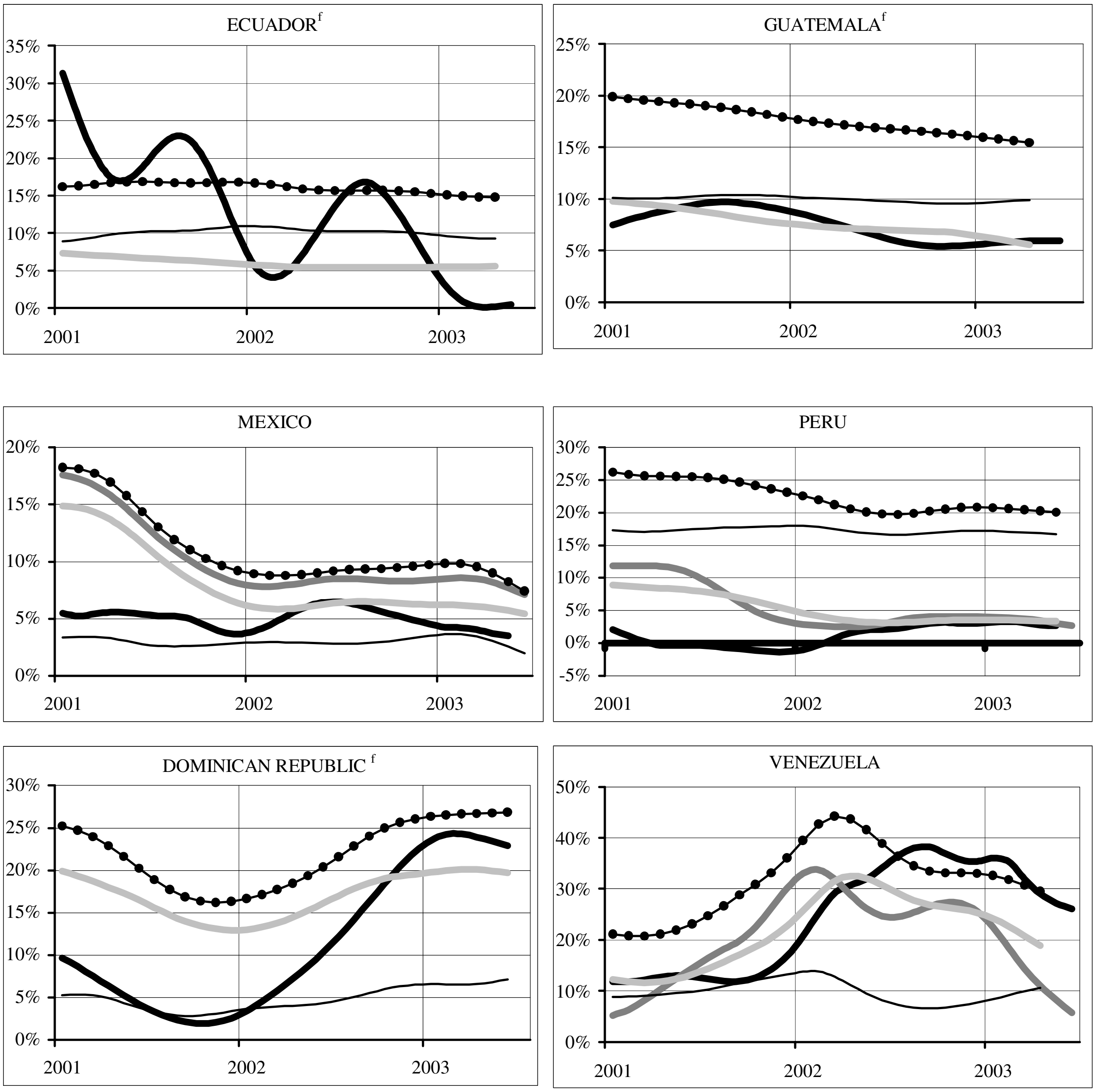
56 Open letter from the Governor of the Central Bank of Brazil, Henrique de Campos Meirrelles, to Finance Minister António Palocci Filho, dated 21 January 2003.

Figure II.30
NOMINAL INTEREST RATE TRENDS [a]
(*Annualized percentages*)



deposits. In the first half of 2003, the central bank allowed the level of international reserves to rise, in order to avert excessive appreciation of the local currency against the dollar; the counterpart of this meant putting substantial quantities of pesos into circulation. In June, the central bank revised its monetary programme, since the monetary expansion during the year had not affected prices, and a range of between 20% and 35% was defined for the growth of the monetary base in 2003 as a whole. Although the central bank continued to lower interest

Figure II.30 (continued)



Source: ECLAC, estimated on the basis of official figures.

[a] Deseasonalized series (X-12), smoothed using the Hodrick-Prescott filter (l =10).

[b] Monthly trend inflation (annualized).

[c] Interbank rate on one-day operations in all cases except Mexico, where the 28-day equilibrium interbank interest rate (TIIE) is shown; nominal percentage rates per year.

[d] Deposit rates on operations of up to 90 days, except for Argentina, Chile, Guatemala and Mexico.

[e] Prime 30-day lending rates, except for Bolivia, Brazil, Chile, Venezuela and Guatemala.

[f] Does not include the interbank interest-rate series.

rates on its bills, which fell from 20% in April 2003 to 6% in June, the situation facing commercial banks and their debtors resulted in a 12.2% contraction in lending to the private sector up to June 2003, following its 37% decline in 2002. For the government that took office in May 2003, the most pressing problems that remain to be solved include restoring solvency in the financial system, re-establishing the credit system and dealing with the debt. In this regard, a medium-term arrangement with IMF has been put forward as a possibility.

The Uruguayan economy's exposure to financial risk from Argentina caused foreign-currency deposits (of which almost 60% belonged to non-residents) to retreat by 45% in the first seven months of 2002. In late June, the prevailing foreign-exchange regime collapsed, setting off a crisis in the financial sector which ended with the suspension of several banks. Against this backdrop, the authorities had recourse to a programme agreed with IMF that included the establishment of a Banking System Stability Fund, and the United States Treasury Department granted a bridging loan broadly matching the amount extended by the programme. After the peso had been put into a free float, bills were issued in local currency at high interest rates in order to keep the rate of monetary expansion consistent with the inflation target. In the final quarter of 2002, the run on bank deposits was halted. In 2003, interest rates in local currency fell, and the pace of currency devaluation and inflation both slowed sharply. In May, the government carried out a successful debt swap.

Paraguay also suffered as a result of the unfolding crisis in Argentina. The guaraní depreciated by 34% in 2002, while inflation rose to 14.6%. Monetary-policy interest rates climbed steeply, from 21% in late 2001 to an average of 30% in the third quarter of 2002, before falling back in the ensuing months to reach 12% by June 2003. In the first half of 2002, foreign-currency deposits shrank by 33%, and private-sector credit fell by 13% in real terms over the year as a whole. One of the country's largest banks was forced into liquidation as a result of losses suffered in Argentina, and this had repercussions for the rest of the financial system. The average arrears index has approached 20%, and in the early months of 2003 three banks and another financial institution were closed down. As progress could not be made in negotiating an arrangement with IMF, access to external credit became difficult and led to the postponement of debt-service payments, including amounts owed to multilateral organizations.

Countries in the second group (Chile, Colombia, Mexico and Peru) managed to avoid crises such as those outlined above, and their inflation rates remained in single figures. These countries all operate with free-floating exchange rates and inflation targeting; the respective targets were met in Chile and Peru, but not in Mexico and Colombia. In all cases, annual variations of the exchange rate against the dollar were relatively moderate, but greater than the rise in consumer prices. In Mexico and Colombia, monetary policies seem to have wavered between supporting economic recovery and meeting the inflation target.

In an attempt to kick-start output, Mexico lowered interest rates aggressively in 2001, and again more moderately in the first nine months of 2002. This took place against a backdrop comprised of the recession that began in the United States in 2001, prolonged appreciation of the Mexican peso and wage hikes above inflation. As from April 2002, the equilibrium interbank interest rate (TIIE) was lowered by between one and two percentage points until September, when it returned to its previous levels of around 9%. In 2002, the inflation target of 4.5% was breached for the first time in four years, as prices rose by 5.7%. On two occasions during the second half of 2002, and three times in the first quarter of 2003, Banco de México tightened monetary policy by increasing the *corto* from 300 million pesos to 700 million).[57] This aimed to restrain the fall in interest rates resulting from Mexico's improved country-risk rating.

Interest rates rose until mid-April 2003 before falling back as the peso strengthened once again and inflation fell; the TIIE reached 5.5% in late June. The 2003 inflation target was set at 3%, but the authorities expect growth to undershoot original projections. The gyrations in Mexico's monetary policy seem to be explained by the conflicting aims of supporting economic recovery while at the same time meeting inflation targets.

In Colombia, monetary policy was expansionary in 2001 and 2002 until the regional crisis of the third quarter, which kept interest rates on hold. The local currency appreciated by 22% during the year, while

57 The *corto* is the name given to the target balance established by the monetary authorities for the current accounts that the banking and financial system maintains at Banco de México. As an indicator of monetary policy intentions, a larger positive balance in these accounts points to monetary tightening. In April 2003, the reference system for calculating the *corto* was changed from cumulative to daily balances. Consequently, under the new system the 700 million pesos became 25 million, and this amount was still in force as of the end of June.

inflation, at 7.1%, breached the 6% target. This rate of price increase pushed up intervention interest rates by 100 bps in January 2003, and then again in April. In January, Colombia renewed its IMF programme for a further two years. Twelve-month inflation stood at 7.2% in June 2003, which raised the spectre of again missing the annual inflation target, this time set at 5.5%. Accordingly, Colombia's expansionary monetary policy was reined in during the year to meet the target.

In Chile, the priority goal of monetary policy was to boost domestic demand, for which reason it was kept consistently expansionary. The monetary-policy interest rate was lowered six times between January and August 2002, and a further cut was made in January 2003. Since then, it has remained at a historically low level of 2.75%. Transmission of these interest-rate cuts to market operations was weak for a long period of time, but seems to have strengthened recently, judging by the 9% growth recorded in financial-system lending during the 12 months ending in June 2003.

Peru adopted an expansionary monetary policy in 2001, following four years of flat economic activity. This policy was maintained in the two ensuing years, except in the months immediately after September 2002, when exchange-rate volatility triggered by regional crises forced the authorities to raise the interbank rate and intervene in defence of the exchange rate. Once this situation had been overcome, interest rates fell back and then held steady at 3.8% in the first half of 2003. Nonetheless, bank lending to the private sector remained stalled, and began to register negative year-on-year growth rates in early 2003. During 2002-2003, Peru abided by the policies agreed upon under the programme with IMF; inflation in 2002 came in at 1.5% (equal to the lower limit of the established band), and the same target of between 2.5% and 1.5% was set for 2003.

Bolivia, Dominican Republic, Haiti and Venezuela comprise the third group, for the crises in these countries have each had their own peculiarities. In Venezuela, the government abolished the currency-band regime in the face of falling oil revenues and burgeoning capital flight, and in February 2002 adopted a free-floating system, with the supply of foreign exchange controlled by the monetary authorities. The consequent nominal exchange-rate depreciation and surge in inflation (from 12% in 2001 to 31% in 2002) prompted the authorities to fix the exchange rate in February 2003 and impose currency controls. In 2002, efforts to defend the existing exchange-rate regime by raising interest rates were unsuccessful, and although the demise of the currency band allowed interest rates to fall substantially, they rose again in response to the escalation of political conflicts towards the end of the year, when capital flight also gathered pace once more. Since then, restriction of foreign-currency supplies to the private sector under the new regime has reduced capital outflows and allowed for significantly lower interest rates and an increase in international reserves (see figure II.30). Nonetheless, the general uncertainty prevailing in the country has prevented lower borrowing costs from generating a credit expansion.

The Dominican Republic saw its inflation rate double in 2002, together with a large devaluation of its currency and sizeable capital outflows; this pushed interest rates to substantially higher levels, which have been maintained in 2003. The Economic Development and Stability Pact signed by the government and the business sector in late 2002 was intended to prolong fiscal and monetary austerity in the first half of 2003. The most important adjustments occurred in the foreign-currency domain and in local-currency interest rates, while at the same time the dollarization of banking operations gathered pace. Economic management was complicated further in May when one of the country's leading private banks was declared insolvent. This forced the central bank to inject a large volume of liquidity into the system, and will entail complementary public expenditure. As pressure on the foreign-exchange market and domestic prices persisted in mid-2003, the central bank had to inject liquidity into the banking system, but at the same time attempt to reabsorb it by issuing investment certificates at high interest rates.

Bolivia suffered two runs on bank deposits linked to political events in June 2002 and February 2003. Withdrawals spread to financial institutions of all types and accentuated the vulnerability of the country's highly dollarized financial system. The central bank had to satisfy liquidity needs, raise interest rates in 2002 and accelerate the pace of nominal depreciation against the dollar under the crawling-peg regime. Nominal interest rates in dollars resumed their downward trend in early 2003, and in April that year a standby arrangement was signed with IMF, aimed at moving towards a medium-term programme in the framework of the poverty reduction and growth facility (PRGF).

Haiti pursued an expansionary monetary policy in 2002 aimed at moderating the recessionary trend, in the midst of a prolonged economic and political crisis. Interest rates on bonds issued by the Banque de la République d'Haïti were cut during the fiscal year from 20.1% to 10.3%, and the money supply grew by 6.4% in real terms. Private credit recovered slightly (4.3%) following its 18% decline the previous year, but this was not enough to reactivate the economy's productive sectors.

Countries comprising the fourth group mostly display sluggish growth associated with the economic slowdown in the United States, together with single-digit inflation rates in 2002 and orthodox policies –in some cases in the framework of programmes agreed with IMF. Dominica, Guatemala, Grenada, Guyana, and Nicaragua all have ongoing programmes with the Fund, while the arrangement signed by Honduras ended in late 2002.

In this group, Costa Rica posted the best results in terms of economic growth: 2.6% in 2002 and an estimated 4.5% for 2003. In addition, inflation has been held at around 10% in recent years. Interest rates were raised in 2002 to help curb growth in the consolidated public-sector deficit (from 2.9% to 5.4% of GDP), and at the same time the nominal exchange rate was devalued slightly. In 2003, deposit rates edged down marginally, while lending rates remained stable at high levels (25% in nominal terms).

Nicaragua met its 2002 targets for inflation (4%) and the pace of devaluation (6%), and designed a fiscal-policy adjustment in conjunction with a less restrictive monetary policy. In December 2002, a three-year arrangement was signed with IMF in the PRGF framework. Compliance with the clauses signed will enable the country to reach the "completion point" to join the Heavily Indebted Poor Countries (HIPC) Initiative towards the end of the year and thus alleviate its external debt burden.

In Guatemala, interest rates fell continuously from 2001 until the most recent date in 2003 for which information is available, but this has failed to energize lending to the private sector. Inflation in 2002 came in at 6.3% and the fiscal deficit amounted to 1% of GDP, in a setting of exchange-rate stability under a floating regime. A target range for inflation of between 4% and 6% was set for 2003, with a fiscal deficit of 1.7%. The programme agreed with IMF, which was renewed in May 2003, has been applied.

In Honduras, although interest rates fell during 2002-2003, credit extended by the banking system did not expand. A possible renewal of the arrangement with IMF has been widely discussed, since it would open up the possibility of joining the HIPC Initiative but require reductions in both the deficit and fiscal expenditure.

In most English-speaking Caribbean countries, growth was below 1% or non-existent in 2002, with only Trinidad and Tobago and Belize achieving higher rates (3.2% and 3.7%, respectively). The economic slowdown in the subregion led to higher liquidity ratios in the banking system, which forced the authorities in countries with flexible exchange-rate regimes to intervene on the currency market. In Jamaica and Suriname, however, such efforts proved insufficient to prevent substantial devaluations.

In Jamaica, monetary policy was mildly expansionary in the first half of 2002, but changed direction from June onward in response to downward pressures on its currency which continued into 2003. In Barbados, liquidity expanded in a context of low inflation, but lending to the private sector declined. Bahamas implemented a tight monetary policy involving quantitative limits. In Guyana, the central bank intervened moderately in the foreign-exchange market to keep domestic prices and the value of the local currency stable. Demand for credit stalled, and the financial system maintained a conservative lending policy. In Suriname, the monetary authority imposed direct controls aimed at restricting credit creation by the banking system and slowing the pace of nominal exchange-rate devaluation. In the countries of the Organisation of Eastern Caribbean States (OECS), which maintain a monetary union under a fixed exchange-rate regime, the demand for credit contracted. This ended up generating a liquidity overhang in the banking sector, which was used to acquire foreign assets.

The two countries with highest growth rates in the subregion are Belize and Trinidad and Tobago. The former kept monetary policy tight in order to counter the weakening trend of its currency, while in Trinidad and Tobago, monetary policy fluctuated: in the first three quarters of 2002 it pushed interest rates higher; then in August a more flexible stance was adopted, but policy was tightened once again towards the end of the year. Exchange rates and inflation have both remained stable thus far in 2003.

The fifth group consists of the dollarized economies. In these countries, interest rates on deposits are close to international levels, and, having adopted the rules of dollarization, monetary policy as such does not really exist. In Ecuador, nominal interest rates have remained relatively stable, although they have trended slightly downward. In real terms, however, they have swung from negative in 2001 to positive in 2003, reflecting the fall in inflation. In El Salvador, dollarization has now been in force for two years; interest and inflation rates have remained low, but domestic demand for credit has also been slow to expand. In Panama, interest rates followed the international trend towards lower levels in 2002, in a low-inflation setting. The banks in that country took a conservative stance, prioritizing portfolio quality and liquidity over expansion; as a result, the loan portfolio with the private sector shrank for the first time in 13 years (6.8%), while external credits declined even more sharply (31.8%).

In summary, the most widespread monetary policy trend in the region was aimed at lowering interest rates to help break out of the stalled-production or low-growth situation prevailing in most countries. The exceptions are divided into the following three categories: Brazil, where the preceding climate of political uncertainty and its programme with IMF have led it to maintain high and rising interest rates over the last 12 months; countries such as Mexico and Colombia, which have wavered between more expansionary policies followed by tightening when these have threatened their inflation targets; and the English-speaking Caribbean countries, which have given priority to exchange-rate stability and kept monetary policy tight in order to achieve this.

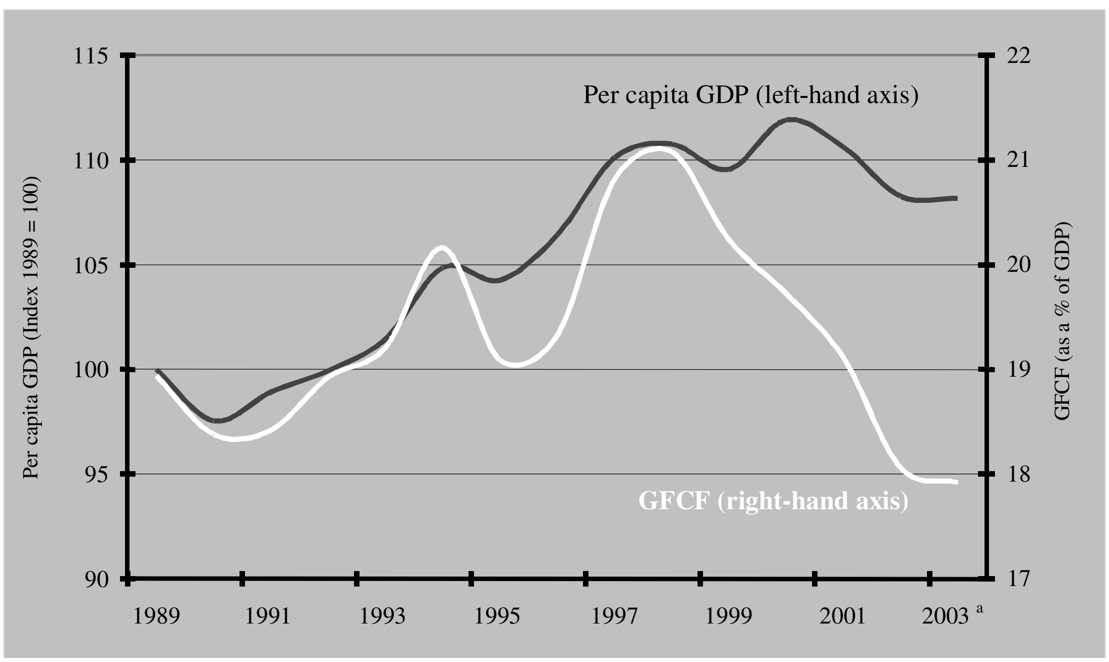
C. Domestic performance

1. Level of activity

(a) Growth and investment in 2002 and 2003

The gross domestic product of Latin America and the Caribbean as a whole shrank by 0.6% in 2002 and is only expected to grow by about 1.5% in 2003, thereby prolonging the economic stagnation that took hold almost six years ago. Gross fixed capital formation declined again in 2002, this time by 6.1%, and is estimated to have remained relatively stable in 2003. As a result, the investment rate in the 2002-2003 biennium will have retreated to its 1988 level (18% of GDP), which in turn was the lowest recorded during the "lost decade" of the 1980s. Per capita output in 2003 is forecast to come in at around 2% below its 1997 level (see figure II.31).

Figure II.31
LATIN AMERICA AND THE CARIBBEAN: PER CAPITA GDP AND GROSS FIXED CAPITAL FORMATION, 1989-2003



Source: ECLAC, on the basis of official figures.
[a] Projections.

The individual economies did not all falter at the same time, nor has the economic situation been equally dire in all countries; nonetheless, the individual cases of rapid growth that could be found up until 2000 had disappeared by 2002-2003.

An overview of the region reveals both common and differentiating features between the individual countries. The *Preliminary Overview of the Economies of Latin America and the Caribbean, 2002* pointed out that a variety of circumstantial factors had affected the economic performance of each country or group of countries in different ways. Some of these factors are predominantly external. Since 2001, Mexico, the Central American countries and the Caribbean have mainly been affected by the economic slowdown in the United States; the MERCOSUR countries proved vulnerable to international financial conditions; and economic performance in the Andean economies (including Chile) has largely been determined by trends in their primary export sectors (oil and gas, or mining) and the terms of trade. In 2003, external conditions have shown a modest improvement. Although world trade remains sluggish, United States imports are recovering from their lows of late 2001 and early 2002, and most commodity prices are beginning to climb out of their 2002 troughs –although, apart from oil, they have yet to regain their pre-Asian-crisis values. Financial conditions, measured by the interest-rate spread on sovereign bonds, have improved in comparison to 2002, and several governments have again issued debt on the international market to meet their funding requirements. Nonetheless, in many cases, sovereign spreads continue to be large, net capital flows remain at comparatively low levels and several countries are having to make use of exceptional financing or funds from multilateral agencies, or else attempt to reschedule the maturity profile of their external debt.

The relative improvement in external conditions in 2003 brought internal factors to the fore, although these had already been decisive for economic performance in 2002. A particular case in point was the costly defence and eventual forced abandonment of the currency-board system in Argentina. This foreign-exchange regime plunged the economy into a lengthy recession, which worsened substantially in the second half of 2001 while convertibility was still in force, and only bottomed out in the first quarter of 2002 after the exchange rate had been allowed to float. Uruguay and Venezuela also had to face major capital outflows, which led to the abandonment of their exchange-rate flotation bands. In the first case the decision was linked to a severe banking crisis, and in the second it was associated with the introduction of exchange controls. Other countries are facing difficult financial situations in 2003 for more specific causes; for example, the Dominican Republic was hit by an acute banking crisis. Without necessarily facing macroeconomic management problems as severe as these, most of the region's countries displayed limited ability to sustain activity levels through monetary or fiscal policy in 2002-2003. In fact, a number of governments pursued contractionary fiscal policies with a view to strengthening capacity to service their large public debt. Lastly, in several countries, the exacerbation of domestic social and political conflicts eroded both economic activity and the investment process. Such conflicts cannot always be viewed as exogenous or non-economic factors, for they are by no means independent of medium- and long-term economic results in terms of growth and job creation. Weakness in domestic markets has also restrained growth and made economies more reliant on international trading conditions.

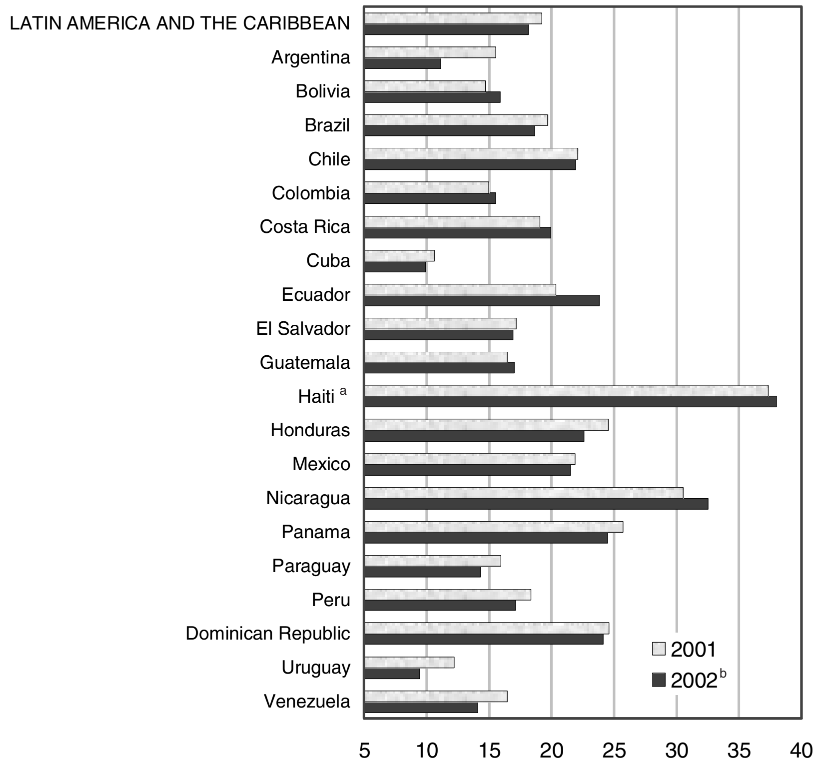
Gross fixed capital formation, measured at constant 1995 prices, retreated by a cumulative 11% between 1998 and 2002. Investment shrank considerably faster than output: while per capita GDP declined by 2.5%, fixed capital formation per person fell by 16.5%. Investment is the expenditure component that displays the widest fluctuations in response to changing economic circumstances: it usually falls furthest during recessions, and it is the last to recover in the subsequent upswing.

In 2002, investment declined both in construction and in the machinery and equipment segments. Apart from the usual causes of investment slowdowns during recessions (increased idle capacity, lower sales and weakening demand prospects), other factors seem to have come into play on this occasion. The sharp decline in construction investments probably was influenced by financial conditions that pushed up interest rates and held back lending in several countries, while in many other cases real devaluations raised the cost of imported machinery, which accounts for a large proportion of machinery and equipment investment. From this standpoint, the adoption of more flexible monetary policies in 2003, supported by stabilization or revaluation of domestic currencies, generated more favourable conditions in several countries. This helps to explain why investment has stopped falling in 2003, even though no major increase is yet discernible in the region as a whole.

Figure II.32

LATIN AMERICA AND THE CARIBBEAN: GROSS FIXED CAPITAL FORMATION

(Percentages of gross domestic product)



Source: ECLAC, on the basis of official figures.
[a] Gross domestic investment.
[b] Preliminary figures.

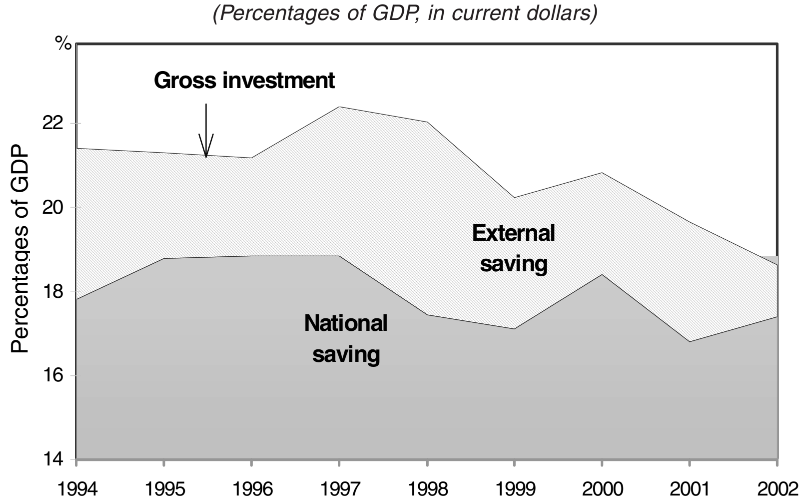
The region-wide rate of investment, measured in constant prices, fell to 18.1% of GDP in 2002 (three percentage points below the 1998 figure) and has held steady at around that level in 2003. A lower investment rate means that fewer goods and less infrastructure are channelled into the productive capacity of the different economies, thereby undermining their growth potential in future years. The retreat of fixed investment, both in construction and in machinery and equipment, was particularly severe in the MERCOSUR countries and Venezuela; investment also declined in Mexico, but less sharply than in 2001. In contrast, a few countries actually registered a significant increase in capital formation; among these are Bolivia and Ecuador, where the oil and gas subsector attracted major investments (an oil pipeline in Ecuador, gas pipelines in Bolivia).[58] Costa Rica also recorded significant investment in machinery and equipment, undertaken by industries established in its duty-free zones and by businesses in the communications field, while investment in Colombia continued to recover from its steep decline in 1999, although it remains low as a proportion of GDP (15.5% in 2002; see figure II.32).

The indicators available for 2003 do not show a recovery in investment at the regional level, since it continued to fall in Brazil (1.5% in the first quarter) and in Mexico (1.1% in January-April). First-quarter figures for 2003 also show investment sliding steeply in the Dominican Republic, Uruguay and Venezuela (compared to levels of a year earlier), while investment grew more slowly than GDP in Chile. In Ecuador, the momentum displayed by investment over the last three years is fading following the completion of construction work on the heavy crude oil pipeline. Meanwhile, fixed investment is recovering strongly in Argentina (20.6% in the first quarter) and more moderately in Peru, while also continuing to grow in Colombia and Costa Rica.

58 In recent years Peru has also seen major investment projects in mining (Antamina) and natural gas (Camisea), which have boosted economic activity. Nonetheless, in 2002 this had not yet shown through as an increase in total gross fixed investment.

Measurement in terms of current prices makes it possible to assess the contribution of domestic and external saving to a given level of gross domestic investment. Figure II.33 shows how the investment/GDP ratio in current prices fell between 1997 and 2002 in two stages. The first phase, between 1997 and 1999, is explained by lower levels of national saving; in contrast, the retreat of investment since 2000 has been associated with a major decline in external saving –in other words, smaller deficits on the current account of the balance of payments. The regional current-account deficit narrowed from 2.9% of GDP in 2001 to 1.2% in 2002 and, according to ECLAC estimates, 0.2% of GDP in 2003. Thus, the retreat of public and private consumption in 2002 (and possibly also in 2003) did not stop investment from shrinking as a percentage of GDP, in either current- or constant-price terms.

Figure II.33
LATIN AMERICA AND THE CARIBBEAN: RELATION BETWEEN SAVING AND INVESTMENT
(Percentages of GDP, in current dollars)



Source: ECLAC, on the basis of official figures.

(b) Economic activity by country groupings

(i) Mexico, Central America and the Caribbean

The economic slowdown in the United States that began in 2001 has weakened a major stimulus for trade in Mexico and most Central American and Caribbean countries. In some cases exports stalled or decreased in 2001-2002, having grown by between 7% and 15% per year on average between 1997 and 2000; examples include Belize, Costa Rica, the Dominican Republic, El Salvador, Guatemala, Haiti, Mexico and Nicaragua. The early months of 2003 presented a more favourable, albeit heterogeneous, outlook: significant export growth in Costa Rica (mainly sales from duty-free zones), Haiti (textiles), Jamaica (bauxite) and Trinidad and Tobago (oil and gas), compared to more moderate trends in Belize, Dominican Republic, El Salvador, Guatemala, Honduras and Nicaragua and stagnation in exports from Mexico, despite stronger oil sales. In addition, tourism-related activities were down in 2001-2002 following the events of 11 September 2001, although this phenomenon has been fading, and in fact tourism inflows in the first quarter of 2003 regained their early-2001 levels.

Foreign trade prices have also had a strong and generally negative effect on the non-oil countries in this group. Plunging coffee and banana prices (although the former regained some ground in 2003) have had significant economic and social effects on the agricultural sector in several countries, while higher oil prices worsened the terms of trade except for Mexico and Trinidad and Tobago. External factors include the positive effect of larger remittance inflows, which play a decisive role in several of these countries, both in the balance of payments and in terms of maintaining private consumption levels.

Although external events have had a major influence on economic performance in this group of countries, which are particularly open to trade and tourism, they have not been the only factors in play. Fiscal adjustment policies and low levels of bank lending in several countries have also weakened domestic consumption and investment demand.

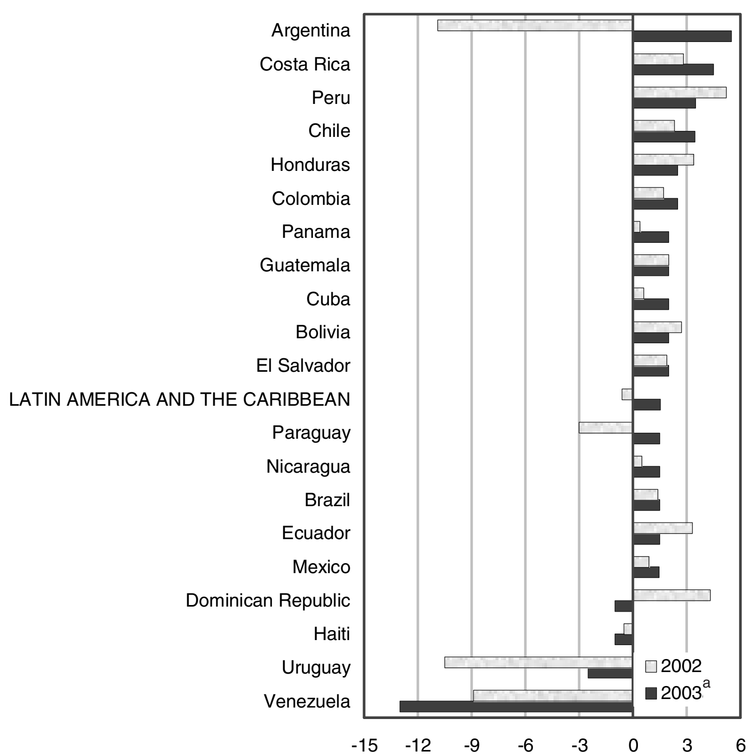
Mexico grew by 0.9% in 2002, and preliminary data suggest the rate will be similar in 2003 (see figure II.34). These meagre growth figures reflect the sluggishness of domestic and external demand; in particular, exports have stalled and investment is far below its 2000 levels. Such growth as there has been is based on private consumption, which is expanding slowly. Activities in manufacturing and agriculture and in commerce, restaurants and hotels were worst hit in 2002 and early 2003, while construction and oil activity staged a recovery. The performance of the maquila industry has been in decline since the third quarter of 2002, although it posted positive annual growth rates for the first three months of 2003, in comparison to the low levels recorded at the start of the year; the data generally show that Mexico has failed to take advantage of the partial recovery in United States imports in 2003, and consumer goods are the most dynamic category within the stalled import sector. These figures may be pointing to a problem of competitiveness, attributable at least in part to the level of the exchange rate, although this has depreciated somewhat over the last year and a half.

In most Central American and non-English-speaking Caribbean countries, the growth slowdown of recent years has continued. The conclusion of armed conflicts in Nicaragua and El Salvador, together with the prolonged upswing in the United States, had fuelled growth at annual rates of over 4% for several years, but this stimulus has now run its course. Loss of economic dynamism revealed the existence of fiscal problems, in some cases stemming from high levels of public debt, but also relating to shortcomings in the financial system. Moreover, better conditions for foreign trade and tourism in 2003 have brought the domestic determinants of economic performance to the fore in these countries, and such factors have generally not been positive.

Figure II.34

LATIN AMERICA AND THE CARIBBEAN: GROSS DOMESTIC PRODUCT

(Annual rates of variation)



Source: ECLAC, on the basis of official figures.

[a] Projections.

The Dominican Republic is a special case. Its economy has lost momentum, and its growth rate, which averaged about 7% per year between 1996 and 2000, slumped to around 1% in 2003. Although the causes of this slowdown were initially exogenous (weaker external demand and a reduction in tourism), the current recession reflects the weakness of domestic demand against a backdrop of combined currency and banking crisis. In the first half of 2002, economic policy attempted to sustain activity through public spending, but exchange-rate and inflationary pressures led to a more restrictive stance being adopted in the second half of the year, mainly through monetary tightening. Nonetheless, while it raised interest rates, the central bank also expanded the money supply to support a major private-sector bank (Baninter) that was slipping into a crisis situation. This adjustment failed to contain either the peso devaluation or the rise in inflation in the final months of 2002 and the first half of 2003, and economic and political management was made exceptionally complicated by the intervention and declaration of insolvency of Baninter in May, involving an asset loss of around 15% of GDP. This has required the central bank to provide a massive liquidity transfusion, and has resulted in significant supplementary quasi-fiscal expenditure in an already fragile fiscal framework. The predictable fiscal adjustment, banking crisis and erosion of incomes by inflation are weakening domestic demand. As a result, economic activity seems to be sustained merely by factors linked to the external sector, such as export activity in duty-free zones, tourism and remittance inflows.

The only country in this subregion where economic growth strengthened during the biennium is Costa Rica. This can largely be explained by the major impact of activities in the electronics assembly industry carried out in the country's duty-free zones. Much of the high level of gross domestic investment in the first three quarters of 2002 reflects the fact that Intel started to build up stocks in the middle of that year in readiness for a planned expansion of output and exports. Consequently, in 2003 the contribution made by investment to economic growth has decreased, but net exports can be expected to grow once the previously imported inputs get used. Major fixed investment also took place in the communications area. Slight upturns in coffee production and external demand for fruit and agro-industrial products improved the situation in agriculture, following a weak performance in 2002. Domestic demand will not provide a comparable stimulus because of the restrictive monetary and fiscal policies in force at the start of 2003, which will restrain expansion overall. In the end, GDP growth in Costa Rica amounted to 2.6% in 2002 and is unlikely to be less than 4.5% in 2003, thanks to the performance of manufacturing (both inside and outside the duty-free zones) and the communications subsector, supported by a recovery in agriculture and tourism-related services. National income can be expected to expand by less, however, because larger flows of profits are being repatriated abroad.

The other countries of the subregion grew slowly in 2002: El Salvador and Guatemala by 2.2%; Cuba by 1.1%; Haiti by -0.5%; Honduras by 2.4%; and Nicaragua and Panama by less than 1%. These countries faced unfavourable terms of trade (high oil prices and low prices for sugar and coffee, although the latter staged a slight recovery in 2003 so far), compounded by sluggish demand in the United States and Mexico, all of which resulted in exports that are either stalled or in outright decline. Private consumption was generally maintained thanks to family remittances, and this situation is expected to continue in 2003.

Agriculture in general, and the banana and coffee segments in particular, performed weakly in most countries, with sectoral GDP reductions registered in Haiti, Panama and Nicaragua and weak growth in El Salvador and Guatemala (Honduras has been the exception). In several countries this has resulted in lower export volumes. In Cuba, a shortage of foreign exchange caused by the decline in tourism and weak exports eroded growth in 2002; moreover, restructuring in the sugar sector, compounded by natural disasters, undermined agricultural output. Fiscal tightening led to cutbacks in public consumption in Guatemala and Nicaragua and to sharp falls in public investment in Guatemala, Honduras and Nicaragua, which mostly affected the construction sector. The situation in El Salvador from this point of view is ambivalent, since government consumption fell, but public investment did not. The modest expansion recorded in 2002 was based on construction (mainly public investment in repair work following the 2001 earthquakes) and manufacturing. For 2003, most countries expect to tighten their fiscal policy stance, in several cases in the framework of IMF arrangements.[59]

59 Guatemala has made a commitment to reduce its public-sector deficit to 1.7% of GDP. Honduras is negotiating a new arrangement with IMF, in which compliance with the agreed targets is a requirement for access to the HIPC Initiative. In addition, the renewal of official assistance flows to Haiti (suspended in 2001 because of the domestic political situation) depends partly on fulfilment of its agreement with the Fund whereby the government undertook to cut the fiscal deficit by half, reduce inflation and improve public-sector efficiency.

Consequently, public expenditure cannot be expected to act as the engine of growth in 2003 and is more likely to have a contractionary effect; a recovery in sales to the United States could elicit a stronger performance in the manufacturing sector, however. The expansion projected for 2003 is very much in line with that achieved in 2002. Family remittances will continue to play a vital role in sustaining private consumption. Haiti is again likely to post zero or negative growth, since the suspension of foreign assistance is being compounded by rapid currency devaluation (amounting to 42% between July 2002 and 2003) and inflation, which is steadily eroding domestic purchasing power (the CPI rose by 32% in the first half of 2003). Economic performance in Haiti over the next few years will largely depend on when and how external grants are resumed. Panama, meanwhile, could grow at healthier rates than in 2002 (about 2%), based on upturns in the construction sector, tourism (especially cruise liners) and activity in the Colón duty-free zone.

Growth in most of the English- or Dutch-speaking Caribbean countries slowed in 2002 as a result of contractions in the leading sectors (tourism, agriculture and mining). The decline in trade and tourism flows had a negative effect on both the balance of payments and the fiscal accounts, given the importance of customs duties and specific taxes linked to tourism in the revenue structures of several countries. This gave rise to fiscal adjustment policies that weakened domestic demand in countries such as Bahamas, Barbados, Jamaica, the OECS countries[60] and Suriname.[61] Several important commodity exports suffered falling prices in 2002 (alumina, bauxite, sugar, bananas), and in some countries their volumes also shrank because of adverse weather conditions. Worsening balance-of-payments current accounts, in most countries resulting partly from higher oil prices, put pressure on several foreign-currency markets and led to monetary tightening (Bahamas, Jamaica and Suriname).

As a result, in 2002 most of these countries posted slightly negative growth rates (OECS members and Barbados) or expansions of around 1% (Guyana, Jamaica and Suriname). Belize achieved better results, growing by 3.7% thanks to an acceptable performance by the tourism sector (a new record was set for the number of tourists arriving on cruise liners) and to public investment. In Trinidad and Tobago also, GDP expanded by 3%, sustained by the oil and natural gas subsector. The pace of economic activity is expected to pick up moderately in 2003 in most countries in this group, based on a recovery in tourism and exports of certain agricultural and mining products. In Trinidad and Tobago, the oil and gas subsector is expected to stimulate growth of around 4% in 2003. Nonetheless, fiscal and banking problems continue to make themselves felt in Barbados, Jamaica and Suriname, for which reason GDP growth in those economies is unlikely to surpass 2%. Among the English- and Dutch-speaking Caribbean countries, GDP growth is expected to approach 2.5% in 2003.

(ii) The MERCOSUR countries

In 2002 and 2003, domestic and external financial variables played a key role in the pattern of economic activity in MERCOSUR. The drastic changes made to exchange-rate regimes in Argentina and Uruguay in 2002, followed by devaluation of their currencies, have had a marked effect on banking organization in MERCOSUR countries and have influenced the trend of economic policies and variables. In Brazil, too, macroeconomic policies have been defined in response to tensions prevailing on currency markets and their impact on inflation; and in Paraguay the banking system is going through a severe crisis.

In 2002, the currencies of these four countries devalued sharply, boosting inflation and altering domestic relative prices. Inflation seriously reduced the real incomes of wage earners, which, together with high levels of unemployment, undermined private consumption demand. Domestic demand was weakened further still by public expenditure cuts and a sharp decline in fixed capital formation. The upturn in inflation was short-lived, and did not trigger a widespread and sustained rise in prices as some had predicted. Thus, the nominal devaluations, which moderated and were partly reversed in 2003, produced real depreciations resulting in relative price corrections between tradable and non-tradable goods that enhanced international competitiveness. This has been a major factor in the contribution made by net exports (exports minus imports) to aggregate demand and thus to the pace of economic activity overall. Nonetheless, the economic authorities are promoting recovery in the domestic market to give a further boost to economic growth. On the supply side, the agricultural subsectors have performed strongly, especially in 2003, boosted by the competitiveness gains mentioned above, in conjunction with stronger international prices and the introduction of technological innovations.

60 See the section on the Caribbean.

61 The fiscal deficit in Suriname surged from 1.2% of GDP in 2001 to 12.7% in 2002, mainly as a result of increased current expenditure.

The financial instability that Brazil had to face in 2002 resulted in a widening of its sovereign-debt spread, compounded by capital flight and devaluation of the real. Against this backdrop, the authorities adopted restrictive monetary and fiscal policies, which were continued and even strengthened by the new government that took office in early 2003. Midway through the year these policies, supported by a substantial trade surplus, had succeeded in easing the situation on international financial markets: the local currency has been appreciating since then, and the external sovereign-debt spread has fallen from a maximum of 2,500 bps in September 2002 to 750 bps in July 2003. At the same time, high domestic interest rates and fiscal tightening, in conjunction with the above-mentioned erosion of real incomes among wage earners, curtailed domestic consumption and investment demand, thus dampening economic activity as a whole. Net exports were the only factor stimulating demand in 2002 and 2003. From a sectoral point of view, strong growth in agriculture (6% in 2002 and nearly 9% in the first quarter of 2003) contributed to the surge in exports. In contrast, manufacturing generally stalled in early 2003, except in subsectors that have participated in the export boom, such as iron and steel. Output grew by 1.4% in 2002 but showed signs of stagnation in the first part of 2003. For the rest of the year, however, lower inflation should make it possible to continue cutting interest rates (in July, the central bank reference rate was eased from 26.0% to 24.5%), which will help domestic demand, particularly private consumption, to recover to some degree. This would suggest growth in 2003 similar to that recorded in 2002, albeit with a tendency to rise.

Argentina entered 2002 in very difficult circumstances. Defence of the convertibility regime in 2001 had deepened the economic crisis, increased the level of external debt, undermined fiscal revenue and finally led to the freezing of deposits in the banking system (the *corralito*), although this failed to stem the outflow of international reserves. The situation eventually led to a partial moratorium on external debt service and abandonment of the fixed exchange rate. The government that took office in early 2002 had to redefine the ground rules in an economy where many contracts and financial assets were dollarized, and it had to do so without the assistance of voluntary external financing. In the first half of the year, reserves continued to shrink as a result of capital flight and payments to multilateral agencies; the local currency continued depreciating, and prices rose by a cumulative 30% over the first six months. Midway through the year, currency controls and intervention on the foreign-exchange market were strengthened and the exchange rate was brought under control. This made it possible to curb the inflationary upsurge and start processes to re-establish payment mechanisms and lower interest rates. The government also decided to suspend payments to multilateral agencies until the latter unblocked previously approved loans, which were intended to finance debt repayments to those same organizations.

Although the economy began to recover in the second quarter of 2002, GDP shrank by 11% for the year as a whole. Two thirds of this was attributable to the slowdown in the second half of 2001. The stronger pace of activity is being driven by net export growth, with import substitution playing a key role. In 2003 exports have grown even faster than in 2002, but, as imports are also recovering, the trade surplus is likely to be similar to that recorded a year earlier. The currency appreciation registered in the first half of 2003 has helped stabilize the general level of prices. Gross fixed investment grew by 20% in the early months of this year, following a 36% retreat in 2002; consumption stalled but showed signs of revival in mid-2003. Having been in the doldrums in the first quarter of 2002, the manufacturing and construction sectors led the expansion in early 2003, although agriculture also performed particularly strongly in the second quarter. A resumption of restaurant and hotel activity shows that devaluation also boosted tourism-related sectors. GDP growth is projected at around 5.5% for the year as a whole.

Contagion from the banking and currency crisis in Argentina resulted in a loss of foreign-currency deposits in Uruguay, which ultimately caused faith in the crawling-band exchange-rate regime to evaporate and heightened risk perceptions in the banking system. Loss of bank deposits and capital flight forced the authorities to float the local currency (and accept its depreciation) in June 2002. The banking system underwent widespread restructuring, which included the suspension of several institutions and the rescheduling of official bank deposits. Meanwhile, recession and devaluation eroded the country's capacity to service the public debt, which also had to be restructured. In this setting, fiscal policy was unable to perform a compensatory function, and government consumption was cut by almost 10%. The central bank raised interest rates in an attempt to absorb liquidity and restrain exchange-rate overshooting. Against this backdrop, private consumption and gross fixed capital formation fell by 12% and 30% respectively, while the steep fall in demand from neighbouring countries depressed exports. With the single exception of agriculture, all economic sectors declined substantially. Although output has been recovering gradually in 2003, driven by import-substituting and export sectors, this will not be sufficient to offset the strongly negative statistical effect of results in 2002, so annual output is expected to fall by between 2% and 2.5% for the year a whole.[62]

In Paraguay also, much of the current economic situation is explained by events in the financial sector and the currency market, involving the withdrawal of bank deposits and capital flight, compounded by devaluations and price hikes. In June 2002, the country's third-largest private bank was intervened, and four other financial institutions were closed down in the first few months of 2003. Output shrank by 2.3% in 2002, with only exports showing any growth, since private consumption contracted by 5%, gross fixed capital formation slumped by 12% and the government attempted to implement a fiscal austerity package at the same time. In 2003, the factors undermining domestic demand are having negative effects in many productive sectors. Nonetheless, as production prospects for agricultural exports are highly favourable (the soya and cotton harvests are expected to be up by 27% and 37% respectively), this will allow for GDP growth of 1.5% in 2003, given the importance of the agricultural sector in the economy overall.

(iii) The Andean countries

Economic activity in the Andean countries in 2002-2003 was heavily influenced by their capacity to finalize investments in the mining and oil and gas sectors, boost output and exports and maximize the impact of these activities on the rest of the economy, including their effect on fiscal revenues. Consequently, international price trends among the corresponding products also played a significant role. The prices of most minerals remained comparatively low during 2002 and 2003, although some staged a recovery in the first half of 2003 (tin, nickel, copper). Gold, along with oil and gas, posted the largest increases, particularly from December 2002 onward, reflecting international tensions and the restriction of oil supplies by OPEC countries.

This combination has maintained the terms of trade at relatively high levels for oil- and gas-exporting countries (Venezuela, Ecuador, Bolivia and Colombia), but at historically low levels for countries that export minerals and import oil, such as Chile and Peru, notwithstanding a slight upturn in 2003. Another element common to several countries in this group has been the passing of the Andean Trade Promotion and Drug Eradication Act (ATPDEA) in the United States, which allows free entry of certain textile and agricultural products into that country, as a way of supporting the fight against illegal drug production and trafficking. Although this could potentially give a renewed boost to textile exports, no significant improvement is yet discernible.

Political conflicts are having a major effect on economic performance in the Andean countries, particularly in the mining and oil and gas sectors, given their strategic importance. Major debates are raging on the subject of taxation and the role of external capital in these sectors, and there is also discussion concerning the routes to be taken by oil and gas pipelines –an issue that raises environmental problems and arouses national claims. On top of this, a strike called to terminate the mandate of the President of Venezuela had severe repercussions on oil activity. Political and social protests have also made it difficult to implement fiscal adjustment measures or carry out privatizations, and in some cases have forced such policies to be reviewed or even abandoned altogether.

The economies of Bolivia, Ecuador and Peru grew much more strongly than the regional average in 2002, driven by investments either in the oil and gas sector or in mining. Slower growth is forecast for 2003, however. In Bolivia, growth of 2.7% in 2002 was based essentially on the production and export of natural gas and on investments linked to these activities. Public spending was another stimulating factor, but was not sustainable in 2003.[63] The financial panorama was complicated further by a withdrawal of deposits from the banking system in mid-2002 and by a rise in interest rates and capital flight in February 2003, which eroded international reserves. Although prospects for 2003 include factors of external stimulus, such as investment in the production and export of natural gas, there is uncertainty over its amount; the outlook also contains contractionary factors arising from fiscal and financial difficulties and weak consumer demand. Growth is not expected to exceed 2%.

In Ecuador also, activity growth (3.8% in 2002)[64] has been based on investments in the oil and gas sector (construction of the heavy crude oil pipeline) and public expenditure. Private consumption has also played its part, thanks to remittance inflows and higher public-sector wages. External trade had a net contractionary effect,

62 This is the "statistical drag" effect: as the GDP contraction was concentrated in the second half of 2002, if activity during 2003 were to remain at the deseasonalized level of late 2002, total GDP for the year as a whole would be less than that recorded in 2002.

63 In fact, Bolivia's fiscal accounts registered a large deficit in 2002, resulting from wage hikes, higher capital expenditure, interest on the high level of public debt and the costs of social-security reform. In early 2003, the plan to curb public-sector wages had to be abandoned in the wake of the protests and violence that erupted in February.

64 This is the growth rate calculated by ECLAC in terms of 1995 dollars. The official growth figure for Ecuador in 2002 is 3.4%.

however, as export volumes stalled while imports grew by about 20% against a backdrop of burgeoning currency appreciation. This is hurting the manufacturing industry, where activity levels have remained flat, and projections for 2003 see growth slowing to around 1.5%. It will be impossible to maintain the previous year's fiscal expenditure stimulus; in fact, the first economic decision made by the government that took office in early 2003 involved fiscal tightening in the framework of an arrangement with IMF. Another source of growth that will come to an end in 2003 is the construction of the oil pipeline, although bringing the pipeline on stream will boost the potential for export growth. Investments to expand crude oil production have been delayed, however.

Economic growth in Peru in 2002 (5.3%) was driven by large-scale mining projects coming into production (which gave a substantial fillip to exports) and by a recovery in domestic demand in the second half. Public funding for the construction of low-income housing also made a significant contribution. Thus, the most buoyant activities were mining and quarrying and construction, while the other goods-producing sectors (agriculture and manufacturing) also put in strong performances. Peru is one of the countries least constrained by its macroeconomic accounts, having managed to increase exports, stabilize the exchange rate and keep inflation low. Nonetheless, a slightly lower growth rate is expected for 2003 (3.5%), reflecting a loss of dynamism in mining (as the effect of the Antamina project coming on stream fades), a poor first quarter for fishing (and consequently for the commodity processing industry) and fiscal tightening through tax increases. The latter reflects the government's determination to curb the growth of the public debt and to reschedule its maturity profile, thus complying with the demanding targets agreed with IMF.

Although 2002 was another year of relatively modest growth in both Chile (2.1%) and Colombia (1.5%), growth in both countries is expected to improve in 2003. Chile tried to spark economic recovery through low interest rates, narrow spreads on its external debt, absence of currency-market tensions and an exchange rate that favours tradable-goods-producing sectors. The low interest rates did not have much effect on investment, but manufacturing has been benefiting from private consumption growth since mid-2002. Exports to date in 2003 have increased in both value and volume, reflecting the strong pace of mining activity (which began to show through in the final quarter of 2002) and stronger foreign sales of other products such as salmon, wine and wood pulp. A potentially more robust economic performance in 2003 could be undercut by the fiscal adjustments needed to sustain the medium-term fiscal rule; consequently, the economy will probably grow by about 3.5% for the year as a whole.

In Colombia, monetary policy was expansionary throughout 2002. Nonetheless, currency depreciation, particularly in the third quarter, followed by a rise in inflation between January and April, led the government to tighten its policy stance in 2003. The behaviour of long-term interest rates did not reflect the management of short-term rates, but instead reacted to variations in the sovereign spread: an increase in the latter during the third quarter of 2002 forced up the long-term interest rate, and the interbank rate declined; the opposite occurred in 2003. Meanwhile, the sustained expansion of Colombia's public debt stock has elicited a series of tax hikes from the fourth quarter of 2002 onward. Thus, although by mid-2003 it had proved possible to stabilize (and even strengthen) the value of the peso, in addition to moderating inflation and securing fiscal funding for the rest of the year, such achievements required policies that have kept domestic demand on a tight rein. As in previous years, the most dynamic growth factor in 2002 was investment, which is rebounding after sinking to historically low rates in 1999. At the sectoral level, there has been significant progress in construction and basic services, with trends broadly persisting into the first quarter of 2003, when there was also an upturn in manufacturing. For the year as a whole, growth is expected to come in at around 2.5%.

The sharp GDP contraction suffered by Venezuela in 2002 was associated with capital flight (US$ 12 billion for the year) and political crisis, as a succession of events caused GDP to shrink by 9%. In the first quarter, capital outflow and the drop in the price of oil in late 2001 put additional pressures on the currency market and on public accounts, resulting in a tightening of monetary policy and fiscal adjustment. These measures were unable to stave off currency devaluation, however, and inflation gathered pace, eroding private consumption. In the second quarter the economy was overshadowed by political upheaval. The relative economic recovery achieved in the third quarter failed to be consolidated in the fourth, when a strike shut down most of the oil industry and lasted until early February 2003. From that month onward, currency controls have managed to staunch the capital outflow, replenish international reserves and lower interest rates, but at the same time it has become harder to obtain the foreign exchange needed to finance imports. Estimates suggest that pre-strike production levels were broadly regained in May-June; but, as economic activity fell very steeply in the first quarter of 2003 (by almost 30% in comparison to the same quarter of 2002), output is expected to register a two-digit decline for year as a whole –probably of around 13%.

2. Inflation

(a) General trends

The rate of inflation in 2003, as measured by the consumer price index (CPI), is projected at around 8.6% for Latin America and the Caribbean as a whole. This represents a fall of just over three percentage points from the previous year's figure –thereby halting the price surge recorded in 2002, when inflation had soared to twice the 2001 figure following eight years of sustained decline. The monthly inflation rate for the region rose to 1% in 2002 (compared to about 0.5% in 2001), with increases approaching 1.5% recorded in April and November. In January 2003, monthly inflation reached 1.7%, but thereafter a steady decline set in and the figure for June was just 0.2%. Region-wide, inflation is expected to continue falling in the second half of the year, with positive trends in all countries except the Dominican Republic, Haiti and Jamaica (where price rises may continue to accelerate), and Venezuela, which is expected to maintain the high rates recorded in 2002 and the first half of 2003 (see table II.8).

Indices of wholesale (WPI) or producer prices in the 12 countries for which data are available rose by 3.7% in the first half of 2003, which would translate into an annual rate of 7.4%. This represents a major change compared to events in 2002, when the corresponding index soared by 31.3% after having risen by just under 6% in 2001. Wholesale or producer prices had also comfortably outpaced consumer prices in 2002, which is understandable in the context of the widespread devaluations predominating that year. The sharp slowdown in price rises in 2003 is explained in particular by exchange-rate variations, since the currencies that suffered major devaluations in 2002 have since rebounded considerably, albeit without regaining their late-2001 levels. Argentina, Brazil, Ecuador, Paraguay and Uruguay, which had recorded steep WPI rises in 2002, all saw substantial falls in 2003. The exception was Venezuela, where the WPI continued to climb, reaching an annualized rate of 70% in the first half of 2003.

Inflationary trends over the last 18 months have thus been heavily influenced by exchange rates, although these have affected the WPI more than the CPI. Even so, devaluations have not been fully passed through to wholesale prices. Domestic prices have also been affected by the surge in the price of oil on the international market, which in mid-2003 was 50% higher than in late 2001. In contrast, the prices of other products imported by the region have remained relatively stable.

Table II.8

LATIN AMERICA AND THE CARIBBEAN: CONSUMER PRICES

(December-to-December percentage variations)

	2001	2002	2003 [a]
Region-wide total	**6.0**	**12.0**	**8.6**
Argentina	-1.5	41.0	5.5
Barbados	-0.3	-1.0	0.0
Bolivia	0.9	2.4	3.0
Brazil	7.7	12.5	10.0
Chile	2.6	2.8	3.0
Colombia	7.6	7.0	7.0
Costa Rica	11.0	9.7	9.0
Cuba	-0.5	7.0	5.0
Ecuador	22.4	9.4	6.0
El Salvador	1.4	2.8	3.0
Guatemala	8.9	6.3	6.0
Haiti	8.1	14.8	41.7
Honduras	8.8	8.1	6.0
Jamaica	8.7	7.3	12.0
Mexico	4.4	5.7	3.0
Nicaragua	4.8	3.9	7.0
Panama	-0.1	1.9	1.5
Paraguay	8.4	14.6	9.0
Peru	-0.1	1.5	2.5
Dominican Republic	4.4	10.5	30.0
Trinidad and Tobago	3.2	4.3	3.8
Uruguay	3.6	25.9	9.0
Venezuela	12.3	31.2	30.0

Source: ECLAC, on the basis of official figures.

[a] Projections.

In seven economies, substantial exchange-rates hikes generated high rates of inflation in 2002: 41% in Argentina, 31% in Venezuela, 26% in Uruguay and between 10% and 15% in Brazil, Dominican Republic, Haiti and Paraguay. This contrasts with the situation in 2001, when price rises had been significantly lower in those countries, and there was outright deflation in one case. In some countries, exchange-rate overshooting was followed by nominal currency appreciation starting in the final quarter of 2002. As a result, the inflationary upsurge was controlled in nearly all these economies, especially that of Argentina, where prices have risen by very small amounts in 2003. Only two of the countries mentioned (Dominican Republic and Haiti), along with Jamaica, have suffered inflationary surges of any significance in 2003.

Thus the higher rates of inflation recorded in 2002 did not represent a long-term trend, but resulted from devaluations that have been gradually absorbed without generating sustained inflationary processes. In nearly all countries, inflation rates have been much more modest than the devaluations that gave rise to them, given the weak growth or recession that the countries of the region have been experiencing. What did happen was a major change in relative prices, with tradable goods rising appreciably in price at the expense of non-tradables. Wages, in particular, have risen by much less than the CPI and even less than exchange rates.

In 14 other countries of the region, inflation in 2003 was broadly unchanged from the levels of recent years, as nearly all these countries kept price rises in the single digits, and in some cases close to zero. Although several of the economies experienced devaluations, there were no major consequences for domestic prices. Moreover, the knock-on effects of the steep rise in international oil prices were also limited and did not significantly alter the overall pace of inflation. Although the results are similar, some of the policies applied differ significantly from one country to another. Countries can be divided into dollarized economies, on the one hand, and those with freely floating exchange rates, currency bands or crawling pegs, on the other; some countries in the latter group were able to pursue active monetary policies.

(b) Inflation in individual countries

In Argentina, Uruguay and Venezuela, devaluations occurred suddenly in 2002 following the abandonment of existing exchange-rate regimes (convertibility or currency bands) under which relative prices had become distorted to the point of unsustainability. The drastic change of foreign-exchange regime caused the respective currencies to depreciate sharply. In four other countries (Brazil, the Dominican Republic, Haiti and Paraguay) that already had floating exchange rates, local currencies also depreciated, but more slowly. Following steep depreciations in 2002, the Argentine peso, the Brazilian real, the Paraguayan guaraní and the Uruguayan peso have all rebounded in nominal terms during 2003; whereas the Haitian gourde, the Dominican peso, the Jamaican dollar and the Venezuelan bolívar have continued to weaken.

In Argentina devaluation was so steep in the first half of 2002 that the currency lost three quarters of its value. Although this had a major effect on prices, it failed to set off an inflationary spiral, given the depressed state of demand, high unemployment and lack of indexation, particularly among public-utility charges. Nominal wages were not increased significantly to compensate for steep price hikes, and the latter moderated considerably as the months went by. Moreover, in the midst of major upheaval, and with emergency instruments in place, fiscal and monetary authorities were acutely aware of the need to avoid an abrupt escalation in prices and to ensure the survival of behaviour patterns adapted to situations of low inflation. Stabilization of the exchange rate from the second half of 2002 onward, followed by revaluation in 2003, made it possible to lower the rate of inflation in Argentina to the point where cumulative inflation in the first half of 2003 was just 2%, compared to 30% in the same period of 2002. Inflation for 2003 as a whole is forecast at around 5% (see figure II.35). The brunt of the 2002 devaluation was absorbed by wholesale prices, in which imported goods have a high weighting; the WPI rose by 118% in 2002, which was far more than the CPI increase. Nonetheless, in the first six months of 2003 the rise in wholesale prices also slowed sharply and even turned negative. The imported products component of the consumer price index rose by over 200% in 2002, and agricultural prices increased by 171%. In contrast, there were more modest variations in service-sector prices (16% in the case of private services). Food and beverage prices rose by 58%, however, which was more than the overall CPI increase. This pattern of price rises in Argentina stood in clear contrast to various previous episodes in which sharp devaluations had triggered major inflationary surges.

In Venezuela, inflation rose from its 2002 level, following a sustained five-year decline. The break in trend occurred following the abolition of the exchange-rate band, which led to a sharp devaluation in the first half of the year. Following a brief period in which inflation eased, price increases gathered pace again in 2003 as a result of the serious political and social tensions afflicting the country, when the bolívar was devalued once again. This situation has caused a radical change in economic policy, involving the establishment of a fixed exchange rate and the imposition of foreign-exchange and price-control measures aimed at stabilizing the currency and reducing inflationary pressures.

In Uruguay, the inflationary resurgence in the second half of 2002 also reflected the steep devaluation that occurred particularly after the crawling-band system was replaced by a floating exchange-rate regime. Consumer prices grew by 26% in 2002 and by 25% up to June 2003 (on a 12-month basis), contrasting sharply with increases of under 4% in 2001. Wholesale price inflation soared to 65% in 2002, but was restricted to just 6% in first half of 2003. The severe recession through which the country is passing, compounded by problems stemming from financial crisis, a drastic reduction in lending and the blocking of deposits in a number of institutions, have eased the impact of the devaluation. Nonetheless, the widespread dollarization of the economy has made it impossible to soften the effect of the exchange-rate increase to any great degree, although many prices had to adjust to the new reality. Wage hikes have been modest, despite accelerating inflation. The slower rise in the exchange rate starting in the fourth quarter of 2002, followed by appreciation in the second quarter of 2003, have made it possible to reduce inflation, despite steep increases in public-utility charges. The annual inflation rate is forecast to come in at just below 10%, which is less than half its 2002 level.

In Paraguay, consumer prices rose by 20% in the 12 months ending in May 2003, while wholesale prices climbed by 42%, owing entirely to devaluation, which gathered pace from the third quarter of 2002 onward. In keeping with the pattern of the cases discussed above, the combination of recession and high unemployment prevented the cost increases caused by devaluation from being passed through to domestic prices to any significant degree. The sharp upturn in inflation in the first quarter of 2003 gave way to deflation between May and July, thanks to which the Paraguayan currency has been appreciating since the start of the year. For 2003 as a whole, inflation is forecast to remain below 10%.

In Brazil, 12-month inflation stood at 16.6% in June 2003, compared to 12.5% in 2002 and 7.7% a year earlier. The resurgence occurred in late 2002 as a result of the currency devaluation that had taken place between May and October that year. Consequently, the target established by the central bank was overshot by an even bigger margin than in the previous two years. Wholesale prices came under even stronger inflationary pressures, as the corresponding index rose by 35% in 2002, surpassing the 2001 figure by over 23 percentage points. Apart from the effects of devaluation, price hikes were driven by rises in fuel prices and public-service charges. An even stronger inflationary surge has been averted by the economy's persistent slow growth, in conjunction with a continuation of the tight monetary policy applied by the authorities to restrain upward pressure on prices and, in particular, to help stabilize the currency market. The monetary-policy benchmark interest rate rose throughout 2002 before settling at 26% per year in February 2003, where it has remained with minor variations since then. Thanks to the revaluation of the real in 2003, inflation began to ease from February onward and deflation was recorded in June. All of this points to a rate of around 10% for 2003 as a whole.

In the Dominican Republic, inflation has accelerated significantly since 2002, with consumer prices rising by 10.5%, compared to just 4.4% in 2001. In June 2003, the 12-month increase in prices amounted to 26%. This acceleration is mainly explained by currency depreciation, the rise in international oil prices and the removal of electricity subsidies. The rise in the exchange rate, particularly in the fourth quarter of 2002, reflected pressures in the foreign-exchange market arising from reduced capital inflows from abroad, private capital outflows and a loss of international reserves. The major banking crisis that erupted in 2003 has aggravated these difficulties, forcing the central bank to provide financial assistance on a massive scale. In Haiti, meanwhile, political and institutional instability had a negative effect on the currency market, generating a steep devaluation, particularly in late 2002 and early 2003. This forced the authorities to raise fuel prices substantially, thereby triggering a rapid inflationary process that brought price increases to 13% in January 2003 and the 12-month inflation rate to 39% by April. In Jamaica, 12-month inflation in June 2003 rose to 10%, reflecting a 16% rise in the exchange rate in the first half of the year.

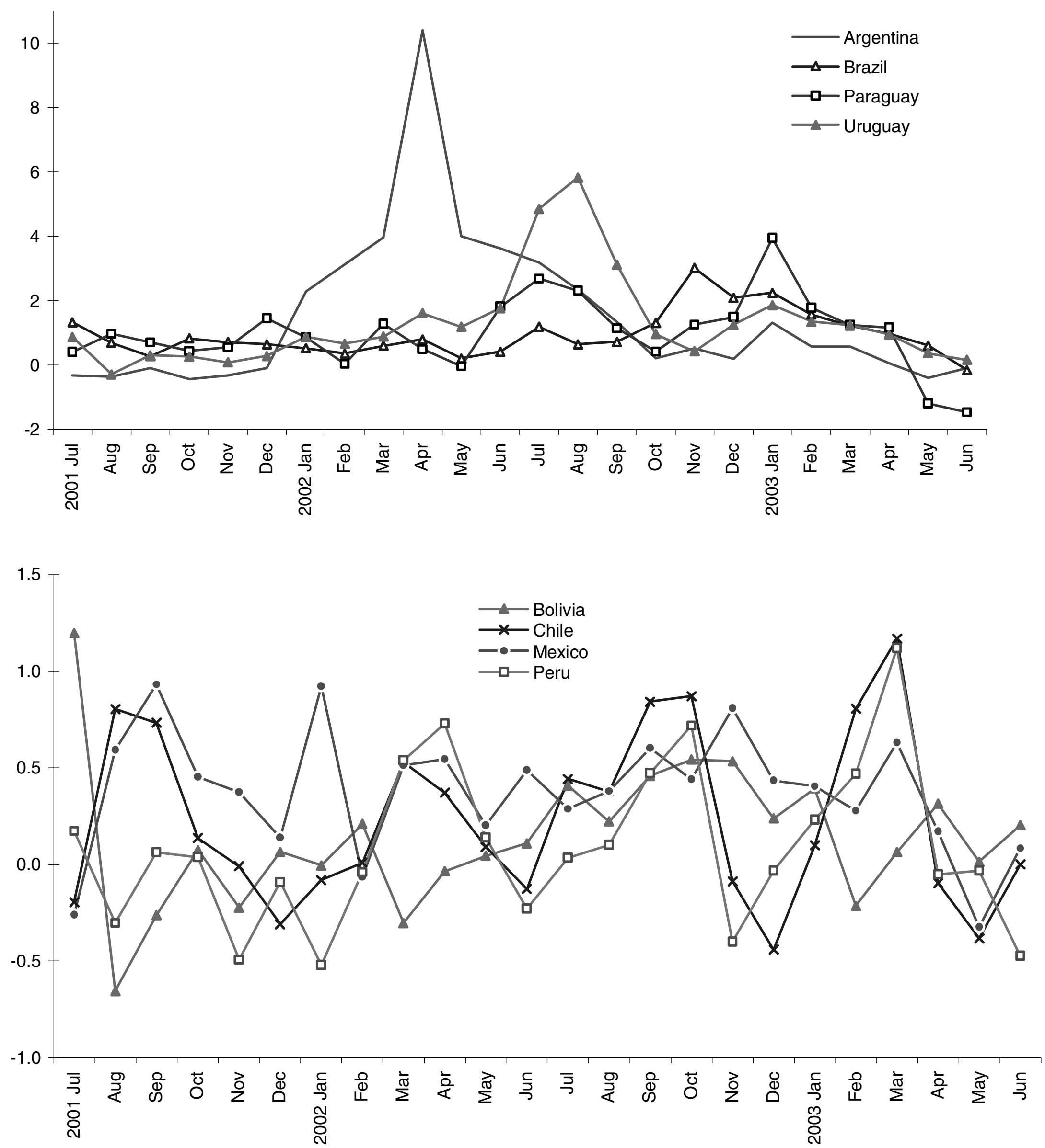
Countries achieving positive results on the inflation front again included Chile, Colombia, Mexico and Peru, which operate floating exchange-rate systems. In 2003, these countries' consumer price indices again rose by small amounts, even though some of them had seen their currencies depreciate, and the solid performance on prices enabled them to implement countercyclical monetary policies. Chile is an outstanding example in this regard, having pursued a clearly expansionary monetary policy involving successive reductions of the central bank benchmark interest rate, which currently stands at an extremely low level. Nonetheless, the other three countries in this group have sometimes found it necessary to restrain the growth of monetary aggregates in response to the international financial situation, and especially the larger spreads charged on the region's foreign borrowing. Colombia, in particular, was forced to abandon its expansionary monetary policy because the foreign-exchange market was coming under heavy pressure and the local currency had depreciated sharply since the second half of 2002. Inflation picked up slightly in 2003, but from May onward it has shown signs of easing. In recent years, the authorities in these four countries have adopted inflation targeting, which gives them an appropriate system for monitoring the stabilization achieved in the recent past. The inflation targets set by the respective central banks have been met.

In Guatemala, which also has a freely floating exchange rate, inflation fell again, although more slowly this time, and the 12-month rate as of mid-2003 stood at 5.2%, one percentage point below the corresponding 2002 figure. This was achieved as a result of the tight monetary policy applied by Banco de Guatemala and the nominal exchange-rate stability maintained over several years. The latter has undermined competitiveness, however, since the real exchange rate has fallen by about 13% over the last three years. Trinidad and Tobago also managed to reduce inflation, posting an annual rate below 4% in 2003; this positive outcome has also been assisted by the exchange-rate stability maintained in recent years. In Nicaragua inflation fell to 4% despite local currency devaluation in 2002, although in 2003 there has been a slight increase since May. In Bolivia the domestic currency has continued to devalue against the dollar at a faster rate than inflation, but this has not affected domestic stability, and the CPI has risen by just 3% year-on-year. Annual inflation in Honduras currently stands at 7%, following several years of two-digit rates, thanks to the fact that the exchange rate has varied only slightly. Lastly, in Costa Rica, inflation stayed close to the 10% rate from which it has hardly varied in recent years, and exchange-rate adjustments matched this.

Ecuador, El Salvador and Panama all kept their dollarization regimes in place. Ecuador recorded a steep drop in inflation, from 22% in 2001 to 9% in 2002, with the positive trend continuing into 2003. Domestic inflation could soon reach developed-country rates, thereby halting the erosion of the country's competitiveness, which has been intensive since the start of dollarization. El Salvador again registered a very small rise in prices, also similar to rates in industrialized countries; but, unlike Ecuador, this country has had single-digit inflation since before the introduction of its new foreign-currency regime. Panama, where dollarization has long been established, maintained its traditional low rate of inflation, and Barbados, which has had a fixed exchange-rate regime for many years now, reported slight deflation.

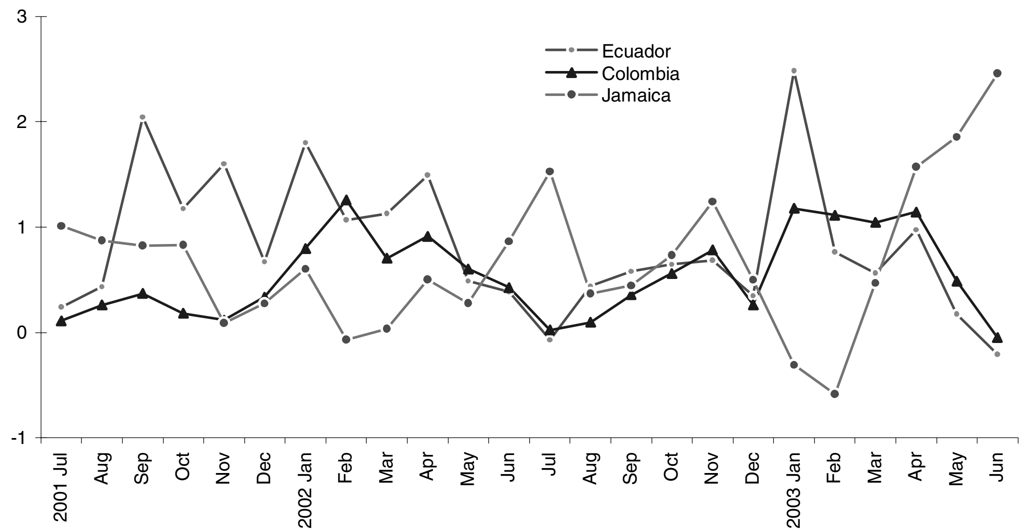
The inflationary outlook for the rest of 2003 is promising in most Latin American and Caribbean countries. In nearly all cases, exchange-rate misalignments have been overcome, so no further large devaluations are foreseeable that might trigger indexation processes or massive pass-throughs of higher costs to domestic prices. Moreover, countries that devalued by too much will probably continue to gradually absorb the exchange-rate overshooting, so inflation should moderate further. In the remaining countries the conditions that made it possible to steadily reduce regional inflation in the 1990s still persist, along with the high priority attached to making this economic-policy achievement secure. Generally speaking, the policy no longer entails measures with the potential to seriously alter relative prices and undermine competitiveness in the long term.

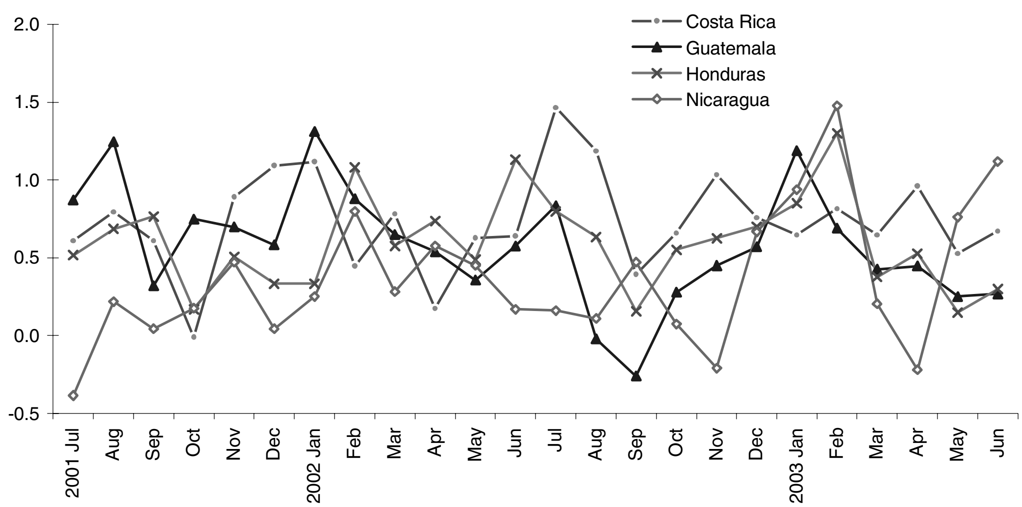
Figure II.35
LATIN AMERICA AND THE CARIBBEAN: CONSUMER PRICES
(Monthly percentage variation)

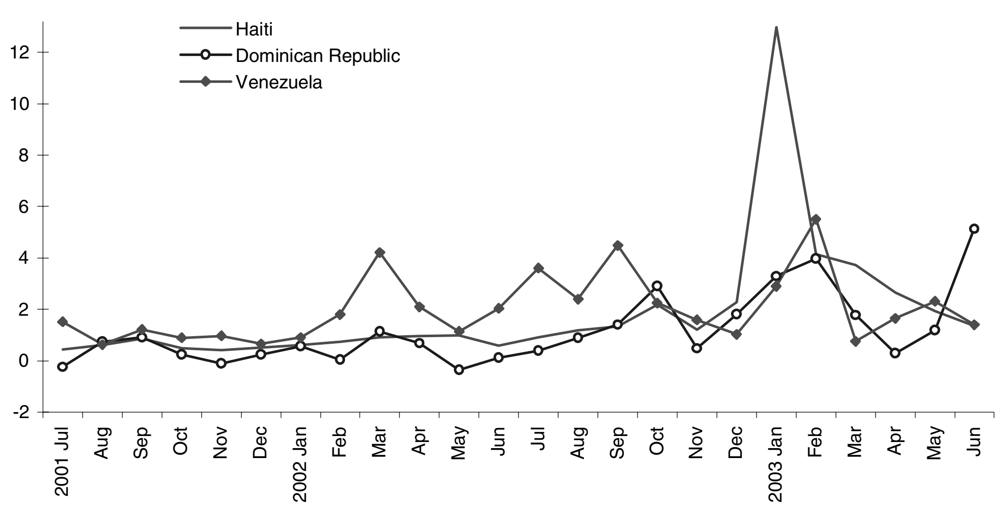


Source: ECLAC, on the basis of official figures.

Figure II.35 (continued)







3. Employment and wages

The "lost half-decade" left its mark on labour-market trends in the region, as employment levels fell significantly and the unemployment rate climbed to a new high, even surpassing the levels recorded during the debt crisis of the 1980s. Between 1997 and 2002 the employment rate (the number of persons employed as a percentage of the working-age population) fell from 54.0% to 52.9%, unemployment rose from 7.5% to 8.9% and real average wages stalled at their 1997 level (see table II.9).

Table II.9

LATIN AMERICA AND THE CARIBBEAN: LABOUR-MARKET INDICATORS, 1990-2002

	1990	1995	1997	1998	1999	2000	2001	2002 [a]
Unemployment								
- Weighted average	5.9	7.5	7.5	8.1	8.8	8.4	8.3	8.9
- Simple average	9.4	10.1	9.9	9.7	10.3	10.0	10.3	10.7
Overall participation rate [b]								
- Weighted average	57.4	58.2	58.2	58.6	58.4	58.6	58.1	58.2
- Simple average	55.1	56.4	57.3	58.2	58.5	58.1	58.6	58.3
Male participation rate [c]	73.2	73.2	72.9	73.3	72.9	71.7	71.5	71.0
Female participation rate [c]	35.9	39.2	39.1	40.8	41.0	40.8	41.0	41.2
Employment rate [b]								
- Weighted average	54.1	54.0	54.0	53.8	53.1	53.6	53.2	52.9
- Simple average	50.8	52.3	52.3	53.0	52.6	52.4	52.5	52.1
Real average wage								
- Weighted average	95.1	100.0	103.3	104.2	103.0	104.6	104.7	103.1
- Median	87.1	100.0	100.7	102.6	103.7	105.1	106.1	107.7
Real minimum wage								
- Weighted average	84.7	100.0	100.1	102.0	102.5	104.5	109.3	108.6
- Median	103.3	100.0	98.8	102.0	103.2	104.1	105.4	104.9

Source: ECLAC, on the basis of official figures (see statistical appendix).
[a] Preliminary figures.
[b] 14 countries.
[c] Simple average for 12 countries; the first column refers to 1991.

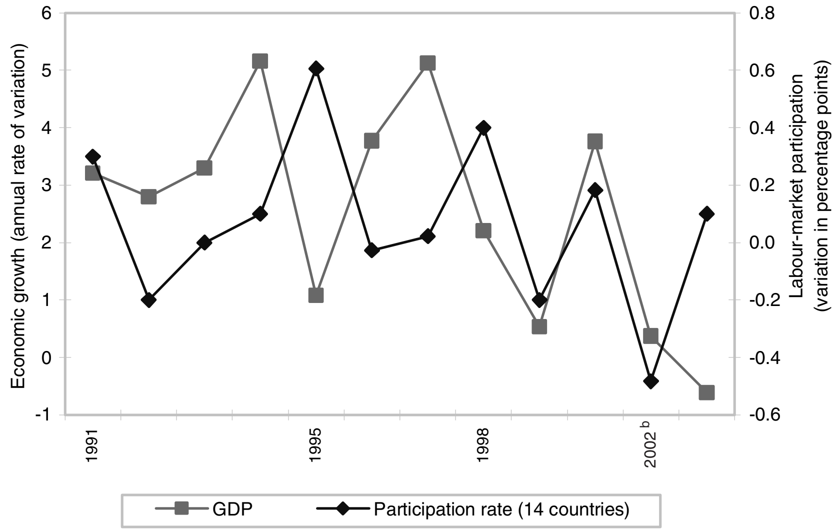
During this period, labour-market participation behaved procyclically, and in years of economic downswing a large contingent of the workforce withdrew from the labour market, discouraged by the lack of job opportunities (see figure II.36).[65] This interrupted the long-term rising trend in the total participation rate, and the growth in unemployment levelled off.[66]

65 For an analysis of the trend of labour-market participation since the early 1990s, see ECLAC, *Economic Survey of Latin America and the Caribbean 2001-2002* (LC/G.2179-P), Santiago, Chile. United Nations publication, Sales No. E.02.II.G.02.

66 The ECLAC Population and Development Division – CELADE predicts that the activity rate will rise from 54.3% to 56.7% between 2000 and 2010, owing almost entirely to greater labour-market participation by women (see ECLAC-CELADE, "Latin America: Economically active population", *Demographic Bulletin* No. 64 (LC/DEM/G.188), Santiago, Chile, 1999).

Figure II.36

LATIN AMERICA AND THE CARIBBEAN: ECONOMIC GROWTH [a] AND LABOUR-MARKET PARTICIPATION, 1991-2002



Source: ECLAC, on the basis of official figures.
[a] Calculated on the basis of figures expressed in dollars at constant 1995 prices.
[b] Preliminary figures.

In 2002, regional labour-market trends were determined by the economic performance of two groups of countries. In those that suffered a sharp GDP contraction and accelerating inflation, employment shrank, especially in the formal sector; and there was a pronounced rise in both unemployment and underemployment, while real wages eroded. In the second group, which includes the vast majority of the region's countries, economic growth rates ranged from low to moderate while labour-market variables performed somewhat more strongly, but even here lower employment rates and higher unemployment prevailed (see table II.10). This group includes the Caribbean countries, where unemployment rose for the first time following a sustained reduction since the early 1990s.

In the region as a whole, the slackness of economic activity was reflected in worsening labour-market indicators. While the urban labour force expanded by 3.9 million people, only 2.9 million new jobs were created, many of them poorly paid and of low productivity. Consequently, urban unemployment grew by around 1 million people, to make a total of some 11 million people seeking work. Unemployment posted a new high of 8.9% as a weighted average and 10.7% as a simple average, while the employment rate fell to its lowest level since 1990. Real wages, which tend to shadow the trend of inflation, declined in weighted-average terms, although the median real wage increased.

Table II.10
LATIN AMERICA AND THE CARIBBEAN: LABOUR-MARKET INDICATORS BY COUNTRY, 2001 AND 2002

	Employment rate		Unemployment rate		Participation rate				Real average wage Rate of variation		Real minimum wage Rate of variation	
					Male		Female					
	2001	2002[a]	2001	2002[a]	2001	2002[a]	2001	2002[a]	2001	2002[a]	2001	2002[a]
Argentina	35.2	34.1	17.4	19.7	55.8	55.1	34.8	35.6	-0.6	-13.8	1.1	-19.5
Bolivia	64.2	61.1	8.5	8.7	75.9	73.3	60.1	56.3	3.8	3.1	10.8	4.7
Brazil	52.9	52.7	6.2	7.1	71.0	70.5	43.9	45.0	-4.9	-2.1	9.1	2.6
Chile	48.1	47.8	9.1	9.0	72.5	71.8	34.0	33.8	1.6	2.0	3.8	2.9
Colombia	52.5	52.9	18.2	17.6	74.3	n.d.	55.6	n.d.	0.3	4.0	1.2	0.7
Costa Rica	52.4	51.8	5.8	6.8	73.7	73.2	38.6	38.2	1.0	4.1	0.2	-0.6
Ecuador	49.8	49.5	10.4	8.6	67.0	66.7	44.7	42.1	12.5	...	11.4	1.2
El Salvador	49.6	48.0	7.0	6.2	69.2	65.8	39.5	38.6	...	...	-3.6	-1.8
Guatemala	...	59.0	...	3.6	...	81.0	...	42.3	0.5	-0.9	8.3	0.3
Haiti	...	...	...	...	...	...	...	...	...	...	-11.6	-8.9
Honduras	50.3	49.7	5.9	6.1	71.8	72.3	34.7	32.5	...	...	6.7	-1.6
Mexico	54.2	53.6	2.5	2.7	74.1	73.4	38.8	38.2	6.7	1.5	0.4	0.7
Nicaragua	44.2	43.3	11.3	11.6	...	...	...	...	4.4	4.3	-4.4	0.0
Panama	52.0	54.2	17.0	16.1	79.5	80.2	41.7	44.8	-2.1	...	7.2	-1.0
Paraguay	53.2	51.6	10.8	14.7	71.6	...	49.1	...	1.4	-6.4	3.7	-0.7
Peru	60.5	62.0	9.3	9.4	77.6	78.3	56.4	59.3	-0.9	4.7	1.2	-0.2
Dominican Republic	45.8	46.2	15.4	16.1	69.2	68.3	40.0	42.1	...	...	5.5	-0.5
Uruguay	51.4	49.1	15.3	17.0	72.2	70.7	51.0	49.4	-0.3	-10.7	-1.3	-10.1
Venezuela	57.7	57.9	13.3	15.8	82.0	83.5	50.9	54.3	2.5	-10.1	0.8	-4.4

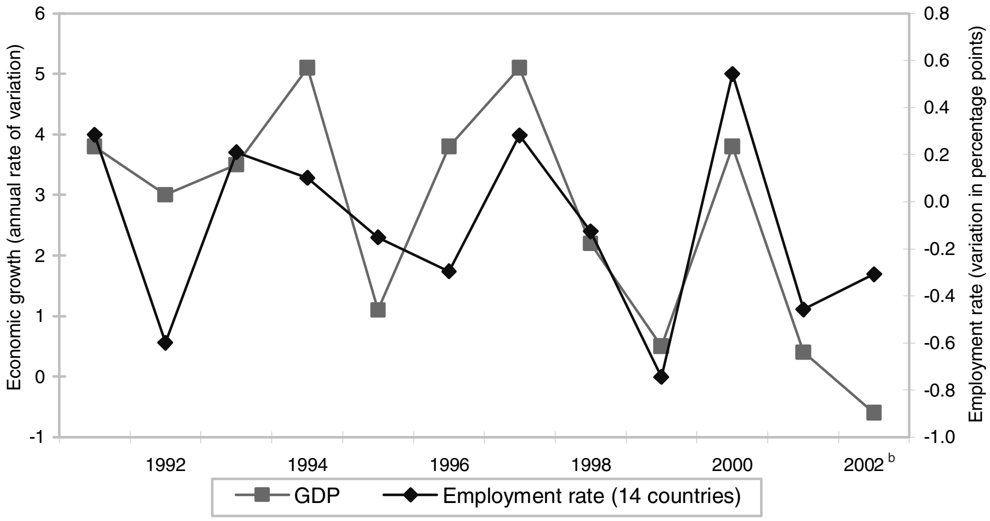
Source: ECLAC, on the basis of official figures (see statistical appendix).
[a] Preliminary figures.
[b] Calculated using the old methodology.

In keeping with the trend of economic growth, which staged a modest recovery in most countries and registered a slight improvement at the regional level, employment strengthened in early 2003. The unemployment rate fell only slightly, however, because of a concurrent expansion of the labour supply. Given the lack of momentum among the region's largest economies, Brazil and Mexico, no significant reduction in unemployment is forecast for the year as a whole. Following several years of weak labour demand, nominal wages rose very slightly in most countries, which meant that real wages remained flat in the first few months of the year. In countries that still have high inflation rates, the purchasing power of wages was eroded still further.

(a) Economic growth and labour supply and demand in 2002

Sluggish economic growth and concomitant weak labour demand are usually reflected in changes in the level of employment and in the composition of supplementary employment. Specifically, the employment rate usually shadows the path of economic growth, and in low-growth situations there tends to be an increase in the proportion of poorly paid low-productivity jobs. As will be discussed in greater detail below, at the regional level the number of persons employed grew by 1.3% in 2002; but as this was less than the growth of the working-age population, the employment rate fell by 0.3 percentage points. Figure II.37 shows that if the employment rate had maintained its previous correlation with economic growth, the sharp retraction of regional GDP would have produced an even greater reduction. The fact that employment fell by less than usual moderated the rise in open unemployment, albeit thanks largely to an expansion of precarious jobs and public employment programmes.

Figure II.37
LATIN AMERICA AND THE CARIBBEAN: ECONOMIC GROWTH[a] AND EMPLOYMENT, 1991-2002



Source: ECLAC, on the basis of official figures.
[a] Calculated on the basis of figures expressed in dollars at constant 1995 prices.
[b] Preliminary figures.

As figure II.36 clearly shows, in the years immediately preceding 2002 the trend of labour-market participation closely followed the business cycle. Thus, if this pattern had persisted, the rise in unemployment could have been expected to slow substantially. Nonetheless, in 2002 the total participation rate remained virtually constant, and changes in the labour supply failed to cushion the effects of low economic growth on unemployment. This contrasted with events the previous year, when unemployment had remained unchanged despite economic growth of close to zero, and was even more different from the situation in 1999, when labour-market participation had fallen sharply throughout the region. In brief, although the participation rate failed to resume its long-term upward trend, there was no retreat in labour-market participation in 2002 as had happened in previous years, so this variable failed to act as a buffer to absorb rising unemployment.

Although the long-term rising trend of total labour-market participation was interrupted during the "lost half-decade", this did not mean a retreat in terms of the growing participation of women. In general, their participation rate rose more or fell less than the corresponding rate for men, so the gender gap in labour-market participation continues to narrow. In fact, in 2002 the fall in the total participation rate was entirely caused by the reduction in the male rate, since female participation continued to rise slightly (see table II.9). The break in the rising trend of labour-market participation is better explained by the fact that young men and women are delaying their entry into full-time employment. In some cases this is because they are staying longer in the educational system, but in other cases it reflects a situation in which they are "neither studying nor working", which damages their future job prospects and impairs social integration in general. In the longer term, population ageing also contributes to a lower participation rate among men, especially in a context of expanding pension-system coverage.

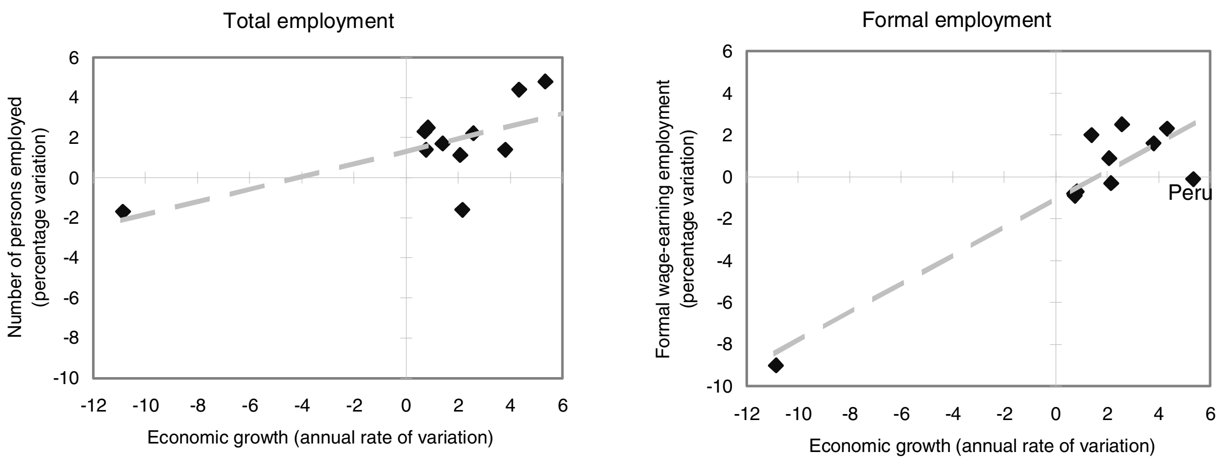
(b) The characteristics of job creation

In 2002, employment did not retreat by as much as the contraction in economic activity would have suggested. Even so, a comparison of 11 countries reveals a slight positive correlation between the increase in employment and economic growth (see figure II.38). Nonetheless, in many countries flat activity levels meant limited labour demand by firms (especially in the formal sector), and a large proportion of the new jobs created were in low-productivity areas. Consequently, if economic growth is compared to the trend of formal wage-earning employment in those same 11 countries, the correlation between the two is stronger (see figure II.38). The main exception is Peru, where formal job creation was very scarce. In the first half of the year economic growth was mainly based on non-labour-intensive activities (mining); only in the second half of the year did strengthening domestic demand contribute more to economic growth and stimulate more labour-intensive activities.

The situation was similar in Bolivia and Ecuador, where moderate growth (2.7% and 3.8% respectively) had little impact on jobs and the corresponding employment rates dropped sharply between 2001 and 2002 (from 64.2% to 61.1% in Bolivia and from 55.6% to 54.1% in Ecuador). Much of the economic growth in these countries was based on stronger performances by non-labour-intensive, natural-resource-based activities, against a backdrop of real exchange-rate appreciation, which at the same time reduced the competitiveness of activities that generate greater labour demand.

Figure II.38

LATIN AMERICA AND THE CARIBBEAN: ECONOMIC GROWTH[a] AND JOB CREATION, 2002



Source: ECLAC, on the basis of official figures.
[a] Calculated on the basis of figures expressed in dollars at constant 1995 prices.

Figure II.38 illustrates the importance of informal employment, expressed by the fact that the trend line crosses the vertical axis in the positive range, which indicates "job creation" even without economic growth. In contrast, economic stagnation causes a reduction in formal employment, as firms seek to raise productivity by maintaining output levels using fewer workers.

The weakness of labour demand on the part of firms is also reflected in figures showing employment growth by occupational category. Wage-earning employment grew by 1.3% region-wide, matching the expansion of employment overall and clearly outstripping GDP growth. This means that average labour productivity in the region has fallen by 2%, not only when the denominator used is the total number of employed persons, but also when considering wage-earning employment alone.

In several countries a large proportion of new wage-earning jobs arose in the framework of emergency programmes and other public-sector activities. The largest-scale experience of this type was in Argentina, where it has been calculated that 798,000 out of all the individuals employed in urban areas in October 2002 were beneficiaries of the Unemployed Heads of Household Plan, which raised the employment rate to 34.6% of the population, compared to the 32.3% it would have been without the Plan. In Peru, special urban and rural employment programmes created 125,000 and 69,000 temporary jobs lasting four and six months respectively.[67]

As a consequence of these and other similar experiences, and contrary to the trend in the 1990s, public-sector employment grew by 4.5% (measured as a weighted average of 14 countries). These programmes clearly played an important role in limiting the decline in the employment rate, and helped to cushion the rise in unemployment. Nonetheless, most of these jobs are temporary by design and are bound to disappear in the

67 Jobs in emergency programmes are typically temporary, so these figures cannot be directly compared with aggregate job creation, which is calculated on the basis of the number of jobs measured in person-years.

future, which will cause the share of public-sector employment in the occupational structure to fall back again.

Self-employment, mostly in the informal sector, grew by 1.3%. The relative weakness of this expansion, at a time of an economic downswing, may be indicating that the informal sector's capacity to absorb workers who fail to find jobs in the formal sector during low-growth periods could be reaching its limits in many countries.[68]

It is well known that open unemployment reveals only one aspect of the insufficiency of job creation. A closely related variable is invisible underemployment, which is the proportion of people who work fewer than the usual number of hours, but want to work more and are in a position to do so.[69] This indicator has deteriorated sharply in countries where open unemployment has risen substantially (Argentina, Uruguay), which is hardly surprising, since both variables reflect problems relating to the volume of employment. At the other extreme are countries such as Ecuador, which registered major reductions in both open unemployment and visible underemployment. In other countries, such as Colombia and El Salvador, visible underemployment grew despite a drop in open unemployment, which probably means that many of the new jobs that made it possible to lower the open unemployment rate were part-time and were accepted by job-seekers in the absence of better alternatives, despite their desire to work full time.

This analysis of employment trends cannot ignore international migration. Although there are no reliable figures on migrant flows in 2002, estimates of remittances reveal the growing importance of this phenomenon. Between 2001 and 2002, workers' remittances to Latin America and the Caribbean grew by 17.6% to total some US$ 32 billion. Most of this came from the United States, with the main recipient countries being Mexico, Brazil and Colombia; nonetheless, the countries benefiting most in relation to the size of their population, and hence those that probably have the largest colonies of citizens working abroad, were the Dominican Republic, El Salvador, Guyana, Jamaica and Nicaragua (see table II.11). In 2002, Argentina, Colombia, Jamaica and Venezuela displayed the strongest growth in remittances, reflecting large recent migration flows.[70]

Table II.11

LATIN AMERICA AND THE CARIBBEAN: REMITTANCES PER CAPITA, 2002[a]

(United States dollars)

Jamaica	500
El Salvador	338
Dominican Republic	243
Guyana	155
Nicaragua	142
Guatemala	141
Ecuador	120
Honduras	113
Haiti	105
Mexico	103
Cuba	101
Colombia	55
Peru	47
Trinidad and Tobago	45
Costa Rica	32
Brazil	26
Bolivia	12
Venezuela	9
Argentina	5

Source: ECLAC, on the basis of official figures.
[a] Preliminary figures.

(c) Real wage trends

Real wage growth was highly variable across countries, and at the regional level the weighted average and median display opposite signs (-1.6% and +1.5%, respectively) (see tables II.9 and II.10).

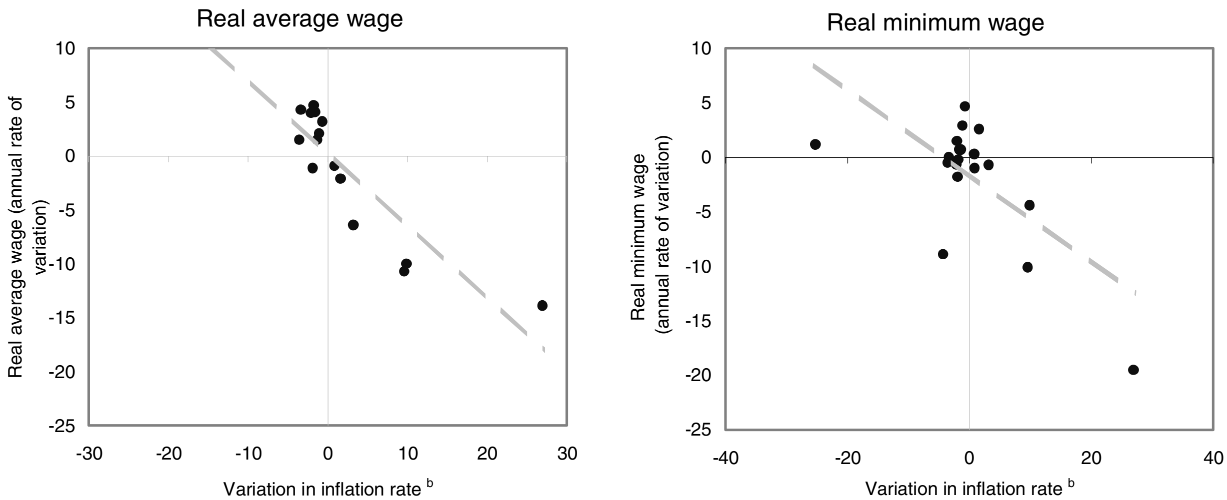
As shown in figure II.39, this heterogeneity largely reflects the inverse relation between the trend in real wages and variations in the inflation rate. Thus, in Argentina, Paraguay, Uruguay and Venezuela real wages suffered significant erosion, whereas in Colombia, Costa Rica, Nicaragua and Peru they rose quite appreciably. This relation is probably partly explained by the relative rigidity of nominal wages in response to large changes in the inflation rate, in cases where wages are negotiated for longer periods (a year or more) on the basis of expected inflation, since it hard to precisely calculate major changes in price levels. Clearly, when nominal wages are negotiated on the basis of past inflation, significant variations in the rate, in either direction, have an even clearer impact. If the resurgence of inflation coincides with a deep economic crisis, the bargaining power of workers is also weakened, which makes it even harder to maintain the purchasing power of wages. The fact that real wages fell sharply at times of high inflation also suggests the absence of strong indexation schemes, which were common in the past.

68 On this point, see *Economic Survey of Latin America and the Caribbean, 1999-2000* (LC/G.2102-P), Santiago, Chile. United Nations publication, Sales No. E.00.II.02, box VI.1, p. 91.

69 See table 1 for each country in the second part of this *Economic Survey*, which gives data on visible underemployment in the cases where information is available.

70 Multilateral Investment Fund, *Sending Money Home: An International Comparison of Remittance Markets,* Washington, D.C., 2003.

Figure II.39
LATIN AMERICA AND THE CARIBBEAN: VARIATIONS IN THE RATE OF INFLATION AND REAL WAGES, 2002[a]



Source: ECLAC, on the basis of official figures.
[a] Preliminary figures.
[b] Difference between average annual inflation rates in 2002 and 2001.

Figure II.39 shows that the correlation between variations in the inflation rate and variations in the real minimum wage is weaker than the equivalent relation between inflation and average wages. Nonetheless, the high correlation in both cases can be partly attributed to situations in Argentina, Uruguay and Venezuela, and, in the case of minimum wages, Ecuador. When these countries are excluded, the correlation between variations in inflation and variations in real minimum wages practically disappears, but it remains quite strong in the case of average wages.[71]

The fact that changes in inflation are less important to the trend of real minimum wages probably means that the inflation orientation used (past or future) is not the decisive factor in determining wage increases, or at least not the only factor (unless one argues that minimum wages are defined with greater prediction power than market wages). Moreover, the weak influence of the minimum wage on the average wage is shown by the lack of correlation between the two variables if Argentina, Uruguay and Venezuela are excluded from the calculation.

Although the goal of wage policy in some countries is to improve the purchasing power of workers receiving the minimum wage, other countries try to keep the real value of the minimum wage constant, or use it as a tool for reducing labour costs and/or combating inflation. In recent years, "conservative" policies of this kind have tended to prevail in the countries of the region. From 1990 to 2002, the median real minimum wage rose by just 1% on a cumulative basis, which means that these wages practically remained frozen (see table II.9). This policy orientation was even more predominant in 2002, when the median fell by 0.5% and the weighted average slipped by 0.7%.

(d) Employment and real wages in 2003

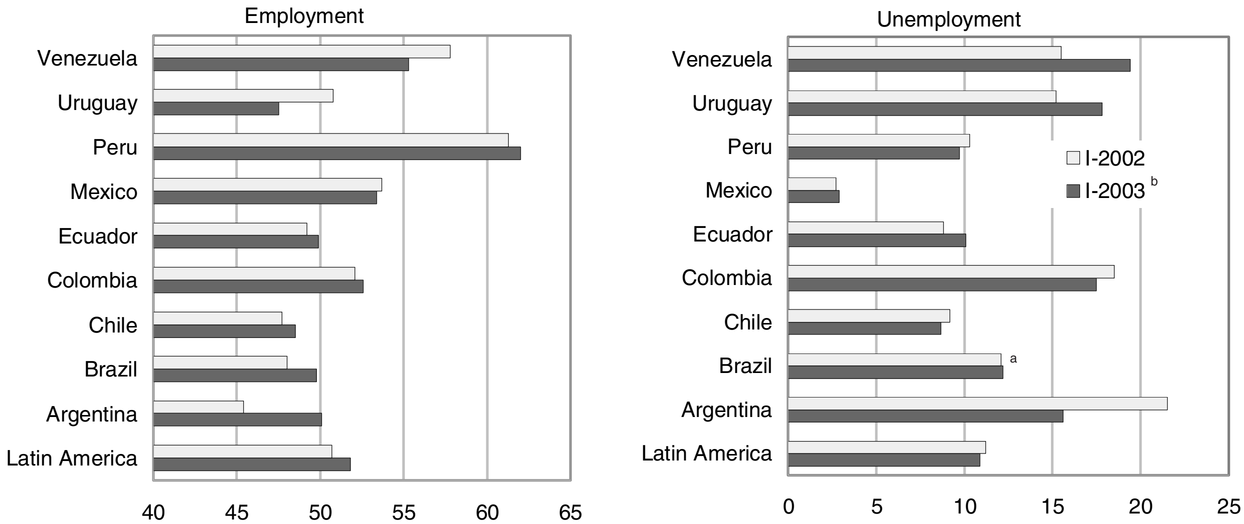
Early in the year, regional employment and unemployment indicators improved moderately, against a backdrop of still-sluggish economic growth, albeit with significant differences between individual countries (see figure II.40). The trend of the main indicators in the region's largest economies, Brazil and Mexico, and the meagre growth being projected for the second half of the year suggest that the regional labour-market situation is unlikely to improve significantly in 2003 overall.

71 A sharp change in the inflation rate is not always unforeseen; for example, in the case of the reduction in inflation in Ecuador in 2002, a larger percentage-point variation was factored into the forecasts. So, strictly speaking, the behaviour of real wages should be compared to the difference between predictions by agents, both public and private, as to the behaviour of prices and the measured behaviour of the CPI.

Figure II.40

LATIN AMERICA AND THE CARIBBEAN: EMPLOYMENT AND UNEMPLOYMENT RATES, 2002 AND 2003

(First half of each year)



Source: ECLAC, on the basis of official figures.
[a] Data from the new official country measurement.
[b] Preliminary figures.

In the first few months of 2003, formal-sector hiring in Brazil remained relatively buoyant, and at the aggregate level a comparison between the first halves of 2002 and 2003 shows significant employment growth.[72] Nonetheless, the momentum of job creation is fading because of high interest rates, compounded by erosion of the purchasing power of labour incomes, while exchange-rate appreciation is eating into the competitive advantages that tradable-goods-producing activities enjoyed throughout much of the past year and the early part of 2003. As a result, the unemployment rate rose continuously between December 2002 and June 2003. On the other hand, significant erosion of the real wage in a situation of persistently high inflation makes labour hiring cheaper and shifts relative prices in its favour, which could maintain the stimulus for formal job creation.

In Chile, practically all branches of economic activity reported employment growth in the early months of the year compared to the same period a year earlier. This showed that economic activity was strengthening on a widespread basis, and led to a moderate reduction in unemployment compared to the previous year. Nonetheless, businesses still remain cautious in their new hirings, and the year-on-year comparison shows that employment growth remains concentrated in own-account occupations.

Peru saw a continuation of the moderate expansion of formal employment that had begun late in the previous year, as this indicator rose by 1.9% over the first five months compared to the same period in 2002. Commerce is the most buoyant sector in employment terms, reflecting a revival of private consumption and modernization of the structure of retail trade. Aggregate job growth for both wage-earning and self-employed workers raised the employment rate slightly and reduced unemployment.

A modest revival in economic growth in Colombia also generated relatively favourable labour-market outcomes early in the year; employment grew as a result, and both underemployment and unemployment retreated despite remaining at historically high levels. In Ecuador, employment indices recovered slightly, but growth in the labour supply meant that the unemployment rate also rose.

72 The Brazilian Institute of Geography and Statistics (IBGE) introduced a methodological change in 2002 that makes it difficult to analyse the data, especially from a long-term historical perspective, but also in comparison to the previous year. In the case of Ecuador, there were also measurement changes that caused larger variations in certain variables. The data presented here should therefore be considered as preliminary.

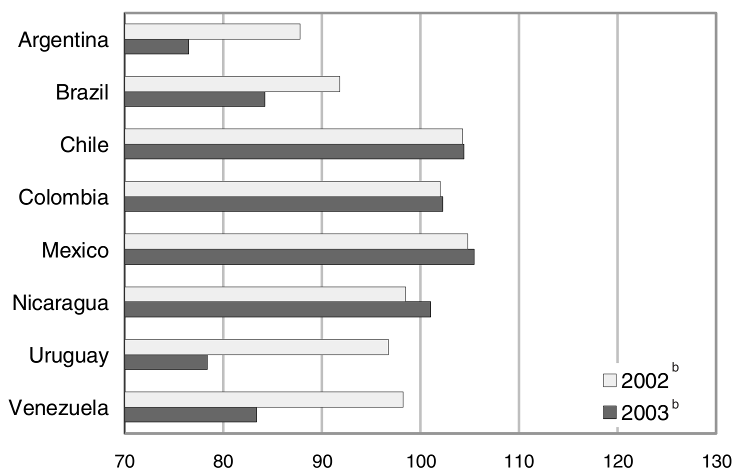
In Mexico, formal employment reached its lowest point in the first quarter of 2002. Since then, negative year-on-year rates have steadily decreased, and the first quarter of 2003 saw an increase of 0.7%. Nonetheless, in April formal employment slipped back once more, and jobs have tended to become more precarious, since most new hirings are based on temporary contracts. The revival of employment in the maquila sector has also been very weak, and the current import-export dynamic in this industry does not suggest active job creation in the coming months. Accordingly, in the first half of the year there was a moderate fall in the employment rate and a slight rise in unemployment. Given the country's economic growth projections, this situation is unlikely to improve in the second half of the year.

In Argentina, following a sharp previous reduction, formal employment began to grow as from the fourth quarter of 2002, and it has been registering positive year-on-year rates since March 2003. As a result of currency depreciation, new job creation has been concentrated mainly in manufacturing and agriculture, although employment in construction has also picked up. The tertiary sector, meanwhile, is still showing negative year-on-year rates. Thanks to the stabilization of formal employment and an expansion of jobs in the informal sector, supported by public employment programmes, the open unemployment rate fell significantly; real wages are also showing signs of stabilizing.

In contrast, the labour situation in Uruguay and Venezuela remained in a parlous state in early 2003. In Venezuela, employment and unemployment rates reflected the impact of the conflictive domestic situation, while in Uruguay the labour market showed signs of stabilization in the second quarter, echoing the slight upturn in economic activity.

Overall, the regional employment rate rose during the early months of 2003, while unemployment fell slightly. Given the lack of momentum in the Brazilian and Mexican economies, however, even these slight improvements could well peter out over the year as a whole, and economic recovery in Argentina is likely to provide the main positive stimulus.[73]

Figure II.41
REAL AVERAGE WAGES, 2002 AND 2003[a]
(First half of each year; indices 1995=100)



Source: ECLAC, on the basis of official figures.
[a] The figures refer to the January-May period, except for Colombia and Venezuela, where they correspond to January-March.
[b] Preliminary figures.

73 The regional employment rate is expected to rise considerably as an annual average. Nonetheless, this is due to its continuous increase in Brazil during 2002, measured using the new methodology applied in that country, whereby 2003 began with a relatively high level of employment.

Following several years of sluggish economic activity, growth in real average wages has practically come to a halt in all countries for which data are available (see figure II.41). In previous years, against a backdrop of falling inflation, the purchasing power of wages grew in several countries despite weak labour demand, either because nominal wages were rigid downward or because they were indexed on past or predicted future inflation. Data for the early months of 2003 suggest that this process has now come to an end. In the eight countries for which information is available, only Nicaragua saw real wages grow by more than 1%, while increases ranged between 0.2% and 0.7% in Chile, Colombia and Mexico, compared to the same period a year earlier. In Brazil, Uruguay and Venezuela, where inflation remains relatively high, the purchasing power of wages continued to decline. In Argentina, although the monthly trend is stabilizing, real wages still display a significant year-on-year deterioration.

D. External debt: recent trends

The build-up of external liabilities between 1989 and 1998, when there was easy access to international financial markets, followed by the drastic curtailment of financing since the crisis that broke out in the Russian Federation in mid-1998, has left several countries with major debt-service problems. The external debt of Latin America and the Caribbean rose from US$ 421 billion in 1989 to hit an all-time high of US$ 766.8 billion in 1998. Despite retrenchment since then, total external debt was still equivalent to about 190% of annual goods and services exports between 1999 and 2002 (see tables A-8 and A-19 of the statistical appendix). Starting in 1997, gross inflows of market borrowing from abroad began to diminish, and the US$ 120.6 billion registered that year had shrunk to US$ 45.3 billion by 2002. During the same period, net external financing flows from private sources –excluding FDI– slumped from a net inflow of US$ 46.2 billion to an outflow of US$ 8.1 billion.[74] Large volumes of inward FDI had offset the reduction in purely financial flows up to and including 2001, but the situation was different in 2002.[75]

The liberalization of domestic financial markets and the lifting of restrictions on residents' ability to move capital abroad have posed additional difficulties. Even in periods considered normal there has been a net outflow of resident-owned capital offsetting the inflow of non-resident capital; at times of crisis, this has intensified in size and seriousness.[76]

Circumstances where payment arrears or significant devaluations of local currencies are foreseeable can easily give rise to runs on the exchange rate and bank deposits, which, compounded by falling local property values, accentuate existing problems in meeting external debt service obligations. These crises could be referred to as "triplets", for they simultaneously affect the banking, exchange-rate and debt domains. They have thus grown from current-account crises –difficulties in financing deficits arising from trade, interest payments, profit remittances or a combination thereof– to become crises concentrated in the financing accounts, characterized by sudden large-scale U-turns in capital flows.[77]

While difficulties in discharging external liabilities have mainly affected governments, they have also made themselves felt in the private sector. Such problems have fuelled each other through devaluations, sometimes compounded by pre-existing problems in the domestic banking sector.

Furthermore, international financial institutions (specifically IMF) have reflected the attitude of the governments of the world's most economically powerful countries by becoming increasingly reluctant to continue

74 Gross flows from abroad are those that can be attributed to non-resident private agents and net inflows from abroad, after deducting amortization payments made during the period. See World Bank, *Global Development Finance*, Washington, D.C., April 2003, statistical appendix, table A.4.

75 Between 1997 and 2001 net FDI entering Latin America and the Caribbean averaged US$ 66.7 billion per year, whereas in 2002 the total barely reached US$ 39.0 billion.

76 In 1997, for example, the net outflow of capital from residents (including errors and omissions estimated in the balance of payments) rose to US$ 23.8 billion, equivalent to 1.2% of the GDP of Latin America and the Caribbean that year at market prices. In 1999 and 2002, such outflows represented 2.7% and 2.1% of the region's GDP, respectively. See World Bank, *Global Development Finance*, Washington, D.C., April 2003, statistical appendix, table A.25.

77 In situations of "good" equilibria, the financial market trusts in the potential of the country in question and continues to extend loans that enable it to refinance cumulative debt service, even though external deficits persist. In "bad" equilibria, investors lose faith in the country's capacity; not only do they stop lending, but capital tends to flee to safe havens abroad. The first case does not give rise to payment difficulties, but the second triggers a crisis. As for the possibility of multiple equilibria in this type of situation (some "good" and some "bad"), there is an abundant literature starting with Maurice Obstfeld's "Models of currency crises with self-fulfilling features", *NBER Working Paper* No. W5285, October 1995. These models were initially inspired by the crisis in the European Monetary System rather than crises that have affected developing countries. See also Graciela L Kaminsky and Carmen M. Reinhart, "The twin crises: the causes of banking and balance-of-payments problems", *American Economic Review*, vol. 89, No. 3, June 1999, pp. 473-500.

providing large volumes of funding at times of crisis, as happened in Mexico at the start of 1995, Brazil in late 1998 or some of the Asian countries in 1997 and 1998. Aside from the debate over whether or not such funding is justified, there is a growing consensus influencing government policy-making in some of the largest economies that "bail-outs" of this type distort the functioning of international financial markets by allowing investors and borrowers to evade the costs of their mistaken decisions (the moral hazard problem). It is also argued that international financial institutions lack the necessary funds to tackle these new crises, which are characterized, as mentioned above, by massive and sudden U-turns in capital movements.[78] Consequently, there has been insistence on the need to find mechanisms for resolving debt crises that limit public financial support as far as possible and, on the contrary, ensure major private-sector involvement in crisis resolution (PSI). This should not be limited merely to the provision of funding, but should also characterize the renegotiation process.

Against this backdrop of difficulty in refinancing a rapidly growing level of debt service, and reluctance among international financial institutions to keep extending massive loans, several developing countries have had to embark on far-reaching restructuring of their external liabilities. In some cases, this has involved voluntary rescheduling processes which normally do not involve any reduction in the net present value of the debt. The aim here has been to postpone principal repayments and reduce the volume of bonds currently circulating in the market in order to give greater liquidity to those issued at the time of restructuring. In other cases, concerted operations have been carried out including a "haircut" factor on the net present value of the debt, as happened in Ecuador in 1999 and is projected in Argentina following the moratorium declared in early 2002. Renegotiations have enabled debtors and creditors alike to gain experience and try out new negotiating strategies.

Meanwhile, in the international domain, both official and private, there has been discussion of new ways of averting and dealing with debt crises. A number of new approaches have been tried in 2003 in Latin America and the Caribbean, the most significant of which have been marked by two events: first, the incipient acceptance and application of collective action clauses (CACs) in contracts issuing external debt in the form of fixed-interest bonds; and second, the steps taken by Argentina and Uruguay to tackle their external debt problems.

1. Collective action clauses (CACs)

The inclusion of CACs in bond issuance contracts is one of the solutions proposed to tackle the specific difficulties arising in debt renegotiations involving bonds issued by governments and private firms. The complications involved in renegotiating this type of debt, which is held by investors dispersed among several countries, are very different from the problems of negotiations with bank creditors. First, the creditors involved usually have little interest in maintaining a permanent relationship with the country in question. Second, the bond issuance contracts do not call for payments made to an individual creditor to be shared among all creditors. Also, in general, and specifically under the legislation of the State of New York –where a large proportion of the bonds issued by Latin American and Caribbean countries are placed– any amendment of contractual clauses relating to debt service requires unanimous investor agreement. Such negotiations face an additional obstacle in that it is hard even to identify individual investors, let alone organize their representation as a group. Consequently, coordination between creditors tends to break down and often leads to individualistic behaviour. Some

78 Moral hazard in this domain would arise from the belief held by debtors and creditors alike that, in the event of debt-service problems, an international financial institution –especially IMF– can be relied upon to release funds to prevent losses among creditors and avert major policy "adjustments" by borrower governments; this faith in the possibility of bail-outs is likely to encourage creditors and debtors to take on excessive liabilities, which would end up triggering crises. Nonetheless, it has been argued that claims of moral hazard supposedly arising from expectations of IMF bail-outs have been greatly exaggerated: see Michael Mussa, *Reflections on Moral Hazard and Private Sector Involvement in the Resolution of Emerging Market Financial Crises*, presented at a seminar organized by the Bank of England (23-24 July 2002) on "The Role of the Official and Private Sectors in Resolving International Financial Crises". See also Timothy Lane and Steven Philips, "Moral Hazard: Does IMF Financing Encourage Imprudence by Borrowers and Lenders?", *IMF Economic Issues*, No. 28, Washington, D.C., 28 March 2002.

bondholders bide their time, waiting for the opportunity to collect the total amount owed, even though the vast majority may have accepted new conditions that are more favourable to debtors. The latter, on the other hand, recognize the risk of having to pay creditors that do not participate in the negotiations, and offer less than they might otherwise have done.

Following the Mexican crisis at the end of 1994, the search began for new crisis resolution mechanisms, in the belief that the existing formulas made it virtually impossible to leave bond debt renegotiation entirely to the market. One of the first proposals was to introduce CACs.[79] Initially it was claimed that the international market would not accept clauses of this type, but studies carried out in the ensuing years suggested that their use would not raise the cost of debt issuance by countries with good credit ratings. The purpose of CACs is to avoid some of the difficulties discussed above by establishing majorities empowered to amend the original payment clauses, distribute any payment obtained from the debtor among all participants and establish collective representation mechanisms for negotiations between the debtor and creditors. This type of clause did not gain immediate acceptance, and in the meantime several cases of external debt problems occurred in developing countries, where it proved possible to achieve restructuring without using the CAC mechanism. Such experiences fuelled outright opposition in financial circles to any innovation in procedures for renegotiating non-performing debts, on the grounds that the market itself was capable of overcoming creditor-coordination problems and the other difficulties mentioned.

In November 2001 IMF proposed the sovereign debt restructuring mechanism (SDRM), a formula for renegotiating public debts similar to the rules for convening creditors and bankruptcy proceedings contained in the domestic legislation of many countries. As this proposal was welcomed in government circles, the International Monetary and Financial Committee recommended that IMF should study both initiatives: CACs and SDRM. Financial-market representatives were flatly opposed to the latter, however, so the governments of the economically more powerful countries (particularly the United States) began to swing behind CACs. International investor circles, which also had initially opposed these clauses, ended up accepting them in mid-2002, and by late January 2003 they had formulated a complete proposal for modifying bond issue contracts, stressing creditors' rights. Accordingly, the International Monetary and Financial Committee decided to stop endorsing SDRM at its April 2003 meeting.

Given these new circumstances, Brazil, Mexico and Uruguay all included CACs in their debt issues or renegotiations in 2003. In each case, the markets absorbed the issues and tended to favour them in comparison to others that did not contain such clauses. Mexico used only "qualified majority clauses" set at 75%, to alter arrangements for the repayment of amounts due.[80] Nonetheless, it also accepted alteration of the usual terms in bond issues that would make future renegotiations less favourable to the borrower. In these issues it was established that matters relating to the legislation governing contracts, jurisdiction and waiver of sovereign immunity required a unanimous vote by the creditors. As a result, "exit consents or amendments" could no longer be applied to those clauses, although they proved extremely useful in reaching an agreement in the renegotiation of Ecuador's sovereign debt.[81]

79 One of the earliest proposals for using CACs can be found in Barry Eichengreen and Richard Portes, *Crisis? What Crisis? Orderly Workouts for Sovereign Debtors*, Centre for Economic Policy Research (CEPR), London, 1995. In the official domain, inclusion of these clauses was first raised in the Rey Report: Group of Ten, *The resolution of sovereign liquidity crises. A report to the ministers and governors prepared under the auspices of the Deputies*, May 1996.

80 There is consensus that the indebted governments or entities under their jurisdiction should not have a vote in such cases. Nonetheless, certain sectors of the financial market have begun to argue that institutions subject to regulatory bodies, such as banks and pension funds, also should not have votes. Application of this approach to the case of Argentina or Turkey would place voting power in the hands of a small minority of creditors.

81 "Exit consents" are used to amend clauses not requiring unanimous agreement and make "old" bonds surrendered in exchange for "new" ones less attractive. Once the majority in favour of restructuring has been obtained, and before carrying out the swap for the new securities, bondholders are asked to "consent" to amendment of such clauses. This encourages the minority to participate in the renegotiation, since by opting out they would be left holding a security of inferior quality. These "exit consents" are used very frequently in renegotiations in the private domain, in the United States for example, for the same purpose of forcing recalcitrant creditors to accept a restructuring.

2. The cases of Argentina and Uruguay

In the last two years Argentina and Uruguay have represented two extreme cases of debt crisis in Latin America. Argentina defaulted on a large proportion of its domestic sovereign obligations, while the government of Uruguay succeeded in agreeing on a massive debt swap without any reduction in net present value, but with a significant postponement of principal repayment.

(a) Argentina

In early 2002, the government of Argentina declared default on a large portion of its domestic and external debt. The process that led to this situation had its roots in circumstances that had been accumulating steadily throughout the 1990s at least. As regards the external and public debts, the final crisis was preceded by three attempts to find a solution: "armour-plating" in late 2000, a "mega-swap" in mid-2001 and "phase 1" of public debt restructuring in late 2001.

In the second quarter of 1998, the Argentine economy slid into a lengthy downswing, accompanied by rising unemployment and price deflation, under a currency-board foreign-exchange regime. Although recession combined with deflation helped to improve the current account of the balance of payments, it undermined the primary fiscal result, which was further aggravated by high prevailing international interest rates and an increased country-risk rating. The external and public debts both continued expanding. By late 2001, Argentina's external debt had risen to US$ 140.273 billion, of which US$ 88.259 billion was owed by the non-financial private sector. Total public-sector debt amounted to US$ 144.453 billion, just 2.7% of which was denominated in local currency. Expressed in terms of that year's prices, the external and public debts represented 52% and 54% of GDP respectively.

A peculiarity of Argentina's external and public debt was the large share of multilateral financial institutions in both cases, particularly IMF, an organization reputed to reject restructuring of its loans. Another distinctive feature was the fact that a large proportion of the public debt was held in local bank portfolios, where it ended up representing nearly a quarter of all loans. Lastly, dollarization of the banking system, in terms of loans and deposits alike, was extremely high and still rising.

In fact, the major surge in borrowing from international financial institutions had occurred in 2001, when such liabilities had suddenly expanded by over US$ 10 billion as a result of a major operation with IMF. In the second half of 2000, the private international financial market had been practically closed to Argentina, so additional support from international financial institutions had become necessary. This was the so-called "armour-plating" that extended large quantities of official financing to save Argentina from having to appeal to the market in 2001. The total amount involved was US$ 39.7 billion, equivalent to 15% of GDP, with a disbursement of US$ 23.3 billion scheduled for 2001 –12.5% less than total projected financing needs for that year. Nonetheless, the only really assured sums covered barely a third of the public sector's financing needs for 2001.

Having achieved this "armour-plating", Argentina saw its country risk decline slightly for a period of two or three months, before it returned to its pre-operation levels in March, when the fiscal-deficit target agreed with IMF for the first quarter was missed. In February heavy withdrawals of bank deposits and international reserves began to occur, and the government suspended the issuance of treasury bills and bonds owing to a lack of buyers.

In these circumstances, a new arrangement was negotiated with IMF and a massive swap offer was launched, known locally as the "megacanje" or mega-swap. This aimed to defer interest and amortization payments and to reduce both the number and the variety of issuance conditions. The new programme did not alter the figures contained in the "armour-plating" and, although compliance with the first-quarter fiscal deficit target was waived, the target for 2001 was maintained. The mega-swap involved US$ 65.137 billion in bonds that could be presented for voluntary swap. Eventually, bonds totalling US$ 32.818 billion were presented –compared to the US$ 20 billion originally anticipated– and US$ 29.494 billion were accepted. The face value of the newly issued bonds was US$ 30.401 billion, which meant an increase of US$ 2.255 billion in the par value of the public debt compared to the technical residual value of the bonds redeemed. As a result of the operation Argentina gained significant relief for its immediate financing needs and also for subsequent years. In return, it had to accept high yields of close to 15% per year; it agreed to pay significant premiums on market values; and, starting in 2004, the coupons on medium-term "Global 2008" bonds would be raised substantially. The operation was perceived at the time as successful in overcoming immediate problems, given the circumstances, but it left serious questions in its wake that will need to be resolved in the relatively near future.

Despite the appreciable (US$ 4.59 billion) reduction in borrowing requirements for the subsequent year (2002), and even assuming that the funds committed by international financial institutions in the "armour-plating" framework would be disbursed within the expected deadlines, an additional US$ 15 billion was still needed. Release of the "armour-plating" funds, which were essential to meet financing requirements even during the remainder of 2001, also depended on compliance with increasingly ambitious fiscal-deficit targets, which were likely to be hard to achieve in a recessionary setting. In July, the government adopted a zero-deficit rule and had its standby credit arrangement with IMF raised by US$ 8 billion: US$ 5 billion available for immediate release and the remainder reserved to support a "voluntary and market-based operation to increase the viability of Argentina's debt profile".

In the ensuing months a third attempt was made to solve the debt problem, as recession deepened and both deposit and international-reserve losses intensified. In October 2001 the government declared its willingness to negotiate a restructuring of its public debt, and a few days later it announced its intention to split this into two phases. Phase 1 would be restricted to local debt holders, while phase 2 would include foreign creditors. In November the government agreed on a public-debt restructuring with local investors amounting to nearly US$ 58 billion. Of this, US$ 42 billion in national government bonds held by banks and retirement and pension fund managers (AFJPs) was converted into collateralized loans, and US$ 16 billion of provincial debt denominated in pesos and dollars was converted into new long-term domestic government bonds in pesos.[82] Days later, IMF concluded that since the country had failed to meet the agreed fiscal-deficit targets, it could not approve the review of the existing arrangement and would not release the remaining US$ 1.3 billion as scheduled. Consequently, the arrangement with IMF was suspended and was not renewed until early 2003.

In early 2002, under a new economic affairs minister and then a new President, the government decided to default on the public debt that had not been covered by phase 1. This was followed by abandonment of the fixed exchange rate. Peso devaluation then drove the ratio between public external and domestic debt (almost all of which was issued in foreign currency) and GDP, and between this debt and fiscal receipts, to such high levels that the government decided to convert the "collateralized loans" into pesos. These "pesified" loans, along with new National State Optional Bonds (BODENs) issued subsequently to compensate the banks for the mismatch caused by the asymmetry of the "pesification" process, as well as existing debts with international financial institutions, totalling US$ 96.0 billion altogether, are not in arrears. On the other hand, the remainder of the public debt, which by late 2003 is projected to stand at US$ 76.701 billion including overdue interest, is past its due date. Most of this debt consists of bonds issued under international laws and dispersed among hundreds of thousands of individual investors. The bulk of the private external debt of the non-financial sector (just over US$ 35.2 billion by late 2001) out of a total institutionalized debt with residents and non-residents approaching US$ 47.0 billion, is in a default situation, as is a significant proportion of domestic private-sector debt, which in addition is subject to litigation to contest its "pesification".

Although restructuring is fraught with difficulties under these conditions, most debt-holders have sought to associate and are trying to negotiate with the State without recourse to the justice system. The government has insisted that it intends to pay, but that it will ask for grace periods, together with longer amortization terms and reductions in interest rates and/or principal. It has also welcomed the idea of issuing bonds indexed to GDP. In addition, it made a public commitment to present a general outline for a debt-restructuring proposal at the annual IMF-World Bank meetings, held in September 2003 in Dubai, United Arab Emirates, and it has held conversations with individual and institutional bondholders with a view to setting up advisory committees.

(b) Uruguay

The Uruguayan economy grew at an average annual rate of 3.9% between 1990 and 1998 (except in 1995). During that period, the overall public-sector deficit shrank to an average of 1.2% of GDP and the country achieved "investment grade" rating. Following the establishment of MERCOSUR, Uruguay's goods exports were increasingly sent to the region's two largest markets. However, the reorientation of foreign trade towards Argentina, compounded by a reliance on tourism from that country and the large volume of deposits held by Argentine residents in the Uruguayan banking system, made the country more vulnerable to events in its neighbour's economy.

82 "Collateralized loans" offered two advantages: first, as they were loans rather than bonds, the financial institutions holding them were not required to value them at market prices, and thus avoided having to recognize the devaluation they had suffered; and second, their service was guaranteed through the imposition of a tax on banking operations that was collected by those same institutions.

The economic situation in Uruguay began to deteriorate rapidly as from 1998: GDP registered a cumulative reduction of 18% between 1998 and 2002, and foreign-currency-denominated public debt grew from 59% of GDP in 1999 to 78% in 2001. Free flotation of the peso as from mid-2002 pushed this ratio above 100%. Meanwhile, contagion from the Argentine crisis spread to the banking system in Uruguay, which saw nearly half of its deposits drain away. In early 2002, Uruguay's public debt lost its "investment grade" rating, and country risk soared.

The government tried to ride out the crisis without defaulting on its commitments or renouncing its obligations to the banks, which were overwhelmingly denominated in foreign currency. By mid-2002 systemic difficulties began to be overcome through the rescheduling of maturities with official banks, while the problems of closed banks and public-sector obligations were put on hold.

In order to solve the banking-sector and public-debt problems, an enormous financing package was negotiated and obtained from IMF and multilateral development banks. Funds provided by IMF between March 2002 and 2003 represented more than 20% of Uruguay's GDP. In late 2002, the public-sector debt was estimated at US$ 10.797 billion, of which US$ 5.804 billion (59% of GDP) represented "market-based" debt; 65.2% was held by residents and just under 5% was denominated in local currency. The due dates on the corresponding bonds varied widely, from just a few weeks to 2027.

In early 2003, the government decided to attempt a voluntary public-debt swap operation to reduce the quantity of bonds maturing that year and into the future. The announcement of the swap proposal on 14 April covered a total of US$ 5.350 billion. In the case of a bond issue offered in Japan, equivalent to US$ 250 million and subject to CACs, an attempt was made to amend the original conditions of issue with the consent of the bondholders. In the other cases, encompassing 46 domestic bonds totalling US$ 1.6 billion and 18 bonds issued abroad for a total of US$ 3.5 billion, the offer was to exchange them virtually at par. For this purpose two new alternatives were proposed: "maturity extension bonds" and "benchmark bonds". The first involved extending the expiry date of the bond surrendered in the swap for a further five years, without altering its other terms, and was aimed fundamentally at individual holders. The second alternative, targeting institutional investors, offered a smaller set of new bonds, thus affording greater liquidity at longer maturities and rising interest rates. In addition, bonds paying a coupon of 7.875% and maturing in 2003 received a cash payment.

The Government of Uruguay made every effort, both before and after formalizing the offer, to maintain a highly active and cordial dialogue with its creditors. It also pointed out that if rescheduling were to fail, the country would very soon be forced to default. Nevertheless, existing debt service was maintained throughout the negotiation period. Also, to discourage recalcitrant bondholders, it was made clear that the new bonds would take precedence over earlier ones in terms of servicing. Exit consents were also used, as in the Ecuadorian case, whereby a majority of holders were able to alter the terms of the "old" securities in order to make them less attractive. Lastly, to avoid possible payment embargoes on holders of the "new" bonds, a trusteeship structure was designed instead of the usual "fiscal agent" scheme. The "new" bonds were also issued with collective action clauses that included an innovative "aggregation" clause whereby the minimum 75% majority required to alter payment terms on each individual bond could be reduced to two thirds, if 85% or more of the bondholders wishing to amend the terms accepted the changes. This was an attempt to prevent investor groupings holding 25% or more of a specific bond issue from being able to block renegotiation. In addition to what had already been accepted by Mexico, Uruguay agreed to tighten up on certain aspects of the new bonds. Unanimity was required to amend the waiver of sovereign immunity, applicable legislation and jurisdiction, and if "exit consents" were used in future debt swaps the new clauses could not be less favourable to the holders than the previous ones. Moreover, individuals accepting the swap could not be issued new bonds that would dilute the value of pre-existing holdings by making the debt even larger. This will make it much harder to use exit consents in future renegotiations (which, as mentioned above, have proved highly effective for borrowers).

Since a high level of participation was required for the swap to be successful and substantially reduce financing requirements, the offer was made contingent on the participation of 90% of bondholders, including 90% of those whose bonds were scheduled to expire before 2008. If the level of participation represented between 80% and 90% of the total debt, and not just the eligible securities, the government reserved the right to go ahead with the operation.

In fact, bondholders participating in the swap did represent 90% of total eligible debt, and the operation made it possible to reduce principal repayments on medium- and long-term bonds. For 2003, amortization payments fell from US$ 469 million to just US$ 23 million, and for the period 2003-2007 payments will decrease from US$ 2.1 billion to US$ 300 million. As a result, the debt/GDP ratio should fall steadily towards a level of 60%. Although no reduction in the face value of the bonds was requested, the original coupons were preserved; but as these now represent below-market yields, many analysts consider the net present value of the debt to have been reduced.

The successful reprofiling of Uruguay's public debt was assisted by a favourable trend in interest rates on developing-country bond issues and by the fact that until recently the country's debt had been rated "investment grade", which meant that interest rates on its bonds already in circulation were relatively low. Nonetheless, the ultimate success of the operation will depend on whether the government achieves a significant increase in its primary surplus, for which targets have been set of 3.2% of GDP in 2003, 3.3% in the biennium 2004-2005 and 4% in the medium term.

3. Conclusions

The sudden drying-up of external financing flows and the high level of debt presage difficulties in meeting external debt service obligations, which have already come to the surface in some countries. Also, contrary to beliefs held until recently, it has been found that it is not impossible to restructure bond debt, or even in some cases to obtain face-value reductions; the international financial market also, in practice, accepts collective action clauses, despite the continued opposition expressed by some organizations representing sectors of that market.

Nonetheless, doubts persist as to whether experiences thus far can be generalized. As regards the use of CACs to solve problems generated by debt crises involving dispersed creditors, two types of difficulties arise. An initial practical problem is that most of the bonds in circulation do not have CACs, so the success achieved in the few countries that have issued bonds which include them might not be replicable elsewhere, at least not without higher costs. Paradoxically, the countries whose debts are least in need of restructuring are likely to obtain the most flexible contracts, while those most likely to encounter problems will probably gain the least in terms of market concessions.

The second problem is the question of whether the inclusion of this type of clause will be enough to ensure successful negotiations, which many people doubt. Several studies have argued that, in a world of incomplete information, coordination problems among creditors (leading to "strategic" behaviour whereby creditors define a negotiating strategy based not only on their own information, but also on assumptions about the behaviour of the other participants) cannot be solved by the market even with assistance from CACs. In such conditions, the only possible solution would be intervention by a third party such as a bankruptcy court; this implies a sovereign debt restructuring mechanism. Although the fact that some negotiations have been concluded without CACs seems to belie this need, the disadvantages of excessively lengthy negotiations for all participants suggest the opposite. The fact is that the endless preliminary discussions of the 1980s were ultimately mostly resolved through third-party intervention in the Brady Plan framework.

Moreover, following the withdrawal of the SDRM proposal, institutions representing the financial market have refloated an idea once promoted by Banque de France, which consists of designing a code of conduct to govern relationships between creditors and debtors in emerging markets. Some analysts see this as a way of reintroducing the proposal for that mechanism; others consider it a means of ensuring that official institutions participate in debt restructuring on an equal footing with the private sector. This would be tantamount to an initiative for public-sector participation in crisis resolution, as a counterpart to the proposal on private-sector participation put forward by the Group of Seven a few years ago.

In terms of the potential of restructuring operations in the future, a number of additional points need to be considered. First, the operations that were successful in the past had massive support in the form of funding from international financial institutions, but the political backing needed for this is lacking today. Second, if the current international financing shortage persists, it is quite possible that mere postponement of expiry dates will store up problems for the not-too-distant future. Third, the fiscal effort required to sustain the new debt profiles is still very onerous. This could impair growth and detract from efforts to address social needs, without regaining the international financial market access needed to lighten the burden of external debt service and make additional resources available for development.

Chapter III

Development banks and production financing

Introduction

The financing of productive activity requires that policies for increasing national saving be complemented with measures to ensure that these resources are actually allocated to investors in the production sector. An effective financial system should efficiently channel savings into investment and technological innovation and should make those funds more accessible to the different agents of production.

In general, the financial systems of the Latin American and Caribbean countries are not well developed. Although they have undergone major structural changes in the last few years, they have yet to create deeper, more stable financial markets. The banking crises that have broken out in a number of countries in the region have shown that the health of these systems depends not only on macroeconomic stability, but also on regulatory and prudential supervision mechanisms that guarantee adequate levels of solvency and liquidity on the part of financial intermediaries. Also needed are explicit policies and instruments to promote long-term financing and facilitate access to the financial system for sectors that have traditionally been excluded.

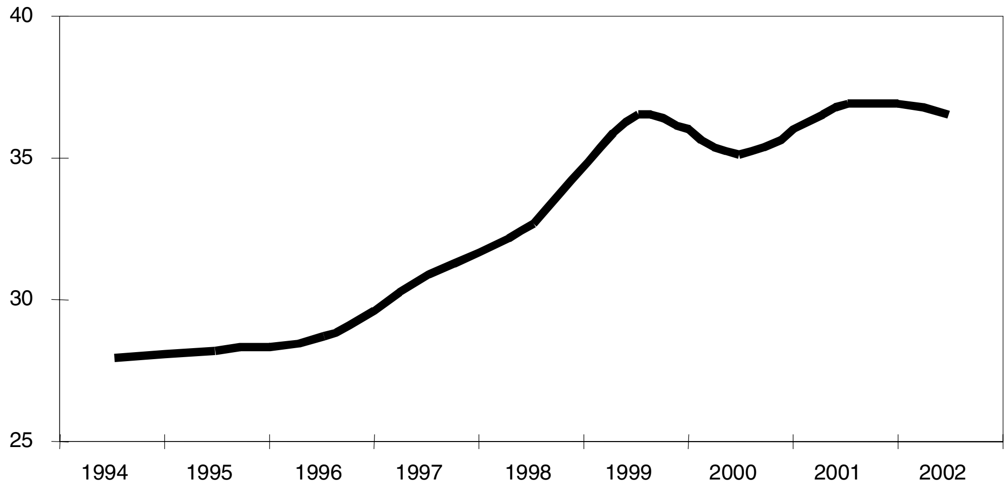
Latin America's financial markets are dominated by banks and its capital markets are poorly developed. Private bank financing tends to focus on short-term loans, interest-rate spreads are high and credit is conspicuously geared to large corporations, leaving small and medium-sized enterprises largely ignored.

This chapter will briefly examine the development of the financial system in the region and will analyse the role of development banks in financial intermediation for productive development and in the promotion of capital markets, particularly the securities market.

1. Recent financial developments

Although the region's financial systems have deepened in the last few years (as measured by the M3-to-GDP ratio), in comparison to the developed economies their capital markets are still underdeveloped and bank credit remains low as a proportion of GDP.[1]

Figure III.1
LATIN AMERICA AND THE CARIBBEAN: M3
(Percentage of GDP)



Source: ECLAC, on the basis of figures provided by central banks in the region.

In the 1980s and 1990s capital market deficiencies and low levels of development banking activity exacerbated the problem of long-term financing and held back economic expansion.[2] In a number of countries the creation of long-term financial instruments is still incipient and has taken place mainly in the bond market, the venture capital industry, investment and guarantee funds, loan insurance and derivatives markets.

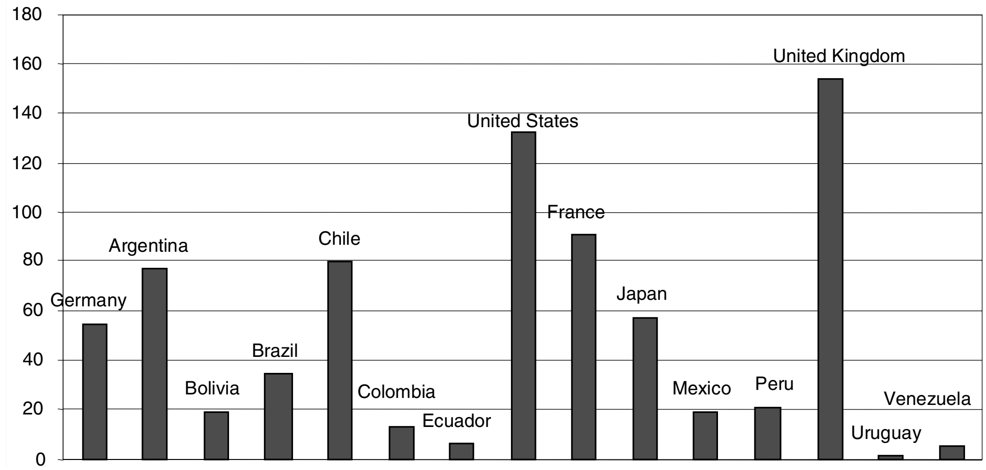
One indicator that is commonly used to measure the depth of the capital market is the stock market capitalization-to-GDP ratio. Figure III.2 shows that, in the period 2000-2002, the value of this ratio in the countries of the region was well below the figures recorded in the developed countries, where the stock market evidently plays a larger role in financing production.[3]

1 M3 includes cash in circulation, sight deposits, local-currency time deposits and foreign-currency deposits. It is a good indicator of an economy's liquidity, especially in countries that have become significantly dollarized without having adopted the dollar as legal tender.

2 See Latin American Association of Development Financing Institutions (ALIDE), "Líneas y programas de crédito para las micro, pequeñas y medianas empresas", *Boletín ALIDE*, Programa de Estudios Económicos e Información, General Secretariat of ALIDE, October-December 2002, and "Finanzas para el desarrollo: nuevas soluciones para viejos problemas", May-June 2003.

3 Stock market capitalization is the aggregate obtained by multiplying the number of shares of listed firms by their current market value.

Figure III.2
STOCK MARKET CAPITALIZATION/GDP, 2000-2002
(Percentages)



Source: ECLAC, on the basis of data from Standard & Poor's and IMF, *International Financial Statistics*, Washington, D.C.

Strikingly, the region's average stock market capitalization-to-GDP ratio was lower in 2000-2002 than it had been in the period 1991-1999. This variable rose in the developed countries (except Japan), even though stock prices dropped, while data for 10 Latin American economies show that the region's stock markets have been adversely affected. In most of the countries, especially the less developed ones, the economy is dominated by family businesses financed primarily from their own resources and undistributed earnings. Moreover, as shown in table III.1, the number of firms that finance their investments through the issue and sale of shares has actually declined. In addition, some countries lack suitable regulations to address the risks associated with transparency problems and to protect the rights of minority shareholders in the management of open companies.

Table III.1
LATIN AMERICA AND THE CARIBBEAN: STOCK MARKET-LISTED COMPANIES

	1996	1997	1998	1999	2000	2001	2002
Total	**1 723**	**1 810**	**1 763**	**1 654**	**1 494**	**1 349**	**1 281**
Argentina	147	136	130	129	127	111	83
Brazil	851	536	527	478	459	428	399
Chile	283	295	287	285	258	249	254
Colombia	189	189	163	145	126	123	114
Ecuador	42	41	37	28	30	-	-
Mexico	193	198	194	188	179	168	170
Paraguay	-	60	55	55	-	-	-
Peru	231	248	257	242	230	207	202
Uruguay	-	16	19	17	-	-	-
Venezuela	87	91	94	87	85	63	59

Source: ECLAC, on the basis of figures from Standard & Poor's and IMF.

Table III.2
LATIN AMERICA AND THE CARIBBEAN: BANK CREDIT TO THE PRIVATE SECTOR/GDP
(Percentages)

	1997	1998	1999	2000	2001	2002[b]	1994-1999	2000-2002
Argentina	19.8	22.3	24.4	23.4	22.3	16.3	20.5	20.7
Bolivia	45.5	49.8	55.1	52.4	47.8	44.0	46.9	48.1
Brazil	27.0	29.7	30.6	27.2	27.9	27.5	29.0	27.5
Chile	54.4	57.7	59.1	63.3	65.0	66.7	52.2	65.0
Colombia	17.5	20.7	21.2	18.3	18.3	19.2	17.4	18.6
Ecuador	25.2	30.4	36.8	30.1	28.6	23.5	26.0	27.4
Mexico	14.5	16.5	14.5	11.8	10.3	9.6	19.8	10.5
Paraguay	23.4	23.7	22.5	21.4	22.4	22.4	21.5	22.1
Peru	20.8	25.3	27.4	25.6	24.6	23.2	19.1	24.5
Uruguay	24.3	29.7	47.0	50.4	51.8	60.5	27.2	54.2
Venezuela	8.2	10.7	9.6	8.8	9.8	9.5	8.6	9.4
Average Latin America	**25.5**	**28.8**	**31.7**	**30.2**	**29.9**	**29.3**	**26.2**	**29.8**
Average developed countries[a]	**92.1**	**93.4**	**95.0**	**98.2**	**101.6**	**105.4**	**91.7**	**101.7**

Source: ECLAC, on the basis of figures from IMF.
[a] Developed countries include France, Germany, Japan, United Kingdom and United States.
[b] Preliminary figures.

Another trait of domestic financial systems is that they are based on banking activity. Bank credit to the private sector as a percentage of GDP continues to be low in the region, however, in comparison with international standards. This indicator has followed different trends in different countries; since 2000 the regional average has stabilized at around 30% of GDP, but the average for developed countries exceeds 100%.

By the same token, bank interest-rate spreads, measured as the difference between lending and deposit rates, are well in excess of the spreads seen in OECD and Asian countries (see table III.3). Wide interest-rate spreads hurt the production sector's competitiveness by raising the cost of financing.

Table III.3
BANK SPREADS[a]

	1997	1998	1999	2000	2001	2002[b]	1997-2002
Latin America[c]	13.3	12.3	11.4	11.3	10.4	10.8	11.6
OECD (simple average)	3.4	3.4	3.0	3.1	3.1	3.2	3.2
Asia (simple average)	2.5	1.5	2.9	3.1	3.3	3.6	2.8

Source: ECLAC, on the basis of figures from IMF.
[a] The bank spread is the difference between lending and deposit rates.
[b] Preliminary figures.
[c] Weighted average for Argentina, Bolivia, Brazil, Chile, Colombia, Costa Rica, Ecuador, Guatemala, Honduras, Mexico, Panama, Paraguay, Peru, Uruguay and Venezuela.

In addition to the considerations outlined above, the supply of credit, which is mainly short-term, is poorly suited to the borrowing needs of firms, which tend to be long-term. This forces firms to take out short-term loans to finance their long-term investments, thus heightening the vulnerability of the production sector and, indirectly, of the financial sector itself.

The Latin American and Caribbean countries suffered a string of severe financial crises in the 1990s. Thirteen countries encountered serious bank solvency problems. In general, these crises were set off by two sets of factors. First, financial regulation and oversight were weakened by deficient risk management, inadequate regulations on capital and loan-loss provisions and the presence of explicit or implicit State guarantees on deposits and other obligations.[4] Second, distortions in relative prices and highly volatile macroeconomic activity impacted negatively on the financial system.

If the financial system is to play its role as an intermediary –in other words, to channel resources to the production sector without compromising financial and macroeconomic stability– it needs, among other things, an appropriate public regulatory and oversight policy that requires intermediaries to maintain a suitable balance between portfolio risks and returns and safeguards the solvency and stability of the system. Regulation should serve to effectively avert systemic risks and contribute to the smooth operation of the payment chain. This means protecting the property rights of savers. Otherwise, national saving will diminish and production financing will suffer.

Most of the countries in the region have now adopted the banking regulation standards set out in the 1988 Basle Accord.[5] The Accord centres the assessment of credit risk on individual loans, without considering the benefits of diversifying loan portfolios by type of activity or geographical area. It thus encourages a heavier concentration of bank credit and magnifies the bias against applicants that carry a higher relative risk. The larger the role of the banking sector within the financial system and the more its share of the market exceeds the international average, the more strongly financial intermediation is influenced by standards of bank credit regulation.[6] Managing portfolio risk at the individual level significantly increases or decreases the capital and reserve requirements for lending to worse- or better-rated borrowers, as the case may be. This raises the cost of financial intermediation for applicants rated as more risky and deepens the segmentation of the credit market.

The concentration of credit and the fact that many productive activities have limited access to banking services also reflect other traits of the financial market, such as asymmetric information and financial intermediation costs, which hinder proper risk management and resource channelling.

2. The development banking system

This section examines the role that the development banking system can and should play in improving the access of different production sectors to financial intermediation, in the framework of standards of regulation and prudential supervision that guarantee the stability and solvency of the financial institutions concerned. It also looks at development banks' potential role in creating markets for long-term financing and in expanding the capital market by addressing unmet needs.

The existence of public development banks is justified by market failures, asymmetric information and the endogenous segmentation of credit. Public banks play a role in financing production even in developed

4 See Günther Held, "Liberalization or financial development?", *CEPAL Review*, No. 54 (LC/G.1845-P), Santiago, Chile, December 1994.

5 The original Basle Accord of 1988; established a capital to risk-weighted assets ratio of 8%, which in practice meant that banks could lend up to 12 times the amount of their capital. This considered only reserves of capital to cover the banks' loan portfolio risk, however, not the market risk of their portfolios of tradable assets.

6 A number of criticisms have been levelled at the Basle Accord, one of which is that it restricts bank lending capacity by applying a standard rather than a domestic criterion for risk classification. In particular, under Basle 1998, the value at risk is calculated for a 10-day time horizon and a 99% one-tailed confidence level, which in practice translates into a multiplier of 3 for regulatory capital, given risk-weighted assets. The ECLAC publication *Equity, development and citizenship* (LC/G.2071(SES.28/3)), Santiago, Chile, March 2000, called for the establishment of regulations that take a countercyclical approach to bank portfolio risk, which means increasing reserves during boom periods and easing capital requirements when economic activity turns more sluggish.

countries that have deep financial systems.[7] As mentioned above, the Latin American and Caribbean countries, with few exceptions, have small and relatively unsophisticated financial markets and fewer financial intermediation instruments than the developed countries. Financing is highly concentrated in short-term instruments, especially in economies that have experienced repeated bouts of high inflation. Credit markets are segmented, with the result that access to credit is limited for small and medium-sized enterprises (SMEs), small-scale farm owners and young people who have innovative projects but no credit history. In addition, the Latin American financial system, like the European one, relies heavily on bank lending. Other forms of financing, such as the stock market, are little used.

This means that public development banks –with new operating procedures and corporate-style management– have the potential to play a major role in productive development, either by facilitating access to financing for sectors previously excluded from the process or as catalysts and vehicles for new forms of financial intermediation.

(a) Purposes and principles of development banking

The concept of development banking covers a broad range of institutions at the global, regional and subregional levels (see box III.1). While this chapter focuses mainly on banks at the national level, multilateral development banks have performed well at the regional and subregional levels.

Box III.1
DEVELOPMENT BANKING

Financial institutions for development encompass a wide variety of organizations operating at the global, regional, subregional and national levels. Although each has its own specific features and operating procedures, to a greater or lesser degree they all work to promote economic and social development by mobilizing financial resources, building technical and institutional capacity and knowledge bases and providing global, regional or national public goods, as the case may be. Multilateral development banks normally operate in a large number of countries. They have the capacity to raise funds on international financial markets, which they then lend to member countries on easier terms than those available in private financial markets. They also mobilize resources from official sources and channel them to beneficiary countries.

The International Bank for Reconstruction and Development or World Bank operates at the global level, although it also conducts regional operations). Within Latin America and the Caribbean, the Inter-American Development Bank (IDB) is a regional-level institution. The Central American Bank for Economic Integration (CABEI), the Caribbean Development Bank (CDB), the Andean Development Corporation (ADC), the Financial Fund for the Development of the River Plate Basin (FONPLATA), the Latin American Export Bank (BLADEX) and the North American Development Bank (NADB) are all subregional institutions.

National or local development banks operate at the country level. Their main objective is to promote productive development through technical assistance and the intermediation of financial resources from the State, multilateral banks and the private financial system. Their activities target sectors that normally have difficulty in gaining access to the private financial market, namely SMEs, the agricultural sector, environmental projects and activities related to technological innovation.

Since its founding in 1959, the Inter-American Development Bank (IDB) has been a major driver of economic and social development in the region. It has become a significant source of financing, channelling resources to productive and social sectors.

Throughout the 1990s the Inter-American Investment Corporation, the Multilateral Investment Fund and the IDB Private Sector Department facilitated access to external financing for the countries of the region. The IDB Private Sector Department offers partial risk and loan guarantees in order to attract private investors. Risk guarantees cover loans in relation to specific political risks, such as government contractual obligations and monetary convertibility or transferability. Loan guarantees cover part of the funds lent by private sources and, in practice, convert medium-term loans into longer-term operations. By way of example, in 1997 a project to treat waste water from the Bogotá River was

7 See Joseph Stiglitz and A. Weiss, "Credit rationing in markets with imperfect information", *American Economic Review*, vol. 71, No. 3, 1981, and Joseph Stiglitz, *The Role of the State in Financial Markets*, World Bank, 1993.

the first of this type to be funded with resources raised on the international private capital market, thanks to the guarantees furnished by IDB. Since it came into existence six years ago, the Private Sector Department has co-financed projects worth US$ 12.7 billion, of which IDB has contributed US$ 2.1 billion directly. This represents 51 investment projects in 14 countries. The Inter-American Investment Corporation, which began operations in 1989, has channelled more than US$ 8 billion in loans and capital investments to over 2,400 goods and services suppliers in Latin America and the Caribbean. These resources have been used to support SMEs in the countries of the region. The Multilateral Investment Fund, which was established in 1993, has approved 386 projects for a total of US$ 1.2 billion, of which US$ 660 million came from the Fund itself. The money has been used to develop both human resources and small businesses. The Fund has shown a notable capacity to attract additional resources: in 2000, for example, average project co-financing was as high as 54%.

The Andean Development Corporation has become one of the leading multilateral banks in the Andean subregion. In the five-year period 1995-2000 it provided 51% of the US$ 27 billion in loans approved for the Andean countries (see table III.4).

Table III.4

ANDEAN COUNTRIES: LOAN APPROVALS BY ADC, IDB AND THE WORLD BANK, 1995-2000 [a]

(*Millions of dollars and percentages*)

	Cumulative 1995-2000		2000 [b]	
	Millions of dollars	Percentages	Millions of dollars	Percentages
ADC	13 447	50.6	2 276	51.4
IDB	8 014	30.1	925	20.9
World Bank	5 140	19.3	1 227	27.7
Total	**26 601**	**100.0**	**4 428**	**100.0**

Source: Annual reports of ADC, IDB and the World Bank.

[a] Loan approvals are not necessarily equivalent to the amounts disbursed in the year under consideration. The Andean countries are Bolivia, Colombia, Ecuador, Peru and Venezuela.

[b] Preliminary figures.

Since the Andean Development Corporation has a better risk rating than its member countries, it is in a position to facilitate their access to international private financial markets at more attractive rates and maturities. This serves to illustrate how important the support of multilateral development banks has been in giving the countries access to more stable, preferably medium- and long-term international financing at lower cost.

With respect to national development banks, productive development activities have traditionally been associated with lending to certain sectors at below-market cost in the form of interest-rate subsidies. Such lending has not necessarily targeted activities with an acceptable social rate of return.

In recent decades national development banks in a number of Latin American and Caribbean countries have experienced financial difficulties rooted in serious failings in resource management. Where explicit mandates and institutional frameworks have been lacking, resources have often been managed according to political criteria. Lending has typically failed to give due regard to risk management and this, together with inadequate collection policies, has translated into loan recovery rates that are well below those of commercial banks. Since financing has been based mainly on fiscal and multilateral sources and budgets have been insufficiently transparent, those resources have carried a high opportunity cost.[8]

In the 1990s far-reaching financial reforms were carried out in the Latin American and Caribbean countries to improve the quality and efficiency of financial intermediation. These reforms mainly involved liberalizing interest rates, changing standards of financial regulation and oversight, opening the economy to foreign banks and to foreign capital inflows in general, creating new financing instruments and dismantling most directed-credit instruments.

8 See ECLAC, *Growth with stability: Financing for development in the new international context*, Santiago, Chile, Economic Commission for Latin America and the Caribbean (ECLAC), 2002.

Although these financial reforms generated changes in the countries' financial systems, many of the expected outcomes failed to materialize. In particular, the chronic problem of insufficient saving, especially long-term saving, has not been resolved. This means that the engagement of development banks continues to be necessary to strengthen the market. Long-term financing, especially mortgage lending, is on the rise in a number of countries, but there has been no significant development of markets for long-term investment lending, at least not for domestically financed investment.

Asymmetric information –i.e., differences between the information available to lenders and to borrowers– cause operational problems in financial markets which either impair the proper development of certain segments or rule out their existence altogether.[9]

Measures such as the use of certain instruments, insistence upon guarantees and collateral to secure loans and methodologies for assessing the borrower's creditworthiness have proved insufficient to solve these problems. Faced with imperfect information and an uncertain economic environment, private financial lenders tend to ration funds or raise the cost of borrowing significantly.

In practice, the worst affected by credit rationing and segmentation are SMEs, small-scale farm owners and new businesses specializing in technological innovation; these sectors have higher risks and transaction costs in the financial intermediation process. Since would-be borrowers in these sectors usually have only limited information, evaluating and financing them is costly for private financial institutions. Large corporations, which generally have information more in tune with the requirements of the private financial market, can secure funding at lower cost.

The principal lesson to be drawn from the numerous financial crises that have hit the Latin American and Caribbean countries is the importance of preserving and defending financial stability and solvency by means of proper oversight. These crises sharpened discrimination against borrowers who carry a higher potential risk, while the setting-up of loan-loss provisions raised the cost of borrowing. The need to expand the coverage of financial services while observing prudential standards of regulation and oversight of risk management opens up a large playing field for development banking. Development banks should be capable of raising funds and channelling them to high-risk activities without compromising the solvency of the banking system or the stability of the regulatory system in general, and should thus guarantee the efficient allocation of credit with satisfactory rates of return.

In short, development banking should be governed by the principles of complementarity and transparency, and its financial instruments should operate according to criteria similar to those of the market.

(b) Development banking in today's world

Public development banks are not the only entities engaged in productive development activities. As shown in table III.5, out of 105 institutions in 21 countries of the region, 22% are privately owned and 10% are of mixed ownership. In early 2000 development financing institutions held estimated assets of over US$ 400 billion and provided a significant proportion of the credit extended in a number of Latin American and Caribbean countries, especially to the agricultural, agro-industrial and manufacturing sectors, followed by housing, construction and infrastructure, commerce and external trade.[10]

Table III.5
LATIN AMERICA AND THE CARIBBEAN: OWNERSHIP OF DEVELOPMENT FINANCING INSTITUTIONS

Ownership	No. FDIs	%	Assets	%
Public	71	68	273 699	76
Private	24	23	9 372	3
Mixed	10	10	76 477	21
Total	**105**	**100**	**359 548**	**100**

Source: Latin American Association of Development Financing Institutions (ALIDE). Includes 105 development financing institutions in 21 countries of the region.

9 Information problems are one of the main justifications for government intervention in these markets (Joseph Stiglitz, *The Role of the State in Financial Markets*, World Bank, 1993). Asymmetric information leads to problems known as moral hazard and adverse selection, among others. Moral hazard refers to situations where the risk structure of a borrower's project changes after the loan is extended, potentially resulting in a lower rate of return for the lender. Adverse selection refers to the concentration of lending in more risky projects, since borrowers are prepared to pay a higher price to secure funding for such enterprises.

10 See R. Acevedo, *Banca de desarrollo: paradigmas en el nuevo milenio*, Lima, Latin American Association of Development Financing Institutions (ALIDE), 2002.

Development financing institutions have embarked on far-reaching alterations to their institutional structure and management in order to adapt to the new economic and financial conditions in the countries. One of the main results of this process has been the growing tendency of development institutions to operate as second-tier banks. This kind of bank channels resources to public or private first-tier commercial banks, which then use those resources to extend loans. The financial risk is thus spread between the two types of banks, and the evaluation of end-borrowers' levels of risk and creditworthiness is the responsibility of the first-tier banks. This arrangement makes it easier to improve financial risk management but harder to target funding, which is an essential part of development activities. As shown in table III.6, out of 104 institutions, 21 operate as second-tier banks and 10 as both first- and second-tier institutions.

Table III.6
OPERATING MODALITY OF DEVELOPMENT FINANCING INSTITUTIONS IN LATIN AMERICA AND THE CARIBBEAN

	No. FDIs	%	Assets	%
1st-tier banks	73	70	197 689	55
2nd-tier banks	21	20	51 516	14
1st- and 2nd-tier banks	10	10	110 335	31
Total	**104**	**100**	**359 540**	**100**

Source: ALIDE. Includes 104 development financing institutions in 21 countries of the region.

Development banks now face the challenge of ensuring that their financial management promotes sound banking discipline in terms of risk management, profitability and financial solvency. To this end, their operational independence should be strengthened within a framework of functions and objectives defined by the appropriate authorities.

(c) Institutional framework

The objectives and functions of development banking must be clearly defined so that the allocation of funding will reflect developmental rather than political considerations. Development banks' resource endowment, decision-making criteria, lending policies and technical assistance must be determined in accordance with the principles of sound business management. The new institutional structures should enhance the autonomy of decision-making and minimize direct government intervention in the extension of credit. Statutory and operational reforms to achieve this are already under way. In order to guarantee that development banks are independently, transparently and responsibly managed, it is necessary to devise criteria with regard to what can and cannot be done and to establish independent boards of directors made up of individuals who are legally accountable for the results of their actions. Like independent central banks, development banks should report annually to the appropriate authorities on the results they have achieved in relation to their objectives and functions.[11] They should also strengthen their financial viability by having their risk portfolios regularly rated by external auditors.

Collection policies need to be improved if banks are to avoid the large volume of unpaid loans that was common in the past. It has been argued that second-tier development banking supported by first-tier commercial banking would be a good alternative in this regard.[12] Recovery rates could be expected to rise significantly if commercial banks were responsible for lending, given their broad experience in assessing and monitoring risk and loan recovery probabilities.

11 For example, the maintenance of real net worth could form part of their mandate.

12 See ECLAC, *Growth with stability: Financing for development in the new international context,* Santiago, Chile, Economic Commission for Latin America and the Caribbean (ECLAC), 2002.

(d) Budgetary transparency and sources of financing

The activities of development banks in the region have traditionally been funded from public budgets and contributions from multilateral financial institutions, but there is no reason why these banks should not also raise funds on private financial markets. The issuance of commercial paper to attract private investors should be an important source of funds for development banking. In Europe many successful institutions of this type have a wide variety of funding sources, which has afforded them greater independence in management and decision-making, better risk management and more stable financing flows. The private capital market has become a significant source of funds for Germany's development banking system and for Spain's Official Credit Institute, among others. Moreover, development bank instruments issued on private financial markets can become a significant engine of market growth and deepening. Indeed, an increasing number of such institutions in the Latin American and Caribbean countries are licensed to participate in a broad range of financial activities, although their involvement is limited in practice (see table III.7).

Table III.7
LATIN AMERICA AND THE CARIBBEAN: OPERATING MODALITIES OF DEVELOPMENT FINANCING INSTITUTIONS

Operating modality	Licensed	%	Practising	%
Medium- and long-term lending	47	96	47	96
Short-term lending	44	90	43	88
Investment in corporate capital	28	57	23	47
Investment in stock and/or bonds	38	78	34	69
Trust administration	26	53	20	41
Participation in venture capital firms	13	27	8	16
Provision of loan guarantees	30	61	24	49
Leasing	17	35	13	27
Co-financing and co-investment	21	43	16	33
Underwriting	12	24	8	16
Other	11	22	11	22
Technical assistance and training	35	71	30	61
Supply of information	34	69	32	65
Special development programmes	40	82	39	80

Source: ALIDE. Includes 49 development financing institutions in 20 countries of the region.

As public banks, development banks generally enjoy the backing of State guarantees when raising funds on financial markets. This obviously benefits their risk rating, which in turn lowers the cost of raising funds. Insofar as this lower cost is passed on to borrowers, it reduces the cost of loans. The downside of this type of guarantee is that it distorts risk ratings by leading to a situation where the assessment of the risk structure of the banks themselves is tainted by the incorporation of the sovereign risk of State financing.[13]

The State guarantee also introduces an element of unfair competition for resources between development banks and the private sector. In this respect, consideration should be given to the use of the funds. When they are to be used for development activities, in which competition with the private sector is unfortunately scant, the State guarantee should be maintained. When the funds are to be used for activities in which competition with the private sector is more intense, the State guarantee should not be allowed to affect the cost of raising the funds. An interesting example in this regard is the agreement between the German development bank Kreditanstalt für Wiederaufbau (KfW) and the European Commission. The Commission agreed to allow the State guarantee as compensation for the development activities carried out by KfW, while for areas where KfW competes with private banks, such as export and project financing, the bank set up a special subsidiary subject to the same conditions as private banks.

Both in their financial market operations and in the administration of the fiscal resources assigned to them, development banks must conform to transparent accounting standards in keeping with market requirements. It is essential to avoid a situation in which

13 See ECLAC, *Growth with stability: Financing for development in the new international context*, Santiago, Chile, Economic Commission for Latin America and the Caribbean (ECLAC), 2002.

the subsidies implicit in a poor policy of assessment, risk management and loan recovery indirectly affect the public budget by generating unforeseen costs. Hidden, untargeted and unassessed subsidies must be kept to a minimum. Subsidies must be provided transparently and be financed from State resources if development banks are to retain their capacity to generate profits.[14]

(e) New financial instruments

SMEs, the rural sector and innovative activities are the development banks' natural clientele, as their intermediation costs are higher and their risks less diversified than those of large corporations. There is a need for new financial products especially designed to channel resources to these sectors.

Like commercial banks, development banks need to maintain positive and competitive rates of return if they are to remain financially solvent. The profits they generate enable them to increase their resources in the long term and to raise additional funding on the private financial market. Given that the return on the assets held by development banks is subject to institutional and market constraints, the quality of these banks' resource management is crucial to their financial viability.

International experience suggests that the standardization of financial products and processes reduces intermediation costs and facilitates access to new forms of financing. In Latin America and the Caribbean development banks have focused on lending and on complementary non-financial services. They have only recently ventured into the terrain of new financial instruments, factoring, leasing, securitization of assets, trust administration and provision of guarantees (see table III.7).

Thus far, these new instruments have been used mainly to finance housing and infrastructure in the region. Interesting progress has been made with regard to the securitization of mortgage loans in Argentina, Bolivia, Brazil, Chile, Mexico, Colombia and Peru. Project financing with the involvement of both public and private entities has gained ground as a way of funding infrastructure works in several countries.

Mexico's Nacional Financiera has a programme of supplier development through electronic billing, which has expedited SME financing and lowered its cost. Guarantee funds set up in several countries of the region are another example of instruments that stimulate synergies between public and private financing for SMEs. At the international level the involvement of development banks in the securitization of loans and trusts (which is not very common in the region) has also helped to attract resources for SMEs.

Operating in the secondary market, development banks can securitize loans by buying first-tier commercial banks' portfolios of loans receivable from SMEs, packaging them and selling them on the stock market, thereby turning them into liquid assets. The banks thus transfer their credit risks to the stock market and obtain more leeway for further lending. A case in point is that of the German development bank KfW, which in 2002 issued bonds of this type in the amount of some 5.5 billion euros. The volume of securitized loans has to be quite large for the securities to be financially attractive.

Although trust funds are a long-established financial instrument, they have only recently come into their own as a development tool. Trust funds can be used to channel resources into higher-risk activities and sectors without affecting the assets of the institutions administering these funds. In other words, trust funds can be useful for managing financial resources in such a way as to give a variety of economic agents easier access to credit. For example, commercial banks, acting as trustees, can channel resources to SMEs without increasing their loan-loss provisions; since such loans are not part of the banks' portfolios, the standard rules on regulation and prudential supervision do not apply. Since there is also the danger that first-tier banks may be tempted to transfer the risks of their non-performing portfolio to trust funds, standards regulating the management of trust funds must be developed.

Trust funds can also serve to enhance the budgetary transparency of development banks, since they enable the banks to allocate resources for emergency financing without affecting their asset structure. Mexico's National Bank for Public Works and Services recently adopted a mechanism of this type for infrastructure works in the states, financed from windfall petroleum revenues. In El Salvador the Multisectoral Investment Bank set up a trust fund for microenterprise and small business development.

Loan guarantee schemes, while not new, have attracted growing interest in the last few years as a means of giving SMEs easier access to bank credit. Insofar as they diversify risk and reduce the financial risk and transaction costs of loans, funds of this type should generate more favourable terms and maturities and lower demands for collateral.

14 See ECLAC, *Growth with stability: Financing for development in the new international context*, Santiago, Chile, Economic Commission for Latin America and the Caribbean (ECLAC), 2002.

Assessments of the performance of these funds have resulted in the identification of a series of requirements with regard to their operation and financial viability. Guarantees should be extended in a rapid and timely manner, without repeating the entire credit evaluation process carried out by the banks. The default rate should initially be no more than 5% of the portfolio, and should drop to 2% to 3% over time. Collateral should be required whenever possible. Loan recovery efforts should continue even after guarantees are paid out. Banks or other lenders should assume between 30% and 40% of the risk and never less than 20%; risk-sharing of 50% or more could discourage them from participating. The commission charged by the fund should be a function of the guarantee percentage provided on different loans.[15] The operation of these funds should be reviewed regularly by external auditors and should be governed by a specific regulatory framework that sets explicit standards for the ratio of capital to guarantees, systems for loan portfolio and borrower evaluation and policies for managing reserves, among other things.[16]

Guarantee funds can serve to support other means of improving and facilitating financial intermediation for productive development, including the venture capital industry.

(f) Venture capital funds

Development banks can help to promote the creation of venture capital funds. In view of the non-traditional risk structure of these funds' business and their potential for growth and profitability, they may require State guarantees for a time, though not on a permanent basis.

Venture capital funds are designed to finance the establishment of new firms working in innovative –and therefore risky– lines of business. These ventures are not guaranteed to survive but, if they do, they can generate very high rates of return. Venture capitalists form a fund which receives proposals seeking financing, organizational and legal support and strategic advice. In general, these funds operate within a fixed time frame. Depending on the requirements of the investors, firms that receive financing and strategic support must be sold (or liquidated if they are not profitable) after a certain length of time so that profits can be realized and recycled back into the original fund. The firms can be sold on the stock market if they are listed, or through other mechanisms.

In the United States the venture capital industry has played a key role in financing the information technology sector, Internet development, electronic commerce and biotechnology. In the last few years the industry has also gathered momentum in Europe and, to a lesser extent, in Latin America.[17]

In Chile a debate is under way on the possibility of setting up a guarantee fund to encourage private institutional investors to engage in venture capital schemes. Such a fund would be co-financed by the Production Development Corporation, which, in turn, receives funding from the IDB Multilateral Investment Fund as part of its investment in venture capital funds in a number of Latin American countries.

3. Stock and bond markets

Financial markets can be broadened to help channel liquidity to the real sector and provide more opportunities for portfolio and risk diversification. In Latin America stock and bond markets represent a very small fraction of corporate financing raised on the domestic market. The sale of bonds abroad, however, is a means of widening this source of financing. Resources for the region's productive sector come mainly from entrepreneurs' own capital, undistributed earnings and bank credit. The low liquidity indices and capitalization ratios of developing-country stock markets hinder the supply of funds by this means.[18] Bond markets, though increasing in importance, provide even less financing than stock markets in most emerging economies. The level of stock- and bond-market financing

15 See Jacob Levitsky, "SME Guarantee Schemes: A Summary", *The Financier*, vol. 4, Nos. 1 and 2, 1997.

16 See Jorge Castellanos, "The Financial Supervision of Loan Guarantors", *SME Credit Guarantee Schemes*, Washington, D.C., IDB, 1997.

17 See E. Santos, "Venture Capital: An Option for Financing Latin America's Small and Medium Enterprises", unpublished, 2003, and Laura Botazzi and Marco Da Rin, "Venture capital in Europe and the financing of innovative companies", *Economic Policy*, vol. 17, April 2002.

18 See Carkovic and Levine, "Finance and growth: new evidence and policy analysis for Chile", Economic Growth: Sources, Trends and Cycles, N. Loayza and R. Soto (eds.), 2002.

is lowest among small firms, which are less capitalized and have a more concentrated risk structure than larger concerns, making them less attractive for institutional investors. A recent empirical study of a sample of 40 countries in the period 1976-1998 found that stock market liquidity (measured as the turnover of shares as a proportion of market capitalization), rather than the market's size or capitalization, was positively correlated with GDP growth.[19] This study also found that the banking system's level of development, measured as the private-sector credit to GDP ratio, has an independent and statistically significant influence on GDP growth. These findings clarify how the stock market and banking system operate independently to boost economic development.

Pension systems based on some form of capitalization, like the insurance industry and mutual funds, are an important means of deepening capital markets. Most international demand for bonds comes from institutional investors whose liability structures lead them to prefer long-term securities. They not only generate the demand, but also provide the liquidity needed by bond markets. The liquidity shortfalls typical of the Latin American and Caribbean countries both affect the cost of financing and prevent the emergence of agents willing to invest in the markets.

Since the formation of long-term markets in the region has also been held back by repeated outbreaks of inflation, such markets must be indexed if they are to become established at all. Institutional investors' insistence on strict systems of regulation and oversight for public share and bond offers should encourage improvements in corporate management.[20]

4. Conclusions

The financial system's ability to efficiently channel resources to productive activity depends on the provision of low-cost intermediation services and on the development of financial instruments and institutions that can adapt to the different risk profiles and liquidity and maturity needs of the production sector. In general, suitable systems of prudential regulation and supervision, combined with macroeconomic stability, are vital for deepening and developing financial markets.

Although the reforms of the 1990s increased the volume of financial intermediation in Latin America and the Caribbean, the region does not yet have a flexible long-term credit market to finance productive investment. Another problem is that SMEs, small-scale farm owners, technological innovation initiatives and, in general, all sectors of production that carry a higher relative risk have been sidelined from the benefits of intermediation by the persistent segmentation of financial markets. Domestic development banks can help to make up for these capital market deficiencies and promote financing for production in the Latin American and Caribbean countries.

In order to do so, development banks must have clearly defined functions and objectives and be able to make lending decisions free of political interference. In working with intermediation instruments, they should maintain financial equilibrium by seeking suitable levels of profitability and by properly managing risk in their loan portfolios. Like independent central banks, modern development banks should be accountable to the relevant authorities. The basic operational guidelines that should govern development banks are complementarity, emphasis on socially beneficial activities (to which the private sector pays too little attention), additionality, profitability and transparency, and the promotion of synergies between public and private financing. Public banking should play a key role in developing new instruments to help standardize processes and products that make financial intermediation more accessible and less costly, boost the growth of stock markets by securitizing loan portfolios and encourage the use of guarantee funds and the venture capital industry.

In consequence, an agenda for financial development with a view to productive development should include the definition and coordination of mechanisms for using pension-fund resources and the development of the insurance industry and the stock and bond markets, all of which will contribute to greater financial deepening.

19 See Carkovic and Levine (2002).

20 See Roberto Zahler, "Pension Funds and Macroeconomic Stability in Emerging Economies: The Case of Chile", paper presented at the seminar "Management of Volatility, Financial Liberalization and Growth in Emerging Economies", Santiago, Chile, Economic Commission for Latin America and the Caribbean (ECLAC), April 2003.

Second part

Countries

Argentina

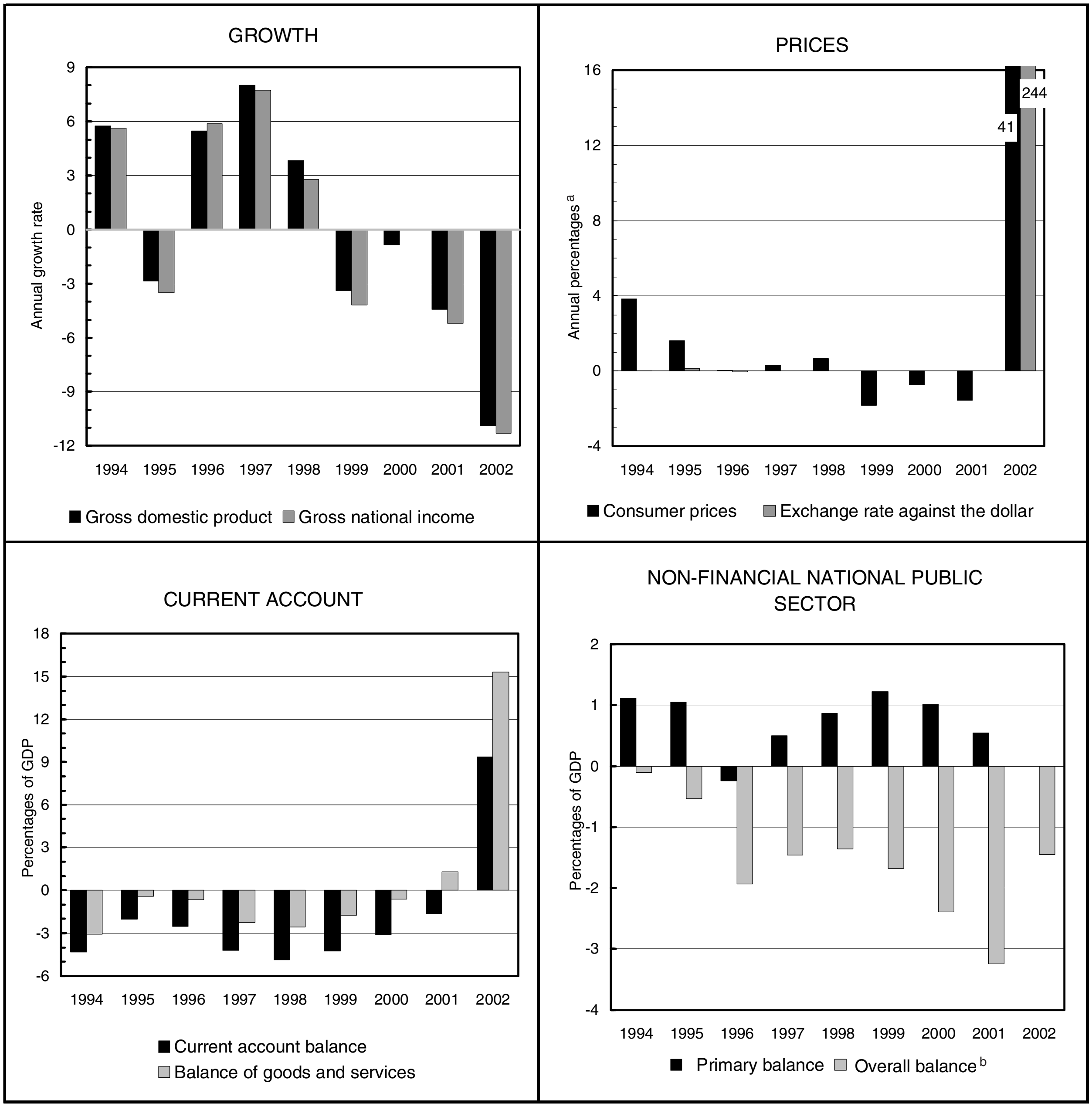
1. General trends

The Argentine economy suffered a crisis of exceptional intensity in 2002, involving monumental financial upheavals and a suspension of payments on part of the public debt. The convertibility regime had served as a basic economic institution and factor of political legitimacy for nigh on a decade, but in recent years it had faced growing macroeconomic imbalances as recession set in. The collapse of the regime in January 2002 shook the foundations of the entire contract system and was accompanied by political convulsions and deep public discontent. At times, fundamental aspects of the workings of the economy were affected. The deterioration of economic performance was reflected in a sharp output contraction starting in mid-2001, together with soaring poverty indices. The drop in output was particularly steep in the first quarter of 2002, but thereafter a slow but persistent recovery began to take hold. This limited the output decline for the year overall to 10.9%, much of which represented the aftershock of the negative results of 2001. Recovery gathered pace in the new year, and 5.5% growth is forecast for 2003 as a whole.

In the midst of this critical situation, continuous negotiations were held with the International Monetary Fund (IMF), but these only produced a provisional agreement in early 2003. In 2002 meanwhile, massive private-sector capital flight coincided with demands from multilateral organizations for loan repayments amounting to several percentage points of GDP. Possibly the IMF attitude reflected an expectation that economic meltdown had further to go. Nonetheless, performance indicators started to improve from mid-2002 onwards, despite the intractable problems that continued to bear down on the economy.

The early part of the year witnessed major disturbances caused largely by the effects of a rising exchange rate on asset values, in an economy where most financial assets were denominated in dollars. The “pesification” of dollar deposits decreed by the Government aroused fierce opposition among savers, which expressed itself through public protests and lawsuits. It also generated tensions between the Government and the banks over compensation to be paid for the asymmetry in the rates at which loans and deposits were converted. The public was clamouring to withdraw its holdings from the financial system and purchase foreign currency. Deposit withdrawals restrictions and frequent bank holidays, aimed at staunching the haemorrhage of funds from the banking system, disrupted normal transaction mechanisms. Nonetheless, large-scale deposit withdrawals continued to occur largely as a result of court rulings.

Figure 1
ARGENTINA: MAIN ECONOMIC INDICATORS



Source: ECLAC, on the basis of official figures.
[a] December-to-December variation.
[b] Includes interest.

With the Central Bank granting rediscounts to the banking system, the very low level of tax revenue being collected meant that the Government was also short of funding –it even fell behind with its interest payments. The excess supply of domestic assets put added pressure on the foreign-currency market, with the result that the exchange rate rose sharply and the Central Bank lost massive amounts of reserves. The abrupt slowdown in activity, compounded by financial meltdown and a clearly abnormal monetary and fiscal situation, completed a panorama of great tension.

Although the hike in the exchange rate had clear repercussions on prices and real wages, it failed to set off an inflationary spiral. Depressed demand, in conjunction with high unemployment and the fact that public-utility charges were not adjusted, helped to keep price rises in check. In addition, using emergency instruments, fiscal and monetary policies were specifically aimed at staving off the threat of hyperinflation, while the maintenance of measures suited to conditions of low inflation had a major influence on the demand for money and price-setting. Once the momentum generated by the external depreciation of the currency was halted, the inflation rate moderated appreciably.

The significant rise in the real exchange rate was associated with a sharp increase in the demand for foreign assets –especially in the vortex of events in early 2002– and with a turnround in the current account of the balance of payments. Following drastic cutbacks in imports, the trade surplus grew to the equivalent of over 15% of GDP in dollar terms –clearly reflecting the decline in domestic activity and, above all, the real devaluation. The behaviour of external accounts was consonant with the major contraction in aggregate demand, reflecting expectations and attitudes engendered by conditions of extreme turbulence.

Gradually, signs of relief began to appear. The rise in the level of prices and the effect of recently imposed export duties helped to bolster government revenues; and with public expenditure tightly constrained, primary surpluses began to be generated. In addition, monetary policy focused on reducing rediscounts and generating instruments of regulation through bill issuance. The large trade surplus, combined with a perception that the real exchange rate was now at a very high level, and the introduction of requirements to surrender foreign currency earned from exports, increased the supply of foreign exchange. With the exchange rate no longer gyrating wildly, the foreign-currency market began to open up again, and this moderated expectations of devaluation and reduced incentives to hoard foreign currency. Payment mechanisms were also gradually being re-established. Higher profit margins in a number of firms allowed funds to be generated to ease the constraints of the credit drought. Following a pronounced fall in the first quarter, output then expanded slightly, which, in a situation plagued with risk and doubts over immediate prospects, suggested that the crisis could be levelling out.

This perception gained strength as time passed, although uncertainty was by no means banished. In the final months of 2002, with the foreign-exchange market operating with substantial stability, the Central Bank accumulated reserves at a falling rate of exchange. This contributed to a noticeably slower rate of price increase. Real output grew slightly during the second half of the year, especially as a result of expansions in activities related to foreign trade. Although the public continued to display deep distrust of financial institutions, there was a slight but significant revival in "voluntary" demand for time deposits, starting from rock-bottom levels.

Nonetheless, the legal disputes over bank deposits persisted, and in 2003 the Supreme Court ruled against the "pesification" measure. The early months of the year were dominated by political uncertainty surrounding the presidential elections scheduled for May. Nonetheless, these events failed to reverse the excess supply of foreign currency, which fuelled a substantial appreciation of the peso against the dollar. This softened the effect of the "redollarization" ruling, since it increased the dollar value of the deposits that had been converted into pesos. The fall in the exchange rate led the authorities to renegotiate the monetary limits established with IMF, in order to expand margins for foreign-exchange purchase, although the Central Bank was aiming at an inflation-targeting scheme. Price rises remained under control, and output recovered. In the first quarter of 2003, GDP grew by just over 5% in relation to its depressed level of a year earlier; and increased revenue enabled the Government to easily meet its primary surplus targets.

Notwithstanding clear signs of normalization in the economy, the deep crisis left visible scars. The large number of problems requiring solution comprised a very full agenda for the elected authorities that took office in late May.

The new administration maintained the existing general policy criteria, and the Minister of Economic Affairs was confirmed in his post. The Government made the promotion of social mobility one of its broad goals, by pursuing an economic growth path free from major fluctuations. On the fiscal front, emphasis was placed on bringing public accounts into balance, although the Government was expected to be more active in the infrastructure domain and attached special importance to improving tax compliance. The authorities pledged to allocate funds to service the public debt, following a negotiation adapting obligations to payment capacity; and new negotiations were initiated with IMF with a view to reaching a medium-term agreement. The Government also placed special emphasis on deepening the MERCOSUR integration process.

Table 1
ARGENTINA: MAIN ECONOMIC INDICATORS

	1994	1995	1996	1997	1998	1999	2000	2001	2002[a]
				Annual growth rates [b]					
Total gross domestic product	5.8	-2.9	5.5	8.0	3.8	-3.4	-0.8	-4.4	-10.9
Per capita gross domestic product	4.4	-4.1	4.1	6.6	2.5	-4.6	-2.0	-5.6	-11.9
Gross national income	5.6	-3.5	5.9	7.7	2.8	-4.2	0.0	-5.2	-11.3
Gross domestic product by sector									
Agriculture	7.5	5.6	-1.2	0.5	8.7	2.5	-1.7	1.1	-2.3
Mining	13.8	16.4	4.5	0.7	-3.8	-3.3	6.7	4.7	-3.8
Manufacturing	4.5	-7.2	6.5	9.2	1.8	-7.9	-3.8	-7.4	-10.5
Electricity, gas and water	10.8	7.4	4.1	8.2	7.6	3.6	6.6	1.1	-3.0
Construction	5.8	-12.2	8.4	16.6	8.7	-7.9	-9.3	-11.6	-33.4
Wholesale and retail commerce, restaurants and hotels	6.7	-7.5	7.9	10.9	3.4	-6.9	-2.4	-7.8	-16.7
Transport, storage and communications	10.3	1.7	6.9	11.2	8.9	-1.3	1.7	-4.6	-8.3
Financial establishments, insurance, real estate and business services	9.0	-0.9	5.7	6.9	6.3	-0.6	1.2	-4.1	-9.0
Community, social and personal sevices	1.5	0.6	2.3	3.9	1.5	1.9	1.7	-0.2	-3.3
Gross domestic product by type of expenditure									
Consumption	5.0	-4.3	6.0	8.2	3.0	-2.8	-0.1	-4.9	-13.6
General government	0.4	0.8	2.2	3.2	3.4	2.6	0.6	-2.1	-5.1
Private	5.8	-5.3	6.7	9.1	3.0	-3.8	-0.2	-5.5	-15.3
Gross fixed capital formation	13.5	-13.0	8.8	17.5	6.7	-12.6	-6.8	-15.7	-36.1
Exports of goods and services	10.5	24.6	8.4	14.1	9.2	-3.1	2.8	2.5	0.2
Imports of goods and services	16.5	-11.5	17.6	28.9	7.5	-12.9	-1.4	-15.7	-50.6
				Percentages of GDP					
Investment and saving									
Gross fixed capital formation[b]	20.0	17.9	18.5	20.1	20.7	18.7	17.6	15.5	11.1
Gross fixed capital formation[c d]	20.0	18.5	19.6	20.9	21.0	17.9	17.5	15.6	10.8
National saving[c]	15.6	16.5	17.1	16.6	16.1	13.6	14.4	14.0	19.6
External saving[c]	4.3	2.0	2.5	4.2	4.9	4.2	3.2	1.7	-8.7
				Millions of dollars					
Balance of payments									
Current account	-11,157	-5,211	-6,879	-12,342	-14,632	-12,001	-8,864	-4,429	9,590
Goods balance	-4,139	2,357	1,760	-2,123	-3,097	-795	2,558	7,507	17,239
Exports fob	16,023	21,162	24,043	26,431	26,434	23,309	26,410	26,655	25,709
Imports fob	-20,162	-18,804	-22,283	-28,554	-29,531	-24,103	-23,852	-19,148	-8,470
Services balance	-3,786	-3,458	-3,582	-4,449	-4,516	-4,156	-4,288	-4,021	-1,607
Factor income balance	-3,694	-4,662	-5,502	-6,223	-7,417	-7,433	-7,370	-8,095	-6,457
Current transfers balance	462	552	445	453	398	381	235	180	414
Capital and financial balance[e]	10,482	2,899	10,136	15,672	18,723	14,014	7,647	-17,030	-25,208
Net foreign direct investment	2,622	4,112	5,349	5,508	4,966	22,630	10,654	3,304	1,741
Financial capital[f]	7,860	-1,213	4,787	10,164	13,757	-8,616	-3,007	-20,334	-26,949
Overall balance	-675	-2,311	3,258	3,331	4,090	2,013	-1,218	-21,459	-15,618
Variation in reserve assets[g]	-685	82	-3,875	-3,293	-3,436	-1,186	440	12,084	4,516
Other financing[h]	1,359	2,229	617	-38	-654	-826	778	9,376	11,102
Other external sector indicators									
Real effective exchange rate (index *2000=100*) [i]	106.3	113.1	116.3	114.3	109.9	99.8	100.0	95.9	226.4
Terms of trade for goods *(index 1997=100)*	97.0	91.8	99.6	100.0	95.4	90.4	99.9	99.4	98.3
Net resource transfer (*% of GDP*)	3.2	0.2	1.9	3.2	3.6	2.0	0.4	-5.9	-19.9
Gross external debt (millions of dollars)	85,656	98,547	110,613	125,052	141,929	145,289	146,575	140,273	134,340
Gross external debt (*% of GDP*)	33.2	38.2	40.6	42.7	47.5	51.2	51.5	52.2	131.5
Net interest and earnings (*% of exports)* [j]	-19.1	-18.8	-19.5	-20.2	-23.9	-26.8	-23.7	-26.2	-22.5

Table 1 (concluded)

	1994	1995	1996	1997	1998	1999	2000	2001	2002[a]
					Percentages				
Employment									
Labour force participation rate [k]	41.0	42.0	41.5	42.2	42.2	42.6	42.6	42.5	42.4
Open unemployment rate [l]	11.5	17.5	17.2	14.9	12.9	14.3	15.1	17.4	19.7
Visible underemployment rate [l]	10.3	12.0	13.2	13.2	13.5	14.3	14.6	15.6	19.3
					Annual percentages				
Prices									
Variation in consumer prices	3.9	1.6	0.1	0.3	0.7	-1.8	-0.7	-1.5	41.0
Variation in domestic wholesale prices	3.0	5.8	2.1	-0.9	-6.3	1.2	2.4	-5.3	118.0
Variation in nominal exchange rate	0.0	0.1	0.0	0.0	0.0	0.0	0.0	0.0	243.7
Variation in average real wage	0.7	-1.1	-0.1	-0.6	-0.3	1.1	1.5	-0.6	-13.9
Real deposit rate [m]	2.9	11.1	7.1	6.4	7.0	9.6	10.0	15.2	-1.8
Real lending rate [n]	4.8	16.9	10.3	8.7	10.0	12.7	12.7	23.2	8.2
Equivalent deposit rate in foreign currency [o]	8.1	11.8	7.4	7.0	7.6	8.1	8.3	15.9	-60.1
					Percentages of GDP				
National non-financial public sector [p]									
Current income	19.5	19.0	17.2	18.7	18.8	19.6	19.8	19.0	17.6
Current expenditure	18.4	18.8	18.1	19.1	19.1	21.2	21.3	21.4	18.4
Saving	1.1	0.2	-0.9	-0.4	-0.3	-1.5	-1.5	-2.3	-0.8
Capital balance	-1.2	-0.8	-1.0	-1.0	-1.1	-0.1	-0.9	-0.9	-0.7
Primary balance	1.1	1.1	-0.2	0.5	0.9	1.2	1.0	0.5	0.7
Overall balance	-0.1	-0.5	-1.9	-1.5	-1.4	-1.7	-2.4	-3.2	-1.5
Public debt	...	...	...	...	...	...	...	...	...
Interest payments (% of current income)	6.3	8.3	9.8	10.5	11.8	14.8	17.2	19.9	12.4
Money and credit [q]									
Domestic credit [r]	21.8	23.4	24.6	25.6	28.6	32.2	32.8	32.9	41.4
To public sector	3.2	3.7	5.4	5.5	5.9	7.2	8.5	9.9	24.7
To private sector	18.7	19.7	19.2	20.1	22.7	25.0	24.2	23.0	16.7
Liquidity (M3)	21.3	20.4	22.7	25.6	29.2	32.8	33.7	33.4	29.1
Currency in circulation and domestic currency deposits (M2)	13.5	12.0	13.0	14.8	16.3	17.0	16.6	14.7	25.2
Foreign currency deposits	7.8	8.4	9.7	10.8	12.9	15.9	17.1	18.7	3.9

Source: ECLAC, on the basis of official figures.

[a] Preliminary figures. [b] Based on constant 1995 dollars, at the adjusted official exchange rate. [c] Based on figures in local currency at current prices. [d] In the base year, 1995, the difference with respect to calculation at constant prices arises from the use, for this purpose only, of an adjusted official exchange rate. [e] Includes errors and omissions [f] Refers to the balance on the capital and financial accounts, minus net foreign direct investment plus errors and omissions. [g] A negative sign denotes an increase in reserves. [h] Includes the use of credit and loans from IMF and exceptional financing. [i] Annual average, weighted by the value of exports and imports of goods. [j] Refers to net investment income divided by exports of goods and services from the balance of payments. [k] Economically active population as a percentage of the total population in urban areas. [l] Rates of unemployment and underemployment are percentages of the economically active population in urban areas. [m] 7- to 59-day deposits. [n] 30-day loans to first line companies. [o] Rate on deposits deflated by the variation in the dollar exchange rate. [p] Based on cash values. [q] Annual average values were used for monetary figures. [r] Refers to net credit to the public and private sectors extended by commercial banks and other financial and banking institutions.

Table 2
ARGENTINA: MAIN QUARTERLY INDICATORS

	2001				2002[a]				2003[a]	
	I	II	III	IV	I	II	III	IV	I	II
Gross domestic product (change from same quarter of preceding year) [b]	-2.0	-0.2	-4.9	-10.5	-16.3	-13.5	-9.8	-3.4	5.4	...
Goods exports fob (millions of dollars)	5,996	7,499	6,947	6,014	5,711	6,793	6,759	6,446	6,420	8,093
Goods imports cif (millions of dollars)	5,743	5,777	5,024	3,778	2,072	2,157	2,292	2,470	2,499	3,327
International reserves (millions of dollars)	21,924	21,082	20,584	14,546	12,780	9,629	9,404	10,476	10,517	12,183
Real effective exchange rate (2000=100) [c]	98.8	95.2	94.2	95.3	173.9	251.6	247.2	233.0	213.4	204.8
Unemployment rate	...	16.4	...	18.3	...	21.5	...	17.8	...	15.6
Consumer prices (12-month variation, %)	-1.0	-0.3	-1.1	-1.5	7.9	28.4	38.5	41.0	31.7	10.2
Average nominal exchange rate (pesos per dollar)	1.0	1.0	1.0	1.0	1.9	3.2	3.6	3.5	3.1	2.9
Real average wage (change from same quarter of preceding year)	-7.4	4.9	-10.0	10.0	0.9	-16.3	-17.4	-21.1	-19.2	-11.7
Nominal interest rates (annualized percentages)										
Deposit rate [d]	8.7	12.7	22.9	20.4	9.4	60.9	62.1	24.6	18.3	16.0
Lending rate [e]	12.6	21.0	35.9	41.3	30.7	...	90.6	42.7	27.6	27.5
Interbank rate [f]	9.7	11.0	25.9	48.6	38.7	67.3	48.2	9.7	5.9	5.6
Spread on sovereign bonds (basis points)	945	1,025	1,595	4,404	5,013	6,791	6,629	6,358	6,167	4,505
Stock price indexes (indexes, June 1997=100)	73.0	66.4	40.1	47.7	24.9	15.5	17.1	24.0	30.3	39.4
Domestic credit [g] (change from same quarter of preceding year)	-5.1	-2.9	-7.3	-9.2	36.0	63.1	73.4	66.2	26.3	...

Source: ECLAC, on the basis of official figures.
[a] Preliminary figures [b] Based on figures in local currency at constant 1993 prices. [c] Quarterly average, weighted by the value of goods exports and imports. [d] 7- to 59-day deposits. [e] 30-day loans to first line companies. [f] Buenos Aires Interbank Offer Rate (BAIBOR). [g] Refers to net credit to the public and private sectors extended by commercial banks and other financial and banking institutions.

2. Economic policy

The crisis not only called into question a specific set of measures and instruments, but at times even put the basic institutions of economic policy at stake. The treatment of loans and deposits generated serious conflicts between the executive and judicial branches, in the midst of a highly damaging loss of credibility in economic policies. Nonetheless, in the 2003 electoral campaign a majority of voters agreed on the need to maintain exchange-rate flexibility and to act prudently in fiscal and monetary management.

a) Fiscal policy

In 2002, the public-sector primary surplus was restored as a percentage of GDP, in the midst of deep depression. Primary expenditure was cut by 1.7% of GDP: payroll and social-security outlays declined as a result of lower real wages; and capital expenditure retreated sharply.

Tax receipts as a percentage of GDP also declined in 2002 and continued to plunge in early 2003, registering a first-quarter fall of over 15% in nominal terms compared to the same period in 2001. The primary balance of the national government, which had already been in deficit during the preceding months, became strongly negative. Nonetheless, tax revenues were partially restored as the year progressed. Duties on foreign trade accounted for 12.5% of total receipts in 2002 (compared to 3.6% in 2001). Revenue from levies on domestic activity (VAT and the tax on banking transactions) also gradually recovered.

In the early months of 2003, government expenditure was kept under control while income grew steadily. In particular, revenue collected from taxes on profits and personal assets, on which adjustments for price rises were not allowed, increased substantially. In the first quarter of the year, the national government primary surplus came in at close to 2% of GDP, and a primary surplus of 2.5% of GDP is forecast for the year as a whole (2.1% for the national public sector, and 0.4% for the provinces).

The conversion of liabilities from dollars into pesos had repercussions on the public debt. The “pesification” of certain government liabilities, particularly with the banks, lowered their value in dollar terms. Amounts paid to compensate the banks for asymmetries in the conversion of deposits and loans, and the issuance of securities to savers who opted to trade-in their reprogrammed deposits, worked in the opposite direction. Despite repayments on loans with multilateral agencies, the outstanding debt of the national government expanded to US$ 155 billion in 2002 –an extremely high figure in relation to GDP. Operations that would increase liabilities still further were held back, including: the transfer of provincial debts to national government; the issuance of securities to banks and savers; and recognition of debts owed to public employees and pensioners, in compliance with court rulings against the nominal cuts in wages and pensions that had been applied.

b) Monetary policy

Monetary and financial conditions were clearly atypical during the convertibility-breakdown period; and while order was subsequently restored particularly on the monetary front, credit-market operations remained far from normal.

In the closing months of 2001, both the provinces and the national government issued large amounts of bonds in small denominations as means of payment. At the end of that year, the Government imposed restrictions on cash withdrawals from banks and the transfer of funds abroad, but this failed to lift the pressure being felt in the foreign-exchange market. On the contrary, transaction costs rose steeply, which hurt the informal segments of the economy in particular. All of this helped to foment the protests that led to the government’s demise in December 2001.

The collapse of the convertibility regime was chaotic. Initially the Government decided to adopt a dual foreign-exchange market: one for commercial operations at an exchange rate of 1.4 pesos per dollar; and another operating with a floating rate, albeit subject to controls. The conversion of bank loans and deposits into pesos gave rise to lengthy discussions and heavy pressures, which resulted in different conversion rates being applied on deposits (1.4 pesos per dollar) and loans (one to one). Limits on cash withdrawals (known as the “corralito”) were maintained, and “pesified” debts were rescheduled (the so-called “corralón”).

One way or another, the crisis did not lead to many bank closures, the most notable cases being a few foreign-owned institutions which suddenly decided to pull out of the country. Nonetheless, the configuration and functioning of the financial system continued to be called into question.

The monetary and financial upheaval generated glaring imbalances, which made it hard to interpret the movements of monetary aggregates. In the first quarter of 2002, the monetary base expanded sharply, since domestic credit creation more than compensated for the loss of reserves. Massive rediscounts were granted to overcome liquidity shortages in the banking sector, and the Central Bank stepped up its lending to the Government. The deposit conversion process resulted in liquid peso assets growing by over 70%, while the circulation of quasi-monies also expanded rapidly.

During this period, signs of excess money supply and severe liquidity shortage existed side by side, and there was strong pressure on the currency market. As foreign-currency sales at the fixed exchange rate were few and far between, the official market was abandoned shortly after its creation. The breakdown of credit channels caused serious payment problems. While conversion at 1.4 pesos to the dollar increased the domestic purchasing power of “pesified” funds, savers viewed the measure as a serious and unfair attack on their contractual right to receive dollars. “Voluntary” demand for time deposits practically vanished, and banks seemed to pay little attention to their normal activity. For several months, virtually no new deposits were taken or loans granted.

The treatment of rescheduled fixed-term deposits aroused deep controversy. At one point, a compulsory swap for government bonds was proposed, but the idea was never implemented. This episode was one of the factors leading to the replacement of the economic team in late March. In the ensuing months, voluntary swap operations were accepted by a fraction of depositors, but many of them continued to insist on receiving dollars.

Despite a ongoing climate of extreme tension, the monetary chaos gradually subsided. Efforts were made to reduce the practice of granting rediscounts and credits to the Government; and the Central Bank began to issue bills, which suggested the existence of some demand for interest-bearing assets denominated in pesos. The authorities also sold reserves in the foreign-currency market, and this served to restrain the monetary base, which remained more or less constant throughout the second quarter. Price rises and the reduction in the aggregate volume of saving deposits reduced the real value of money balances, but from then on the demand for money was sustained. In the following months, as domestic credit creation by the Central Bank remained limited, there was no liquidity overhang in pesos putting pressure on the foreign-currency market.

The easing of monetary tensions gradually made itself felt in the latter part of 2002 and the early months of 2003. With the effect of the "corralito" fading, the lifting of the corresponding restrictions had no consequences. Moreover, stronger demand for liquidity made it possible to increase reserves while the exchange-rate was falling, At the same time the issuance of quasi-monies was suspended, and in mid-2003 the Government announced it would buy back the corresponding securities. In addition, voluntary demand for fixed-term deposits was being restored little by little, at interest rates that dropped from about 5% per month in mid-2002 to around 1% in June 2003. There was no recovery in bank lending, however. During 2002, the nominal value of loans extended to the private sector fell by 40%, to represent less than 10% of GDP by the end of the period.

In the last few months of the year the Central Bank actively intervened to sustain the dollar price, in the face of an excess supply of foreign currency. The first half of 2003 saw a significant nominal appreciation in the peso, despite a relaxation of restrictions on currency purchase. In June, the Government placed restrictions on short-term foreign-exchange inflows.

3. The main variables

a) Economic activity

Following output reductions in the previous three years of recession, the 10.9% slump recorded in 2002 was the steepest for several decades. GDP in 2002 was 18.4% below its level of four years earlier and also lower than in 1993. In addition to a drastic reduction in the volume of production, the abrupt real depreciation of the local currency slashed per capita GDP to US$ 2,700, having peaked at over US$ 8,000 just a few years earlier.

The drop in activity levels in the first quarter of 2002 was steeper than that recorded in the second half of 2001 and proved to be the floor of the contraction. Since then, aggregate activity has recorded small but persistent increases. The monthly indicator of economic activity for January-May 2003 posted a rise of 6.1% in relation to the same period a year earlier, and GDP is forecast to grow by just over 5% in 2003 as a whole.

Domestic demand plummeted in 2002. Private consumption fell more steeply than GDP (-15%), reflecting income loss especially among the poorest groups, compounded by pessimism about the future and crippling liquidity constraints. In addition, fixed investment collapsed (-36%) to reach levels unseen since the early 1990s. The downward trend levelled out in early 2002, after which there were signs of a tentative recovery in construction, especially in activities such as repair and maintenance, and in locally produced machinery, particularly for the agricultural sector.

As a result of the massive 50% collapse in import volumes and a slight expansion in exports (0.2%), the trade surplus grew to over 7.5% of GDP measured in constant prices. Given the sharp rise in the real exchange rate, this represented a very substantial 15% of current GDP. The national saving rate in current prices rose by over five percentage points of GDP, while the investment rate slipped by nearly five points. These turnrounds reflected the large volume of resources spent in accumulating net external claims, and the extent of "over-adjustment" in the domestic economy stemming from those movements.

Aggregate sectoral results posted widespread reductions, although these were relatively slight in the primary sector. Despite the decline of agricultural output overall, the 2001/2002 grain harvest was a record. Part of the harvest was held back by producers, as a way of saving without having to make use of the banks. There was a significant increase in the share of soybeans in the total grain harvest (40%), and this trend continued into the 2002/2003 season.

Cattle prices rose in relation to domestic price indices, but fell in comparison to grain prices. In 2002, the total slaughter was maintained at about 11.5 million head. A large percentage of meat sales were sent to export markets, and progress was made in controlling foot and mouth disease. Dairy activity suffered difficulties arising from higher costs and weaker demand both domestically and from Brazil.

Manufacturing activity declined by over 10% in 2002, while construction shrank by 33%. The fall in manufacturing industry was widespread, apart from certain sectors producing intermediate goods (steel, paper and chemicals, particularly those used in agriculture). Output in the automotive industry slumped particularly, despite increased exports. The reduction in manufacturing activity as a whole was very pronounced during the early months of 2002, reflecting the impact of sagging demand and financial upheaval. Nonetheless, the effects of the gradual normalization of domestic transactions as firms began to generate funds, supported by price incentives to substitute imported products, started to make themselves felt from mid-year onwards.

Recovery continued in early 2003. First-semester industrial output was 17% above its rock-bottom level of a year earlier. There was also a very pronounced upturn, albeit again from extremely low levels, in import-substituting activities such as heavy engineering (excluding the automotive sector) and textiles. The production of widely used intermediate goods and construction materials grew at a more sedate pace.

During 2002 the services sector posted significant reductions in commerce and related activities (-16%) and in financial intermediation. The electricity and transport sectors also receded, albeit to a lesser degree.

b) Prices, wages and employment

Although prices rose sharply in 2002, this did not develop into a full-blown inflationary process. The way price increases were distributed reflected the steep rise in the real exchange rate. The imported and agricultural-product components of the wholesale price index rose by about 200% and 170%, respectively, during the year. Movements in the consumer price index (CPI) were less pronounced: a cumulative 40% rise during the year, with smaller increases among services. Food, beverage and clothing prices rose by about 58%, nearly twenty points above the overall index. The easing of price increases over time was reflected in a CPI rise of under 5% (annualized) between September 2002 and June 2003.

Nominal wages grew much more slowly than prices, with the average wage earned by social-security contributors rising by less than 9% in 2002. Pay awards were larger in goods-producing sectors than in services. Although the Government decreed fixed-sum pay rises for the private sector during the year, compliance seems to have been only partial. In July 2003, the Government raised the minimum wage to 250 pesos and plans to further increase it by 10 pesos each month until the end of the year, by which time it would stand at 300 pesos –50% higher than a year earlier.

In May 2002, the unemployment rate reached an all-time high of 21.5%. Employment declined on average for the year, despite a sharp increase in the number of persons employed through official employment plans which encompassed about 4% of the economically active population. These included a subsidy plan for male and female household heads, which managed to cover nearly 2 million people, some of whom provided labour services in return.

Surveys conducted in October revealed recoveries in both employment and labour-market participation, with the unemployment rate edging down to around 18%. Nonetheless, formal employment declined substantially throughout 2002. In the fourth quarter, the number of jobs declared to the social security system was almost 9% down from a year earlier.

By May 2003, the unemployment rate had eased back to 15.6%, nearly six percentage points lower than in May 2002.

Although partly mitigated by the expansion of assistance schemes, the contraction in employment and drop in real wages, especially in terms of the basic consumption basket, caused poverty and indigence indicators to deteriorate sharply. In October 2002, nearly 40 million people were living below the poverty line, with 6.6 million in conditions of indigence.

Although by May 2003, these figures had eased by 610,000 and 160,000 respectively, the numbers of poor and indigent people remained high nonetheless.

c) The external sector

The demise of the convertibility regime in 2001 was accompanied by massive private capital flight, which overwhelmed the emergency funding provided by international organizations. During the first half of 2002 in particular, following the collapse of the fixed exchange-rate regime, private capital flowed out of the country in large amounts while international bodies called in their loans; both the Government and the private sector fell into debt service arrears. The net capital outflow was matched by a loss of reserves, concentrated during the initial months of the year, and a sizeable current account surplus –even including total accrued interest, the service of which was interrupted by a suspension of payments.

In 2002, direct investment flows dwindled, and the private sector suspended bond flotations, having accumulated arrears in debt service despite making amortization payments. Private-sector operations resulted in a net fund outflow on the order of 12% of GDP, about two thirds of this being recorded in the first half of the year. Domestic residents accumulated foreign assets in a variety of forms, including a considerable increase in foreign-currency holdings. During the final months of 2002 and early 2003, the net balance of private-sector financial flows remained negative but shrank significantly in amount.

Net amortization of loans with international agencies accounted for about 30% of the deficit on the capital account in 2002, and was equivalent to over 3% of GDP. The non-financial public sector accumulated arrears in its external debt service of about US$ 8 billion, which added to existing liabilities. The external debt of the public sector grew slightly while private-sector debt shrank, so the total debt diminished somewhat in absolute terms, despite multiplying several times as a proportion of GDP.

The value of exports fell by 3.5%, in the wake of lower prices. Part of this variation may have reflected under-invoicing, following the imposition of export duties and currency-surrender requirements. The reduction in export values was concentrated in fuels and manufactured products. There were a number of contradictory forces operating in the latter category: depreciation of the local currency and weak domestic demand stimulated the search for external markets; but the credit shortage constrained supply, while absorption of goods by other Mercosur members declined. The region's share of the country's total sales continued to shrink, from 28% to 22% –its lowest level for a decade. Among exports of agricultural origin, meat sales recovered thanks to a reopening of markets and an increase in the sales quota to the European Union (EU). On the other hand, the total volume of grain exports shrank, affecting both cereals (wheat, maize and sorghum) and soybeans, while exports of oils and oilseeds increased.

Import values in c.i.f terms were sharply down on a widespread basis, with particularly steep reductions in capital and consumption goods –about 70% in both cases. Equipment purchases fell to slightly over US$ 1 billion, just 15% of the value recorded four years earlier. There was also a substantial reduction in the value of intermediate goods purchased abroad (- 45%).

Bolivia

1. General trends

The Bolivian economy posted a 2.7% expansion in 2002, in a context of sluggish household demand, political uncertainty and faltering exports. Although growth was stronger than in 2001 (1.6%), it still fell short of the 5% recorded in 1997 and 1998. In the first quarter of 2003, gross domestic product (GDP) expanded by just 1.4%, reflecting continued slackness in household consumption compounded by the social disturbances that occurred in February. These growth figures meant a fourth straight year with no improvement in per capita GDP.

In 2002, the non-financial public sector (NFPS) registered a deficit of 8.9% of GDP. Although a major part of this balance reflected the pension deficit resulting from the 1997 reform, its deterioration was largely due to increases in public spending at a time of low activity levels and a drop in hydrocarbon taxes. In the agreement signed with the International Monetary Fund (IMF), the Government set an NFPS deficit of 6.5% of GDP as its fiscal target for 2003; and although the deficit continued to worsen through January-May 2003, the fiscal measures adopted following the signing of the agreement seem to have achieved the aim of curtailing expenditure growth and boosting revenues.

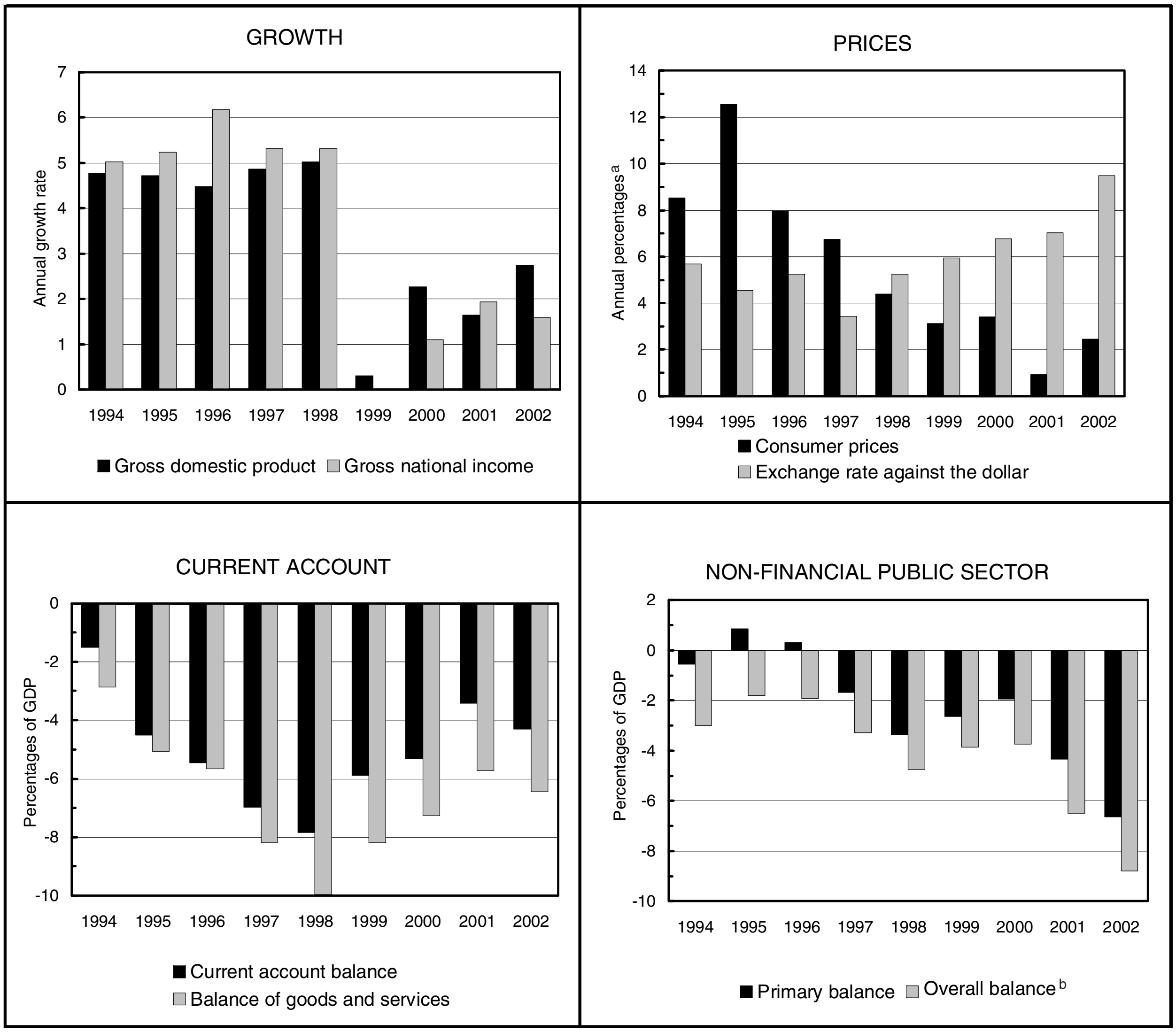
As a result of the bank runs that occurred in mid-2002 and again in February 2003, the Central Bank injected large amounts of liquidity into the system. Nonetheless, 2002 ended with a contraction in both bank deposits and loans. The bank runs temporarily pushed up interest rates throughout the financial system, but these tended to fall back again during the second quarter of 2003. Even so, credit remains flat, while the non-performing portfolio of the banking system has grown substantially during the period, to stand at 19.4% in May 2003.

Inflation remained at a low level, despite rising from 0.9% in 2001 to 2.4% in 2002 and to 3.2% in the 12 months ending June 2003, mainly as a result of the depreciation of the local currency against the dollar during 2002. This devaluation did not prevent a small real effective appreciation of the boliviano, however, given the sharp depreciations experienced by the currencies of Bolivia's trading partners during the course of the year. In 2003 it proved possible to slow the nominal rate of devaluation since the Argentine peso and the Brazilian *real* both strengthened.

Higher international prices for tin and soya, together with access to the United States market under that country's Andean Trade Promotion and Drug Eradication Act (ATPDEA), could potentially boost exports in 2003, and this would have a positive impact on demand. In contrast, the future of natural gas production for export remains uncertain because of domestic conditions in the Brazilian energy market.

The balance-of-payments current account deficit widened from 3.4% to 4.3% of GDP in 2002, mainly reflecting a deteriorating trade balance. Financing equivalent to 3.8% of GDP was required during the year, since capital flight amounting to 8.9% of GDP, reported as errors and omissions, almost entirely absorbed the surplus of 9.5% of GDP achieved on the capital and financial account. A smaller balance-of-payments deficit is forecast for 2003, as a result of generally sluggish imports and a strong export performance from the soya production complex.

Figure 1
BOLIVIA: MAIN ECONOMIC INDICATORS



Source: ECLAC, on the basis of official figures.
[a] December-to-December variation.
[b] Includes interest.

2. Economic policy

a) Fiscal policy

In 2002, the fiscal situation of the non-financial public sector (NFPS) deteriorated further, as its deficit widened from 6.9% of GDP in 2001 to 8.9% in 2002 –three percentage points of GDP above the budgeted level. The key component was the social security deficit resulting from the 1997 pension system reform, which grew from 4.8% to 5% of GDP between 2001 and 2002. In the latter year, public-sector spending excluding pensions increased in nominal terms, while revenues shrank. Relative to GDP, revenue slipped by 2.9 percentage points, while expenditure declined by just 0.9 points.

On the expenditure side, outlays in the personal services category increased, mainly as a result of public-sector wage hikes and other current expenditures. On the other hand, purchases of goods and services decreased from 8.6% to 6.5% of GDP, in the wake of privatization of the petroleum product wholesale division of Yacimientos Petrolíferos Fiscales Bolivianos (YPFB). Capital expenditure grew by 6.3%, as a result of an increase in public-sector investment and continuation of the National Emergency Employment Plan (PLANE); but relative to GDP its share was unchanged at 8.5%. On the income side, the steepest falls are explained by decreased revenues from hydrocarbons: taxes paid by the sector[1] dropped from 5.1% to 4.7% of GDP, as result of lower rates charged in the Special Tax on Hydrocarbons and Petroleum Products, while revenue from hydrocarbon sales declined from 5.6% to 3.2% of GDP, reflecting privatization of the YPFB petroleum products wholesale division.

In 2002, 71% of the fiscal deficit was financed by external borrowing, with disbursements amounting to US$ 527 million. Public-sector external debt was unchanged at 55% of GDP, of which the medium- and long-term component decreased from US$ 4.412 billion to US$ 4.3 billion, mainly thanks to reductions granted by the Paris Club, and relief obtained under the Heavily Indebted Poor Countries (HIPC) Debt Initiative. This meant a change in the composition of the debt: amounts owed to multilateral lenders grew by 11.4%, whereas bilateral debt shrank by 38%. The domestic public-sector debt stock expanded by 2.5 percentage points of GDP, rising from US$ 1.975 billion to US$ 2.17 billion, mainly as a result of bond placements in AFPs. A major portion of the external debt, unlike its domestic counterpart, has a strong concessionary element.

In 2003, fiscal policy strove to comply with the terms of the standby arrangement with IMF approved in April, which set a public-sector deficit target of 6.5% of GDP (or 1.6% excluding pensions). The programme envisages cuts in current expenditure along with several measures to enhance revenue collection and reduce evasion, including the introduction of a new code of tax procedures, and changes in the method for calculating petroleum product prices. As part of the latter, the Government eliminated the "refining margin" (one of the components of the final price of petroleum products), which has boosted revenue collected from the hydrocarbons tax in 2003.

The consolidated NFPS deficit grew from 701 million to 1.259 billion bolivianos between January-May 2002 and the same period in 2003. Nonetheless, elimination of the refining margin submission of the new tax code bill to Congress and efforts to reduce unnecessary (fraudulent) pension spending, are proof of the government's determination to meet its fiscal targets, even though this probably means cutting back on non-essential public investment. Total expenditure grew by 10.2%, driven by a 14.8% increase in spending on personal services and higher interest payments on sovereign debt. Total income expanded by just 3%, largely reflecting the weak performance of the hydrocarbons tax in the first quarter of the year and a reduction in customs revenue, despite a robust trend in receipts from hydrocarbon sales.

For 2003, the Government has budgeted public investment totalling 4.88 billion bolivianos, much of which is earmarked for highway infrastructure. The budget also envisages improvements in the social-security network, including a resumption of payments to citizens over 65 years of age through BONOSOL, and maintenance of the National Emergency Employment Plan.

b) Monetary policy

In 2002, the Central Bank of Bolivia (BCB) injected large volumes of liquidity into the financial system, in order to satisfy the public's demand for cash during the run on deposits that occurred in the middle of the year, which was fuelled in part by pre-electoral uncertainty. Interbank interest rates in dollars climbed from 0.9% per year in March 2002 to 8.3% by August, as result of the mid-year run on deposits, after which they gradually dropped to a new floor of 1.5% in January 2003. In the following month, a new bank run pushed rates up to 3.9%, before falling back once more.

The Bolivian financial sector is highly dollarized: in May 2003, 91% of deposits held by the public were denominated in that currency. The Government has adopted a policy of promoting financial intermediation in local currency, to facilitate monetary policy management and strengthen the role of BCB as lender

1 Gas exports are very important from the fiscal standpoint, with royalties in 2002 amounting to 1.3 billion bolivianos (2.3% of GDP). The firms pay royalties on the value of gas produced, but amounts exported to Brazil in 2002 under the gas export contract signed between Petrobrás and YPFB were less than the minimum volumes the Brazilian firm had agreed to purchase, under the "*take or pay*" clause. Petrobrás is paying for this minimum volume although effectively there is no demand for gas, so the Bolivian State does not receive royalties today on the gas that Petrobrás pays for but does not consume (since the firms do not extract it). This situation is likely to be repeated in 2003.

Table 1
BOLIVIA: MAIN ECONOMIC INDICATORS

	1994	1995	1996	1997	1998	1999	2000	2001	2002[a]
	Annual growth rates [b]								
Gross domestic product	4.8	4.7	4.5	4.9	5.0	0.3	2.3	1.6	2.7
Per capita gross domestic product	2.4	2.3	2.0	2.4	2.5	-2.1	-0.1	-0.7	0.4
Gross national income	5.0	5.2	6.2	5.3	5.3	0.0	1.1	1.9	1.6
Gross domestic product by sector									
Agriculture	6.7	1.4	6.7	4.5	-4.4	2.5	2.7	3.8	0.6
Mining	3.4	7.3	-2.0	6.1	5.5	-4.6	6.4	-1.4	3.6
Manufacturing	5.4	6.8	4.9	2.0	2.5	2.9	1.8	1.8	2.2
Electricity, gas and water	11.4	8.6	3.4	4.7	2.4	4.6	2.9	0.4	1.9
Construction	1.2	6.0	9.0	4.9	35.7	-16.9	-6.8	-6.0	14.2
Transport, storage and communciations	6.0	5.9	6.9	9.2	7.1	-0.8	2.5	2.1	5.1
Wholesale and retail commerce, restaurants and hotels	3.5	2.8	5.1	4.1	2.0	0.7	2.3	2.0	2.1
Financial establishments, insurance, real estate and business services	6.4	3.8	9.1	13.5	13.3	14.0	-0.7	0.1	-1.7
Community, social and personal services	2.6	2.8	2.4	4.9	3.6	2.8	2.2	2.6	3.4
Gross domestic product by type of expenditure									
Consumption	3.8	3.6	3.2	4.2	5.1	2.2	1.7	3.5	3.6
General government	3.1	6.6	2.6	3.4	3.8	3.2	2.1	2.5	3.3
Private	3.9	3.1	3.3	4.4	5.3	2.0	1.6	3.7	3.7
Gross domestic investment	-11.0	12.6	18.9	31.1	27.6	-18.8	-5.3	-23.4	0.5
Exports of goods and services	15.1	9.1	4.1	-2.1	6.5	-12.8	14.5	4.9	2.7
Imports of goods and services	-0.6	8.9	7.9	13.5	22.3	-17.1	2.6	-7.4	4.4
	Percentages of GDP								
Investment and saving									
Gross domestic investment [b]	14.2	15.2	17.3	21.7	26.3	21.3	19.8	14.9	14.6
Gross domestic investment [c]	14.4	15.2	16.2	19.6	23.6	18.8	18.3	14.2	14.7
National saving [c]	9.1	10.2	11.9	12.6	12.7	9.8	11.2	6.9	7.8
External saving [c]	5.3	5.1	4.4	7.0	10.9	8.9	7.2	7.4	7.0
	Millions of dollars								
Balance of payments									
Current account	-90	-303	-404	-554	-667	-489	-447	-274	-335
Goods balance	-30	-182	-236	-477	-655	-488	-364	-193	-222
Exports fob	985	1,041	1,132	1,167	1,104	1,051	1,246	1,285	1,310
Imports fob	-1,015	-1,224	-1,368	-1,644	-1,759	-1,539	-1,610	-1,477	-1,532
Services balance	-142	-158	-182	-172	-190	-190	-245	-267	-281
Factor income balance	-183	-207	-208	-197	-162	-196	-225	-211	-202
Current transfers balance	264	244	222	292	340	386	387	396	369
Capital and financial balance [d]	1	395	672	654	768	515	408	237	43
Net foreign direct investment	130	393	474	731	952	983	723	660	654
Financial capital [e]	-130	2	198	-76	-184	-468	-315	-423	-612
Overall balance	-90	92	268	101	101	27	-39	-37	-293
Variation in reserve assets [f]	-26	-147	-310	-90	-133	-32	39	34	303
Other financing [g]	116	55	42	-11	32	6	0	4	-10
Other external sector indicators									
Real effective exchange rate (index *2000=100*) [h]	109.0	110.7	105.9	103.7	100.0	99.1	100.0	101.3	99.6
Terms of trade for goods *(index 1997=100)*	88.7	86.5	96.6	100.0	95.1	95.0	96.9	95.6	95.1
Net resource transfer (*% of GDP*)	-1.1	3.6	6.8	5.6	7.5	3.9	2.2	0.4	-2.2
Gross external public debt (millions of dollars)	4,216	4,523	4,366	4,234	4,655	4,574	4,461	4,412	4,300
Gross external public debt (*% of GDP*)	70.5	67.4	59.0	53.4	54.8	55.2	53.2	55.0	55.1
Net interest and earnings (*% of exports*) [i]	-14.7	-15.9	-15.7	-14.7	-13.4	-16.3	-16.7	-15.3	-14.6

Table 1 (concluded)

	1994	1995	1996	1997	1998	1999	2000	2001	2002[a]
				Percentages					
Employment									
Labour force participation rate [j]	53.7	55.1	56.5	52.5	49.5	55.9	56.1	60.6	58.0
Open unemployment rate [k]	3.1	3.6	3.8	4.4	6.1	7.2	7.5	8.5	8.7
				Annual percentages					
Prices									
Variation in consumer prices	8.5	12.6	7.9	6.7	4.4	3.1	3.4	0.9	2.4
Variation in producer prices	9.0	9.3	9.8	4.8	2.5	2.8	5.2	...	...
Variation in nominal exchange rate	5.7	4.6	5.3	3.5	5.3	5.9	6.8	7.0	9.5
Variation in average real wage	8.0	1.5	-1.0	6.2	2.9	6.4	0.8	3.8	3.2
Real deposit rate [l]	9.1	4.8	12.1	6.0	9.5	8.4	7.6	9.1	6.5
Real lending rate [m]	43.3	33.1	46.7	38.3	35.1	30.4	30.4	19.2	17.2
Equivalent deposit rate in foreign currency [n]	12.1	13.8	13.2	10.9	7.2	5.9	4.0	2.6	0.1
				Percentages of GDP					
Non-financial public sector									
Current income	31.0	30.7	28.1	29.0	29.9	30.8	31.6	28.7	26.4
Current expenditure	27.5	26.0	24.2	26.5	28.9	28.6	30.5	29.6	28.6
Saving	3.5	4.7	3.9	2.5	1.0	2.2	1.1	-0.9	-2.2
Capital balance	-6.5	-6.6	-5.8	-5.8	-5.7	-6.1	-4.9	-5.6	-6.6
Primary balance	-0.6	0.9	0.3	-1.7	-3.4	-2.7	-1.9	-4.3	-6.6
Overall balance	-3.0	-1.8	-1.9	-3.3	-4.8	-3.9	-3.7	-6.5	-8.8
Public debt	...	...	...	...	68.7	71.8	71.6	78.7	82.9
External	...	...	...	...	54.8	55.1	53.2	53.9	55.1
Domestic	...	...	...	...	13.9	16.7	18.4	24.9	27.8
Interest payments (% of current income)	7.8	8.7	7.9	5.7	4.7	3.9	5.7	7.5	8.2
Money and credit [o]									
Domestic credit [p]	59.5	49.5	54.1	60.1	65.6	65.1	61.3	58.8	59.3
To public sector	9.5	1.3	1.1	1.9	1.7	1.1	2.7	4.8	7.5
To private sector	49.9	48.2	53.1	58.2	63.9	64.0	58.6	54.0	51.8
Liquidity (M3)	42.6	40.0	49.1	52.9	53.6	53.5	52.5	55.0	50.9
Currency in circulation and domestic currency deposits (M2)	7.2	7.5	7.4	8.1	7.7	7.2	7.0	7.8	7.7
Foreign currency deposits	35.4	32.4	41.7	44.9	46.0	46.3	45.6	47.2	43.2

Source: ECLAC, on the basis of official figures.
[a] Preliminary figures. [b] Based on constant 1995 dollars. [c] Based on figures in local currency at current prices. [d] Includes errors and omissions. [e] Refers to the balance on the capital and financial accounts, minus net foreign direct investment plus errors and omissions. [f] A negative sign denotes an increase in reserves. [g] Includes the use of credit and loans from IMF and exceptional financing. [h] Annual average, weighted by the value of exports and imports of goods. [i] Refers to net investment income divided by exports of goods and services from the balance of payments. [j] Economically active population as a percentage of the working-age population in urban areas; up to 1998, departmental capital cities. [k] Unemployed as a percentage of the economically active population in urban areas; up to 1998, departmental capital cities. [l] Fixed-term deposits, effective rate. [m] Average effective lending rate. [n] Average rate for deposits, deflated by the variation in thedollar exchange rate. [o] End-of-year values used for monetary figures. [p] Refers to net credit to the public and private sectors extended by commercial banks and other financial and banking institutions.

of last resort, thus making the financial sector less vulnerable to a bank run. The introduction of an inflation-linked unit of account (UFV) is intended to support this aim, with the idea of promoting financial operations denominated in UFV rather than dollars. Up to mid-2003, however, banking and financial operations in UFV were virtually non-existent.

The run on deposits in mid-2002 caused serious difficulties in the financial system, such that the year ended with a 13% fall in total bank deposits. The loan portfolio of the banking sector also shrank by 9.9%. In the first half of 2003, deposits declined sharply again as a result of the events of 12 and 13 February, and in May 2003 they were still 2.1% below their December 2002

Table 2
BOLIVIA: MAIN QUARTERLY INDICATORS

	2001				2002[a]				2003[a]	
	I	II	III	IV	I	II	III	IV	I	II
Gross domestic product (change from same quarter of preceding year)[b]	1.4	0.5	1.1	1.2	1.9	2.1	3.8	2.4	1.4	...
Goods exports fob (millions of dollars)	269	296	344	320	276	329	358	364	348	397.1
Goods imports cif (millions of dollars)	401	439	427	442	401	463	469	437	379	380.4
International reserves (millions of dollars)	798	885	844	886	752	673	688	580	470	...
Real effective exchange rate (2000=100)[c]	101.6	100.5	100.1	102.8	100.7	101.3	98.3	98.1	102.9	109.4
Consumer prices (12-month variation, %)	1.8	2.7	0.0	0.9	0.9	0.2	1.0	2.4	2.8	3.2
Average nominal exchange rate (bolivianos per dollar)	6.4	6.5	6.7	6.8	6.9	7.1	7.3	7.4	7.5	7.6
Nominal interest rates (annualized percentages)										
Deposit rate [d]	10.8	10.1	9.0	9.4	8.8	9.1	9.7	10.7	12.0	11.0
Lending rate [e]	19.6	20.6	19.8	20.2	18.3	23.8	19.6	20.9	18.7	24.6
Interbank rate	6.1	7.5	7.1	6.7	6.4	8.3	10.1	8.4	5.8	4.3
Domestic credit [f] (change from same quarter of preceding year)	-1.6	-2.9	-3.9	-2.9	-1.7	-0.1	0.3	1.5	1.9	...
Mature credit as a porportion of total credit (%) [g]	15.4	14.0	15.9	14.4	15.8	16.6	18.9	17.7	20.1	...

Source: ECLAC, on the basis of official figures.
[a] Preliminary figures. [b] Based on figures in local currency at constant 1990 prices. [c] Quarterly average, weighted by the value of goods exports and imports. [d] Fixed-term deposits, effective rate. [e] Average effective lending rate. [f] Refers to net credit to the public and private sectors extended by commercial banks and other financial and banking institutions. [g] Refers to total credit extended by the banking system.

levels, and 7.7% below those of May 2002. Bank lending had also not fully recovered: the loan portfolio was 0.9% smaller in May 2003 than in the previous December, with a cumulative reduction of 5.9% since May 2002. Deposits and credit both expanded slightly between March and May 2003, however.

The non-performing portfolio of the banking system continued its upward trend of recent years, rising from 4.6% in December 1998 to 19.9% in May 2003. During the past year, prudential standards have been altered: an increase in the value of collateral was included for provisioning purposes; loan rescheduling was permitted with no deterioration in risk rating; and the arrears accounting criterion was amended to exclude loans that are less than 30 days overdue.

Since late 2001, the nominal interest-rate for borrowing in dollars has trended downwards (from 13.7% in January 2002 to 9.9% in May 2003), while the nominal deposit rate in that currency has held steady around 2.2% per year. Both rates rose temporarily (in particular the deposit rate) during the bank run of July and August 2002, and the lending rate rose again during the events of February 2003. Nominal interest rates in bolivianos remained volatile. Low interest rates on dollar deposits have meant cheap funds for the banks, and the substitution of resources obtained abroad at higher cost and shorter maturities.

The two recent bank runs highlighted the need for a strong and stable financial system, since banking-sector deposits and loans have both been contracting steadily since 1998, and problems of arrears in a shrinking portfolio exacerbate systemic risk. It is therefore worth highlighting the government's pledge to reduce the vulnerability of the system through incentives to use local currency in financial transactions, improvements in supervision and problem-solving, and an expansion of mechanisms for accessing liquidity.

c) Exchange-rate policy

The Central Bank of Bolivia is operating a crawling peg exchange-rate policy, adjusting the pace of boliviano devaluation against the dollar so as to maintain a constant real exchange rate. In 2002, the nominal devaluation of the boliviano against the dollar amounted 9.5%, implying a real depreciation of 9.9%; but the currency also appreciated in real terms by 56.2% against the Argentine peso and by 21.6% against the Brazilian *real* during the same period. Thus, events occurring in Mercosur mainly explain why the real effective boliviano exchange rate strengthened by 4.6% during the period, despite a sharp real devaluation in dollar terms.

In 2003, the nominal devaluation of the boliviano against the United States currency has been much slower (1.4% between December 2002 and May 2003), owing to the appreciation of the Argentine and Brazilian currencies against the dollar. The real depreciation of the boliviano against its most important trading partners raised its real effective exchange rate by 10.3% during the period, and in June 2003 it was at its highest level (devaluation) since 1995.

3. The main variables

a) Economic activity

Growth in 2002 was hampered by the sluggishness of private-sector domestic demand, compounded by political uncertainty and a cooling of demand both worldwide and in neighbouring countries. GDP grew by 2.7%, boosted by construction (which expanded by 14.2%) and hydrocarbons production (6.5%, mainly gas), which in turn provided positive stimulus to transport and communications (5.1%, especially gas pipelines). Public administration services grew by 3.2%, reflecting higher levels of public spending. The mining sector remained stalled. During the first quarter of 2003, output grew by just 1.4%, partly reflecting the events of February that year. Moderate growth is expected for the year as a whole –driven mainly by exports, given the depressed state of private consumption and budget constraints on public-sector investment.

On the demand side, public-sector consumption growth picked up from 2.5% in 2001 to 3.3% in 2002, while private consumption continued to expand at about 3.7% per year. Gross fixed capital formation grew by 10.9%, thereby partially reversing the previous year's slippage of 19.7%. In the first quarter of 2003, government consumption rose by 3.6%, in contrast to the sluggishness of household consumption (0.1%). Gross fixed capital formation expanded by 5.7% during the same period.

Soya production is looking good for 2003 thanks to this year's bumper harvest and the high prices prevailing in the first half of 2003. During the first quarter, agriculture, hunting, forestry and fishing grew by 3.3%. The Government is projecting 3.5% growth in the agribusiness products sector (which includes soya) for 2003 as a whole. The summer soybean harvest for 2002-2003 came in at over 1.2 million tons as of June 2003, thanks largely to higher yields per hectare.

Export-oriented manufacturing is also likely to be buoyant this year, particularly industrial soya production, whose subproducts are displaying strong prices as of mid-2003. The Government also projects an upturn in the production of textile, leather and wood (furniture) products, following Bolivia's inclusion in the agreement contained in the United States Andean Trade Promotion and Drug Eradication Act, whereby the country obtains preferential access to the United States market in return for collaboration in the fight against drugs. To gain the benefit from these tariff preferences, the Government adopted measures such as fiscal credits to encourage capital goods imports and investment in industrial infrastructure, postponement of VAT payments on capital good imports, and inclusion of replacement parts and pieces in the list of capital goods subject to a zero tariff. During the first quarter of 2003, the manufacturing sector grew by 2.7%.

Hydrocarbons extraction fell by 0.1% during the first three months of 2003. For the remainder of the year, investment in this sector is likely to be below its 2002 level, while doubts are dispelled surrounding the future trend of the Brazilian energy market and the project for exporting liquefied natural gas to California. In the case of construction, sectoral output fell by 7.9% in the first quarter of 2003 relative to the same period a year earlier, and by 42.2% compared to the fourth quarter of 2002.

b) Prices, wages and employment

Consumer price inflation in Bolivia came in at 2.5% in 2002, above the 0.9% recorded in 2001. The rate was very low or negative during the first half of the year, but gathered pace from July onwards, partly reflecting the devaluation of the boliviano against the dollar. The low rate of inflation in tradable goods during 2002 can be attributed to the sharp devaluation of the Argentine and Brazilian currencies, which made goods imported from these two countries cheaper in dollar terms, although the 9.8% devaluation of the boliviano against the United States currency partly mitigated this effect.

Cumulative twelve-month inflation amounted to 3.2% as of June 2003, and the Government is projecting a rate of 2.8% for the year as a whole. There are at least three reasons why inflation is likely to stay low in 2003. Firstly, the most buoyant sectors of the economy are oriented towards commodity exports (soya, hydrocarbons) and have little impact on domestic employment and prices. Secondly, if fiscal revenue fails to grow sufficiently to fulfil the agreement on drawing rights, the Government will probably be forced to under-execute budgeted public expenditure, thereby restraining aggregate demand. Lastly, the rate of devaluation against the dollar is expected to be less than in the previous year.

The employment situation in Bolivia deteriorated during 2002. The urban employment rate slipped from 55.4% in 2001 to 53.0% in 2002, as a result of a 1.8% drop in the number of persons employed, while the working-age population expanded by 2.8%. The urban open unemployment rate only edged up from 8.5% in 2001 to 8.7% in 2002, because the reduction in the number of people employed was partly offset by a 1.6% decrease in the economically active population. This trend affected female workers in particular: the number of women in employment fell by 4.7%, and their urban open unemployment rate rose from 9.7% to 10.3%.

During 2003 it will be hard to achieve sufficient growth in formal employment to absorb the large number of people joining the labour force, considering the limited demand for labour in the most dynamic sectors, which tend to be either capital-intensive (hydrocarbons, industrial soya production) or natural-resource intensive (the soybean agricultural sector). Sectors with job-creating potential include services and public works, in addition to textiles, leather goods and furniture manufacture –in the latter case assuming growth in exports encompassed by the Andean Trade Promotion and Drug Eradication Act.

c) The external sector

The current account deficit of the balance of payments widened in 2002 (4.3% of GDP) compared to 2001 (3.4%), reflecting a worsening trade performance. Imports grew by 3.7%, partly reflecting purchases of capital goods to build the Yacuiba-Río Grande gas pipeline and for other natural-gas investment projects, while exports expanded by just 2%. The capital and financial account posted a surplus equivalent to 9.5% of output, thanks to net FDI inflows amounting to 8.4% of GDP. The latter consisted of investments of US$ 979 million, less disinvestments and outward investment abroad amounting to US$ 325 million. Of total FDI inflows, 70.5% was channelled into activities relating to the extraction and transport of natural gas. Errors and omissions registered a negative balance of 8.9% of GDP, representing the capital flight provoked by the mid-2002 bank run. Consequently, the current account deficit was largely financed by drawing down international reserves.

During the first quarter of 2003, the current account deficit narrowed, mainly because export values grew faster than imports. The latter are expected to grow little during the year because of the real depreciation of the boliviano against the Argentine and Brazilian currencies, compounded by sluggish domestic demand and fewer imports for the construction of gas pipelines.

Bolivian exports are heavily concentrated in three product groups: hydrocarbons (particularly natural gas); minerals; and soya and related products (such as soybean oil and residue cake). Overall, these categories account for about three quarters of the country's exports. The value of hydrocarbon exports rose by 14.3% in 2002, while external sales of natural gas, mainly to Brazil, grew by 10.9% to reach US$ 266 million and account for 20% of total foreign sales. Growth of these exports in the short run is subject to the terms of the contract signed between YPFB and Petrobrás in 1996; in the longer term, their performance also depends on implementation of the Pacific LNG project for exporting liquefied natural gas to Baja California. Gas exports grew in volume terms during 2002, although their price fell slightly. Even so, exports to Brazil (10.3 million m^3/day on average) were less than the 14.3 million m^3/day that Petrobrás had undertaken to purchase in the take-or-pay clause of the signed contract. The Bolivian and Brazilian governments are currently discussing this issue, bearing in mind that the volume of gas to be acquired by Petrobrás under this clause rises to 18.45 million m^3 per day in 2003. In the first quarter of 2003, the value of natural gas exports increased by 19.7%, thanks to sharply higher prices, while volume rose by just 5.1% to 11.9 million m^3 daily.

The value of mineral exports grew by just 1.4% in 2002, with varied performance across the different minerals. While gold, silver, tin and led exports all increased, zinc sales fell back. In January-April 2003, mineral exports expanded by a further 17.2%, as a result of strong performances in silver, zinc and tin. Prospects are good for the remainder of the year, for although gold production is forecast to decrease in the short term its price is expected to remain strong. The price of tin could continue to trend upwards in response to global supply and demand factors; but zinc prices are set to remain low until demand from industrialized countries recovers.

Exports of soybeans and subproducts increased by 15.6% in 2002, and will continue to grow on the back of this year's strong harvest and the prevailing attractive prices.

The total value of imports fell by 5.6% during the first quarter of 2003; consumer goods imports declined by 17.9%, while those of raw materials and intermediate products dropped by 12.7%, despite higher fuel prices. In contrast, imports of capital goods grew by 19.2% during the same period.

Brazil

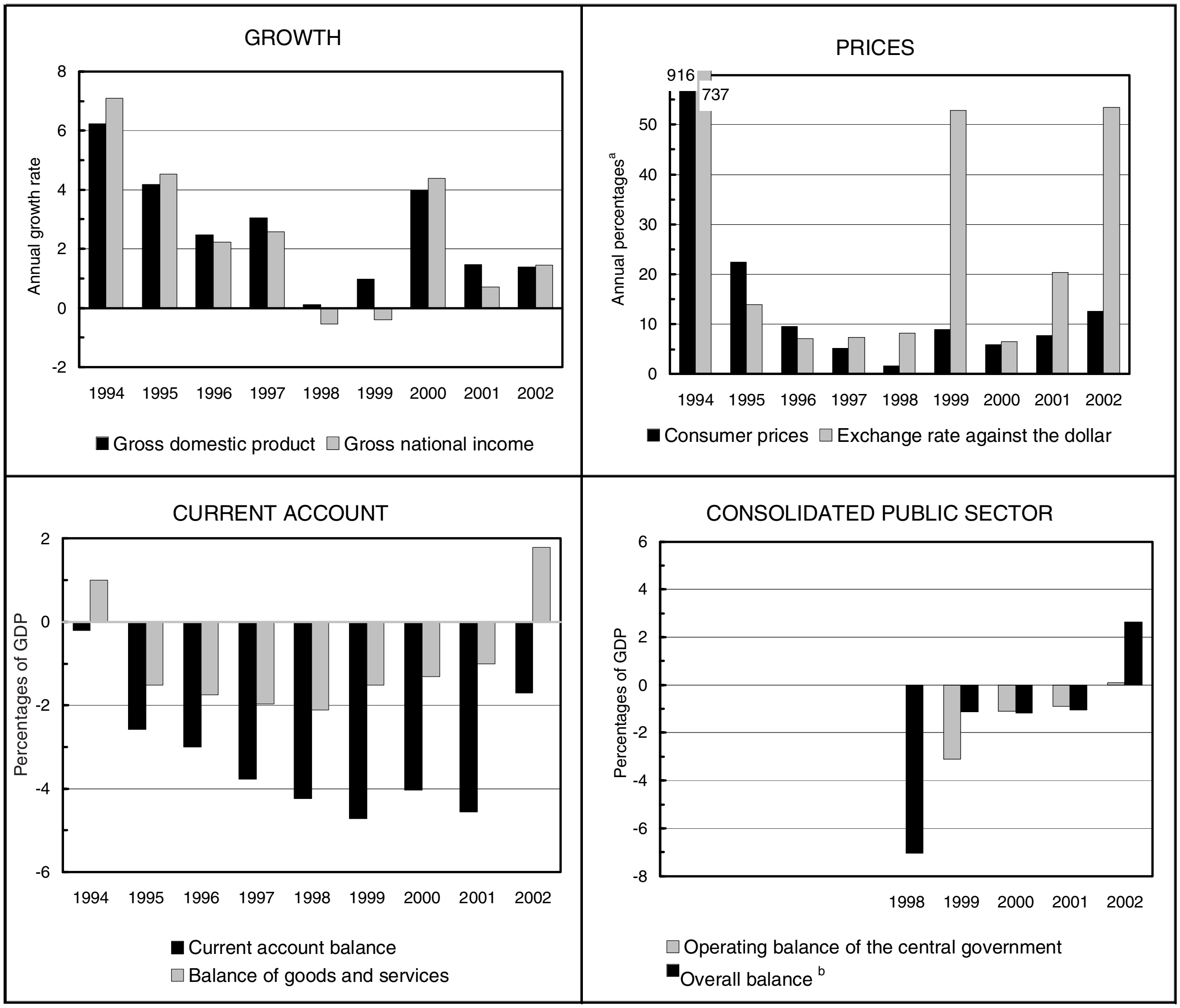
1. General trends

In 2002 the Brazilian economy came up against serious difficulties that prompted international financial markets to raise its country risk and triggered a drastic decline in capital inflows, which, in turn, led to a significant devaluation of the real and an upsurge in inflation. These difficulties arose from uncertainty as to what economic policy would be adopted by the administration to be elected in October and from the country's high levels of external and public borrowing, as well as from the reduced availability of international capital as a result of the slump in activity in the developed countries and a loss of confidence in emerging markets following Argentina's declaration of default in late 2001. Economic policy was accordingly geared to regaining the confidence of financial markets and keeping inflation in check, which forced the authorities to apply very tight monetary and fiscal measures. These actions, together with the end of the uncertainty surrounding the election, made it possible to stem the speculative attack, especially when the new government took office in 2003. However, this tight policy dampened the level of activity, which again posted modest growth (1.4%); the rate for 2003 is expected to approximate the levels of the past two years.

Over the course of 2002 Brazil's country risk soared to 2,200 basis points, eventually causing its external debt instruments to be traded at only 48% of their face value. This loss of confidence shut off the inflow of new resources, generating pressure on the foreign-exchange market and driving the exchange rate up by 62% over its level of late 2001. This external shock also hit the local financial markets, mainly because some of the country's domestic public debt instruments were indexed to the exchange rate. As of late 2001 these instruments already represented nearly 30% of the total, or almost 10% of GDP. Net public debt thus reached the equivalent of over 60% of GDP in September 2002, when the crisis reached its height.

The steep devaluation, in turn, put pressure on domestic prices. Inflation in 2002 climbed to 12.5%, compared to 7.7% the previous year, while wholesale prices jumped by 33%. These changes took place primarily in the last quarter of 2002 (6.6% of the change in consumer prices and 17.5% of the change in wholesale prices). The situation was further complicated by the effects of higher international prices for fuel and certain agricultural exports and by public utility rate increases, particularly electricity surcharges reflecting the costs of

Figure 1
BRAZIL: MAIN ECONOMIC INDICATORS



Source: ECLAC, on the basis of official figures.
[a] December-to-December variation.
[b] Includes interest.

the power rationing that became necessary in 2001 and lasted into 2002.

This bleak picture began to brighten in 2003. In the external sector, a large trade surplus (US$ 8 billion in the first five months) and the return of international credit lines to the country, including the first sovereign bond issue in over 12 months, set the stage for a significant recovery of the real's value against the dollar –which by June had reached over 20%– and for an increase in the value of the main Brazilian debt instrument traded abroad (the C-bond) and a reduction in Brazil's country risk to approximately 750 basis points. A record primary fiscal surplus (equivalent to 6% of GDP) and an austere monetary policy (which raised the benchmark interest rate to 26.5% annually) demonstrated the government's commitment to fighting inflation. Thanks to the currency's revaluation and to renewed confidence in macroeconomic management, inflation gradually subsided over the first six months of 2003, with both consumer and wholesale prices showing deflation in June. For the year as a whole, inflation is expected to be close to the target of 8.5%.

Nevertheless, both expectations of faster growth in 2003 and the possibility of raising wages and reducing unemployment were sacrificed for the sake of maintaining this tight economic policy. Economic activity remained subdued, with the result that a GDP growth rate of about 1.5%, similar to the 2002 rate of 1.4%, is expected for 2003. Likewise, unemployment is projected to show little progress, ranging between 11% and 12% of the economically active population (EAP). Lastly, the uncertainty that emerged in 2002 and the country's austere fiscal and monetary policies have led to the deferral of investment, which has prolonged the difficulties faced by sectors such as construction.

The government is hoping that a growth-friendly virtuous circle will re-emerge once the country's credibility in financial markets has been restored and low inflation has been achieved. Economic projections for 2003 are hampered by uncertainty as to the international context and, especially, the decisions to be taken by the monetary authorities with regard to interest rates and the possibility of easing fiscal policy, since the primary surplus target of 4.25% of GDP has already been exceeded.

2. Economic policy

In 2002 economic policy had to respond to increasing pressure from abroad, but without exerting too adverse an effect on the level of activity, employment and public finances. The authorities opted to maintain the currency float but also to regulate foreign-exchange transactions in the financial system. The central bank is to provide support for maintaining credit lines for foreign trade. Moreover, the agreement with the International Monetary Fund was expanded in terms of both the amount and the term of the credit to be provided, which was extended to September 2003. The consequent increase in available resources (US$ 30 billion) will be more than enough to finance the current-account deficit. In 2002 the authorities sought to ensure that fiscal and monetary policy reacted only to actual changes and not to temporary shocks.

a) Fiscal policy

In the face of severe financial turmoil, the consolidated public sector's primary surplus target was raised from 3.5% of GDP in 2001 to 3.8% in 2002, but the actual surplus amounted to nearly 4%. Tax increases boosted receipts to a record high, equivalent to 35.9% of GDP. Public-sector financing needs, including the impact of the devaluation on total dollar-indexed domestic debt, reached 10.3% of GDP, their highest level since 1995. Accrued interest rose from 8.8% of GDP in 2001 to 14.3% in 2002. Adjusted for the impact of the devaluation, however, financing needs in 2002 amounted to only 4.6% of GDP, which is not much higher than the 3.6% recorded in 2001.

The consolidated public sector's primary surplus widened because its receipts increased by an amount equivalent to 2.1% of GDP, thanks to a legal agreement with pension funds and other taxpayers concerning the payment of income tax, the introduction of an economic intervention tax on fuels, the taxation of the sale of government bonds, payments of royalties and financial compensation for natural resource exploration and concessions, and higher revenues from financial transactions taxes. The larger volume of available resources enabled the federal government to increase spending in real terms; the increases were concentrated primarily in social security payments, health care, targeted poverty reduction programmes and compensation to the states for maintaining federal highways.

Starting in January 2003 the new administration demonstrated its commitment to fiscal responsibility and to the priority task of curbing inflation by taking measures such as raising the consolidated public sector's primary surplus target to 4.25% of GDP in 2003 and reducing liquidity in the economy by raising the benchmark interest rate to 26% a year in January and 26.5% in February. One of the main outcomes of this policy was the generation of a sizeable primary surplus between January and April (6.5% of GDP), which nearly exceeded the six-month target agreed upon with IMF. In April the public sector even posted a small nominal surplus.

These efforts succeeded chiefly because spending was tightly restrained. Between January and April, federal government outlays on other current expenditure (excluding payroll expenses, social security benefits, unemployment insurance and subsidies) and capital expenditure fell by 10% in nominal terms. In addition, steps were taken to control the growth of other expenditure. For example, wage and salary increases were limited to only 1% for the civil service and 20%

Table 1
BRAZIL: MAIN ECONOMIC INDICATORS

	1994	1995	1996	1997	1998	1999	2000	2001	2002[a]
	Annual growth rates[b]								
Gross domestic product	6.2	4.2	2.5	3.1	0.1	1.0	4.0	1.5	1.4
Per capita gross domestic product	4.7	2.7	1.1	1.7	-1.2	-0.3	2.6	0.2	0.1
Gross national income	7.1	4.5	2.2	2.6	-0.5	-0.4	4.4	0.7	1.4
Gross domestic product by sector									
Agriculture	5.5	4.1	3.1	-0.8	1.3	8.3	2.2	5.7	5.8
Mining	6.2	3.7	6.0	5.3	7.4	0.1	11.1	3.4	10.4
Manufacturing	7.3	2.1	2.1	3.2	-3.4	-2.6	5.4	0.6	1.9
Electricity, gas and water	4.2	7.6	6.0	5.9	5.2	1.4	4.2	-5.6	1.5
Construction	7.0	-0.4	5.2	7.6	1.5	-3.7	2.6	-2.6	-2.5
Wholesale and retail commerce, restaurants and hotels	9.3	8.5	1.8	3.0	-4.7	-0.6	4.5	1.5	0.2
Transport, storage and communciations	7.1	11.9	5.5	4.3	0.9	4.0	8.6	7.4	3.1
Financial establishments, insurance, real estate and business services	2.5	-0.6	2.8	3.1	1.9	1.9	4.3	1.6	1.6
Community, social and personal services	2.2	1.4	1.3	1.4	1.0	2.1	1.8	0.8	1.3
Gross domestic product by type of expenditure									
Consumption	6.0	6.5	2.9	2.4	-0.2	0.1	4.0	0.3	0.1
General government	0.3	1.3	1.4	2.1	2.4	2.4	1.3	1.0	1.0
Private	8.2	8.3	3.5	2.5	-1.0	-0.7	4.9	0.0	-0.2
Gross domestic investment	12.9	8.1	2.8	9.3	-0.3	-7.2	4.5	1.1	-4.1
Exports of goods and services	4.0	-2.0	0.6	11.2	3.7	9.3	10.6	11.2	7.7
Imports of goods and services	20.3	30.7	5.4	17.8	-0.3	-15.5	11.6	1.2	-12.8
	Percentages of GDP								
Investment and saving									
Gross domestic investment[b]	21.5	22.3	22.4	23.7	23.6	21.7	21.8	21.7	20.5
Gross domestic investment[c]	22.1	22.3	20.9	21.5	21.1	20.2	21.5	21.2	19.3
National saving[c]	21.2	19.5	17.8	17.4	16.8	15.4	17.3	16.6	17.6
External saving[c]	0.9	2.8	3.1	4.1	4.3	4.7	4.2	4.5	1.7
	Millions of dollars								
Balance of payments									
Current account	-1,153	-18,136	-23,248	-30,491	-33,416	-25,336	-24,225	-23,213	-7,695
Goods balance	10,861	-3,157	-5,453	-6,652	-6,574	-1,199	-697	2,651	13,143
Exports fob	44,102	46,506	47,851	53,189	51,140	48,011	55,086	58,223	60,362
Imports fob	-33,241	-49,663	-53,304	-59,841	-57,714	-49,210	-55,783	-55,572	-47,219
Services balance	-5,346	-7,495	-8,059	-9,309	-10,111	-6,977	-7,162	-7,759	-5,038
Factor income balance	-9,091	-11,105	-12,177	-16,344	-18,189	-18,849	-17,887	-19,743	-18,190
Current transfers balance	2,423	3,621	2,441	1,814	1,458	1,689	1,521	1,638	2,390
Capital and financial balance[d]	7,751	31,105	31,930	22,240	16,117	14,549	32,285	19,763	-3,483
Net foreign direct investment	2,035	3,475	11,667	18,608	26,002	26,888	30,497	24,715	14,084
Financial capital[e]	5,716	27,630	20,263	3,632	-9,885	-12,339	1,788	-4,952	-17,567
Overall balance	6,598	12,969	8,682	-8,251	-17,299	-10,787	8,060	-3,450	-11,178
Variation in reserve assets[f]	-7,215	-12,920	-8,326	8,284	7,970	7,822	2,262	-3,307	-302
Other financing[g]	617	-49	-356	-33	9,329	2,965	-10,322	6,757	11,480
Other external sector indicators									
Real effective exchange rate (index *2000=100*)[h]	83.6	75.6	72.2	71.1	73.5	108.4	100.0	120.2	132.1
Terms of trade for goods *(index 1997=100)*	88.2	96.4	94.5	100.0	100.0	90.2	87.6	87.4	84.7
Net resource transfer (*% of GDP*)	-0.1	2.8	2.5	0.7	0.9	-0.2	0.7	1.3	-2.3
Gross external public debt (millions of dollars)	153,572	165,447	186,561	208,375	259,496	241,468	236,156	226,067	227,689

Table 1 (concluded)

	1994	1995	1996	1997	1998	1999	2000	2001	2002[a]
Gross external public debt (*% of GDP*)	28.1	23.5	24.1	25.8	32.9	45.0	39.2	44.4	50.3
Net interest and earnings (*% of exports*) [i]	-18.3	-20.8	-23.1	-27.7	-31.0	-34.4	-27.8	-29.4	-26.1
					Percentages				
Employment									
Labour force participation rate [j]	59.3	59.3	59.6	58.5	58.2	57.1	58.0	56.4	56.7
Open unemployment rate [k]	5.1	4.6	5.4	5.7	7.6	7.6	7.1	6.2	7.1
Visible underemployment rate [k]	...	...	...	...	...	...	...	...	3.6
					Annual percentages				
Prices									
Variation in consumer prices	916.4	22.4	9.6	5.2	1.7	8.9	6.0	7.7	12.5
Variation in wholesale prices (IPA DPI)	857.7	6.4	8.1	7.8	1.5	28.9	12.1	11.9	35.4
Variation in nominal exchange rate	736.7	13.9	7.2	7.4	8.2	52.9	6.5	20.4	53.5
Variation in average real wage	0.8	3.8	7.9	2.6	0.0	-4.4	-1.0	-5.0	-2.1
Real deposit rate [l]	79.5	26.6	16.3	19.1	27.0	15.3	10.9	9.1	4.0
Real lending rate [m]	...	...	...	69.9	83.2	65.4	48.0	46.4	42.3
Equivalent deposit rate in foreign currency [n]	54.5	35.3	18.7	16.9	18.4	-17.6	10.3	-2.5	-22.4
					Percentages of GDP				
Consolidated public sector									
Total income of central government [o]	...	...	...	...	...	18.1	17.8	18.9	20.1
Total expenditure of central government [p]	...	...	...	...	...	21.4	19.0	20.2	20.4
Saving of central government	...	...	...	...	...	...	...	...	...
Capital balance of central government	...	...	...	...	...	...	...	...	...
Operating balance of central government [q]	...	...	...	...	...	-3.1	-1.1	-0.9	0.1
Operating balance	...	...	...	...	-7.1	-1.1	-1.2	-1.1	2.6
Public debt	30.0	30.6	33.3	34.4	41.7	49.2	49.4	52.6	52.6
External	8.7	5.6	3.9	4.3	6.2	10.4	9.8	10.4	10.4
Domestic	21.3	25.0	29.4	30.1	35.5	38.8	39.7	42.2	42.2
Interest payments (% of current income)	...	...	...	...	...	...	...	...	...
Money and credit [r]									
Domestic credit [s]	34.9	39.8	40.3	41.1	42.6	47.3	43.7	44.4	47.1
To public sector	3.0	4.8	7.8	10.5	9.4	12.1	10.9	11.0	14.1
To private sector	31.8	35.0	32.4	30.7	33.3	35.2	32.8	33.4	33.0
Liquidity (M3)	...	...	...	...	...	...	...	...	...
Currency in circulation and domestic currency deposits (M2)	37.0	23.5	22.7	23.8	26.9	26.7	24.2	24.2	26.4
Foreign currency deposits	...	...	...	...	...	...	...	...	...

Source: ECLAC, on the basis of official figures.

[a] Preliminary figures. [b] Based on constant 1995 dollars. [c] Based on figures in local currency at current prices. [d] Includes errors and omissions. [e] Refers to the balance on the capital and financial accounts, minus net foreign direct investment plus errors and omissions. [f] A negative sign denotes an increase in reserves. [g] Includes the use of credit and loans from IMF and exceptional financing. [h] Annual average, weighted by the value of exports and imports of goods. [i] Refers to net investment income divided by exports of goods and services from the balance of payments. [j] Economically active population as a percentage of the working-age population in six metropolitan areas. [k] Rates of unemployment and underemployment are percentages of the economically active population in six metropolitan areas. [l] Deposit certificates accumulated in the month. [m] Average rate on credit operations with free resources, general total. [n] Interest rate on deposits, deflated by the variation in the dollar exchange rate. [o] Refers to total income net of transfers. [p] Includes real interest. [q] Includes adjustments to the operating balance. [r] Average annual values were used for monetary figures. [s] Net credit to the public and private sectors extended by commercial banks and other financial and banking institutions.

Table 2
BRAZIL: MAIN QUARTERLY INDICATORS

	2001				2002[a]				2003[a]	
	I	II	III	IV	I	II	III	IV	I	II
Gross domestic product (change from same quarter of preceding year) [b]	4.0	2.1	0.5	-0.8	-0.8	1.0	2.5	3.4	2.0	...
Goods exports fob (millions of dollars)	13,788	15,139	15,447	13,849	11,891	13,161	18,466	16,844	15,045	17,957
Goods imports cif (millions of dollars)	14,469	14,533	14,117	12,464	10,863	11,609	13,185	11,574	11,225	11,379
International reserves (millions of dollars)	34,407	37,318	40,054	35,866	36,721	41,999	38,406	37,823	42,335	47,957
Real effective exchange rate (2000=100) [c]	107.7	118.0	128.8	126.2	110.2	114.5	142.7	161.2	150.3	128.6
Urban unemployment rate [d]	6.0	6.6	6.2	6.2	12.2	12.0	11.7	10.8	11.6	12.7
Consumer prices (12-month variation, %)	6.4	7.3	6.5	7.7	7.7	7.7	7.9	12.5	16.6	16.6
Average nominal exchange rate (reais per dollar)	2.0	2.3	2.5	2.5	2.4	2.5	3.1	3.7	3.5	3.0
Real average wage (change from same quarter of preceding year)	-1.0	-3.4	-5.1	-9.9	-6.1	-1.7	-1.5	3.1	-7.1	-12.2
Nominal interest rates (annualized percentages)										
Deposit rate[e]	15.3	16.5	18.9	19.1	18.9	18.1	18.0	21.2	25.6	26.1
Lending rate[f]	51.8	55.0	61.0	62.6	60.8	59.4	62.6	68.7	72.4	72.3
Interbank rate [g]	15.4	16.6	18.9	19.1	18.9	18.3	18.0	21.3	25.7	26.2
Sovereign bond spread (basis points)	814	841	1,163	870	717	1,527	2,396	1,439	1,059	788
Stock price indexes (indexes, June 1997=100)	59.6	58.5	40.3	54.1	56.4	42.2	26.0	36.2	37.6	46.4
Domestic credit[h] (change from same quarter of preceding year)	10.3	3.8	15.5	17.6	17.6	23.3	18.2	11.8	14.2	...
Mature credit as a porportion of total credit (%) [i]	4.8	3.9	3.9	4.4	4.7	4.9	4.4	4.0	4.3	4.5

Source: ECLAC, on the basis of official figures.
[a] Preliminary figures. [b] Índice encadenado, base 1990=100. [c] Quarterly average, weighted by the value of exports and imports of goods. [d] New methodology used from first quarter of 2002 on. Data not comparable with earlier figures. [e] Deposit certificates accumulated in the month. [f] Average rate on credit operations with free resources, general total. [g] SELIC (Special System for Settlement and Custody) rate. [h] Refers to net credit to the public and private sectors extended by commercial banks and other financial and banking institutions. [i] Refers to credit extended by the financial system.

for the minimum wage (the basis for calculating social security contributions, meaning that this readjustment represented a real increase of 2.7%). Total income expanded by 14.5% in nominal terms, but income as a percentage of GDP fell by 1.8 percentage points, mainly because pension funds and other taxpayers finished making extraordinary income tax payments to the government.

b) Monetary policy

Monetary policy in 2002 had to adjust to the impact of external shocks such as the increase in international fuel prices and the drastic downturn in capital flows, which led to a sharp devaluation of the currency. For the second year in a row the original inflation target (5.5% for the year) could not be met. The authorities' less than full commitment to the target was demonstrated by the modest reduction of the benchmark interest rate from 19% a year in late 2001 to 18.5% in March 2002 and 18% in July 2002. Not until October did the central bank begin to react to price pressures by raising the rate, first to 21% and then, in December, to 25%.

The delay in using the interest rate as a policy instrument was due in part to problems in addressing external shocks. Apart from the currency devaluation, at the end of the first half of the year the central bank changed the financial market's operating procedures. For example, it required that public and private securities held by investment funds should be valued on a daily basis according to their market, rather than nominal, value; at the same time, the new Brazilian system of payments went into effect, shifting onto the market the daily risk of interbank transactions, which the central bank had formerly administered under its compensation system. Those two changes prompted investors to adjust their portfolios by withdrawing resources from public securities transactions and showing a preference for liquid assets and foreign currency. Accordingly, beginning in June 2002 the monetary base expanded rapidly (by 7.8% that month) and continued to do so until October.

The flight to liquidity triggered by uncertainty was reflected in the growing daily availability of resources on the overnight market. After having shown a balanced daily position in April, excess liquidity reached nearly 10 billion reais in May, 20 billion in July and over 50 billion in October (equivalent to 80% of the monetary base). To soften the impact of the large volume of resources in circulation, the central bank issued securities with a swap option whereby they could be linked to either the interest rate or the exchange rate and took steps to raise the amount of banks' mandatory deposits with the monetary authority. By late December 2002 swaps totalled some US$ 30 billion. In June and August the central bank raised reserve requirements on savings and time deposits to 20% and 15%, respectively, with higher requirements for amounts exceeding US$ 100 million. These additional requirements can raise the mandatory deposit as high as 30% for savings deposits and 23% for time deposits.

In the initial months of 2003 the central bank gained greater control over monetary management. As the country regained access to external financial markets and was even able to float a new sovereign bond issue, investors began to show more confidence in domestic public debt. As a result, daily excess liquidity was reduced by half. At the same time, the proportion of dollar-indexed domestic public debt fell from 36.4% of the total in January to 30.4% in April. Moreover, the increase in the benchmark interest rate to 26.5% signalled the firmness of the central bank's commitment to controlling demand as a means of softening the impact of the 2002 devaluation. The authorities also turned once again to reserve requirements as a way of reducing liquidity, raising the rate on sight deposits from 45% to 60%, with an immediate impact on the bank multiplier.

As a result of these measures, the supply of money and credit shrank considerably. Between January and May 2003 the monetary base contracted by 11.2% and the money supply, by 22.7%. In addition, the banking system cut back the supply of credit, since the total amount of credit in April represented 23.3% of GDP, compared to 26.8% a year earlier.

c) Exchange-rate policy

Exchange-rate fluctuations in 2002 were very pronounced, with a 67% increase in the exchange rate between December 2001 and September 2002. As the rate fell by 10% in the final quarter, the year ended with a cumulative increase of 52%. This was higher than the 49% variation registered in 1999, when the free float had been introduced.

Net capital inflows dropped sharply in 2002, especially from the second quarter onward, with the withdrawal of portfolio investments and the non-renewal of notes and other lines of credit, including, for the first time, commercial credit lines. On the supply side, the government negotiated an extension of its agreement with the International Monetary Fund, which had been set to expire in December 2002. Under the extension, in addition to the resources already agreed upon, a credit line of up to US$ 30 billion was granted, which will be available to Brazil up until September 2003. While this amount has been paid out in instalments in line with the performance of economic policy, it will, in all likelihood, be more than enough to finance the projected current-account deficit. The build-up of reserves enabled the central bank to offer directly to the market limited amounts of foreign exchange and credit lines to sustain trade flows.

On the demand side, in view of the climate of uncertainty surrounding the elections and the depressed level of economic activity, the central bank took action to shore up liquidity in the economy with measures to offset the monetary impact of foreign-exchange outflows. At the same time, it endeavoured to raise the cost of currency speculation by setting limits on foreign-exchange transactions and reserve requirements on bank liabilities. Lastly, it began to operate in the derivatives market, offering swap transactions in federal securities payable according to either the local-currency interest rate or the variation in the exchange rate.

On the political front, in July the chief candidates for the presidency of the Republic pledged to carry out the programme proposed by IMF and to observe the principles of fiscal responsibility and the debt repayment schedule. Once the election was over, the orderly transition made it possible to control the devaluation spiral. Moreover, currency speculation was further reined in by the consolidation of the merchandise trade surplus, which afforded the foreign-exchange market more liquidity.

In the first six months of 2003 the real's value in relation to the dollar climbed by 14%, reflecting increased inflows of external financing. This has sparked an intense debate, since some analysts and even some authorities have pointed out that these inflows consist primarily of short-term capital and that their entry should therefore be more tightly controlled. In addition, government authorities and some production sectors are worried about the falling exchange rate's possible effect on export performance. The real exchange rate's 9.5% decline in the first half of 2003 has opened up a debate as to what the exchange rate's equilibrium level should be to prevent it from compromising the export sector. Some analysts have proposed the establishment of an exchange-rate floor, while others insist that, under the inflation targeting system, a pre-set floor makes no sense and the real must be allowed to float without limitations.

d) Structural reforms

In late April 2003 the government put before the National Congress its tax and social security reform proposals, which are largely the continuation of previous efforts. The tax reform proposal is limited in scope and focuses on three objectives: unifying and simplifying the laws on the state-administered tax on the circulation of goods and services, making the financial transactions tax permanent and seeking ways to reduce tax regressivity and tax accumulation.

The new social security reform proposal is aimed at making changes in the civil-service retirement and pension system over and above the changes introduced under the constitutional amendment adopted in 1998. Its basic objective is to bring the amounts and conditions of retirement benefits in the public sector closer to those provided under the general regime (National Social Security Institute). These proposals have been highly controversial and may therefore undergo major changes in the Congress.

3. The main variables

a) Economic activity

Economic growth reached 1.4% in 2002, closely approximating its 2001 level. The outlook for 2003 points to a growth rate similar to the ones posted for the past two years, of about 1.5%, although a degree of recovery is expected at the end of the year, driven by a probable reduction in interest rates.

Economic activity in 2002 would have been even more lethargic had it not been for the performance of external trade, since the volume of exports rose by 7.7% and the value of imports slid sharply (12.8%). This outcome, which was mainly attributable to the combination of currency devaluation and economic recession, offset the 0.2% contraction in private consumption that resulted from the slump in workers' real income and unfavourable terms for consumer credit.

Investors' response to this situation was procyclical, prompted by high interest rates, the uncertainty surrounding the election, the drying-up of external capital inflows, the soaring exchange rate and, in the second half of the year, the rise in prices. These factors brought gross fixed capital formation down by 4.1%, as the volume of capital goods imports plunged (18%) and construction activity retreated (2.5%). This poor performance was observed throughout 2002, with little movement in the main economic aggregates. The only significant change was in external trade, with respect to both imports (which dropped by 4.3% in the final quarter) and, especially, exports (which jumped by 25% between the second and third quarters).

As in 2001, in 2002 the different sectors contributing to GDP posted varying results. Agriculture expanded by 5.8% and mining, by 10.4%, but manufacturing rose by only 1.9%, as intermediate goods increased by 3%, consumer goods stagnated and capital goods dipped by 1%. Services, meanwhile, showed growth of about 1.5%.

The combination of a recessionary environment and strong export performance was still in evidence in 2003. In the first quarter GDP stalled in comparison to the final quarter of 2002, although consumption rose slightly. Industry grew by 2.9% but suffered a setback in the second quarter. The upshot was that industrial activity expanded by only 0.6% over the first five months in relation to the same period of the preceding year as a result of upturns in the mechanical and metallurgical industries and downturns in the electrical equipment, communications equipment, textile, clothing and footwear and pharmaceuticals industries.

In 2003 GDP growth is projected to border on 1.5%, mainly on the strength of an estimated 3.7% expansion in agriculture resulting from the production of 120 million tons of grain, representing a 23% increase over the previous year's output. Conversely, manufacturing and services will grow more slowly, at about 1.8% and 1.3%, respectively.

b) Prices, wages and employment

As in 2001, in 2002 the inflation targeting system did not guarantee favourable price trends. The consumer price index rose by 12.5%, compared to a target of 6.5%. This discrepancy was due mostly to the steep currency devaluation and also to the effects of administered prices (particularly for energy), higher fuel prices and dwindling expectations. These factors had even more pronounced effects on wholesale prices, which surged by 35.4% in 2002, the biggest annual increase since 1999. Prices for agricultural products, which are more sensitive to exchange-rate fluctuations, jumped by 47%, while manufactures prices increased by 31%.

One of the main outcomes of the new government's economic policy in 2003 was the turnaround in inflation. The marked slowdown in price increases was due largely to the local currency's revaluation against the dollar. After having risen by 3% in November 2002, prices showed slight deflation (-0.1%) in June 2003 and inflation for the year as a whole will probably drop down to a single digit, at just under 10%. Thus, it is likely that the target will again be overshot, but to a lesser degree than in 2002. The decline in inflation was even more dramatic in the case of wholesale prices, which went from a 7.5% rise in November 2002 to contractions of 1.7% in May and 1.2% in June 2003.

The labour market has not been a good one for workers, who suffered a 3.8% loss in real average remuneration over the course of 2002. All categories of workers were affected, even those with higher levels of education. Average unemployment reached 11.7% between March and December 2002, according to the new methodology used by the Brazilian Geographical and Statistical Institute (IBGE). This high rate reflected large increases in both the working-age population (2.2%) and the workforce participation rate, which more than offset surprisingly strong job creation (1.7% in metropolitan areas). In December 2002 the wage bill was 3% lower than it had been in December 2001.

Stalled GDP growth in the first quarter of 2003 led to a downturn in employment and income indicators. Unemployment hit 12.4% in April, representing nearly 2.6 million jobless workers in the main metropolitan areas. In March 2003 the wage bill and real average income were 5.6% and 6.4% lower, respectively, than they had been in March 2002.

c) The external sector

In 2002 Brazil posted a merchandise trade surplus of US$ 13.1 billion, which was US$ 10.5 billion (2% of GDP) higher than the previous year's surplus. A surplus this size had not been achieved since the early 1980s, when high import barriers had brought about a comparable result. The 2002 outcome was due, on the one hand, to the strong upswing in exports in the second half of the year, which more than offset the decline recorded in the first half; and, on the other, to the significant drop in the value of merchandise imports (15%) in comparison to the 2001 figure. Consequently, the current-account deficit amounted to US$ 7.7 billion, which was one third the negative balance posted in 2001.

The upsurge in exports reflected a 9% increase in export volume, which offset the 5.5% drop in prices. Commodities and semi-manufactures grew the fastest, while manufactures showed remarkable resilience: after falling steeply in the first half of the year, their volume increased by 17.8% in the second half and by 5.2% for the year as a whole. In addition, export performance continued to be affected by international prices. Considerable declines were observed in the prices of coffee (11%), soybeans (3.4%), sugar (22.3%), cellulose (12.5%) and tobacco (8.3%).

Meanwhile, the drop-off in imports primarily reflected a 12% reduction in the volume traded. The downturn was most pronounced in the case of consumer durables (38%) and capital goods (20%).

In 2003 the balance-of-payments out-turn was even better than the one achieved in 2002. The overall balance for the first four months was positive and amounted to US$ 2.829 billion, whereas a deficit of US$ 2.882 billion had been posted in the same period of 2002. This was attributable almost entirely to the performance of merchandise trade, which increased its surplus from US$ 1.5 billion between January and April 2002 to US$ 5.5 billion in the same period of 2003. The deficit on the services account narrowed, likewise reflecting the effects of the currency devaluation and sluggish economic growth. The income account, however, was eroded by the considerable increase in profit and dividend remittances, which went from US$ 1.071 billion in the first four months of 2002 to US$ 1.595 billion in the same period of 2003.

Accordingly, between January-April 2002 and January-April 2003 the current-account deficit plunged from US$ 5.235 billion to US$ 884 million. At the end of the latter period it represented 0.6% of GDP –a big improvement over the 3.6% recorded in the same period of 2002 and, especially, the 4.7% recorded in 1999. International reserves thus reached US$ 41.5 billion in April; however, after deducting the resources committed under the IMF agreement, available reserves totalled US$ 15.914 billion.

In the first five months of 2003 merchandise trade ran a surplus of US$ 8 billion, more than triple the surplus posted in the first five months of 2002. Export value reached US$ 27.128 billion and import value, US$ 19.083 billion, which represented increases of 29% and 1%, respectively, over their levels in the same period of 2002. Exports rose significantly in all product categories as increases were observed in both external prices and, especially, the volume of goods shipped. Prices were up by 4.9%, with the biggest increases in commodities (6.4%) and semi-manufactures (12.2%). Nonetheless, the larger merchandise trade surplus primarily reflected a 19.6% rise in export volume. The value of commodity exports surged by 33.7% and that of manufactures exports, by 19.2%. It should be pointed out that 31% of the expansion of total exports was accounted for by soybeans. Some non-traditional exports –such as raw cotton, honey, marble, granite and fruit– also performed well, indicating a reasonable degree of export diversification.

An improvement was also observed in the geographical diversification of target markets for Brazilian exports. Outstanding in this regard was the 230% increase in sales to China, which totalled US$ 1.7 billion, making that market the second most important for the country's exports. Other fast-growing markets were those of Argentina, Germany and the Middle East.

The rise in imports in the first five months of 2003 mainly reflected the fact that prices were 10% higher than they had been in the same period of 2002. This overall increase was strongly influenced by the price hikes of 53% in fuels and lubricants, 7.2% in capital goods and 5.1% in intermediate goods. Import volume dropped by 7.9%, with downturns in all categories, although the steepest slide was in capital goods (31%). The biggest increases were seen in miscellaneous chemicals, agricultural products, petroleum and coal, and plastics.

The fact that import volume has continued to trend downward while industrial output has recovered since the end of 2002 and the real has appreciated in recent months is regarded by some analysts as a sign that an import substitution process is under way and that this process is most intensive in the case of capital goods.

The less rosy aspect of this phenomenon is that capital inflows by way of foreign investment have declined. Net foreign direct investment fell from US$ 5.920 billion between January and April 2002 to only US$ 2.115 billion in the same period of 2003. This means that the FDI-to-GDP ratio has dropped from 4.6% to just 1.9%. In the same four months of 2003 portfolio investment amounted to US$ 1.257 billion, which is considerably lower than the US$ 3.649 billion recorded in the first four months of 2002.

In February 2003 Brazil's external debt amounted to US$ 228.597 billion, of which US$ 187.023 billion consisted of medium- and long-term debt and US$ 24.031 billion, of short-term debt. In December 1998 the country's debt had totalled US$ 241.6 billion. Debt reduction has been most pronounced in the private sector, which has been forced to convert debt to investment in view of low external liquidity. As of late 2002, the composition of external debt was as follows: non-financial public sector, 40%; private sector, 30%; short-term private debt, 10%; IMF debt, 9%; and financial public sector, 4%.

These results reflect an improvement in Brazil's external borrowing indicators. The traditional indicator ¯the debt-to-GDP ratio¯ categorically demonstrates that the country's borrowing has always been very low, especially in comparison to that of other developing countries. The debt-to-exports ratio is less auspicious, given the relatively limited value of external sales. In 2002 this latter ratio was 3.77, which, though high, is considerably lower than the ratio of 5.03 recorded in 1999.

The average maturity of medium- and long-term debt is 6.79 years. Public-sector debt maturities average 9.65 years, while private-sector maturities average 4.06 years. The cost of this debt is relatively low, at 7% to 8% a year.

Chile

1. General trends

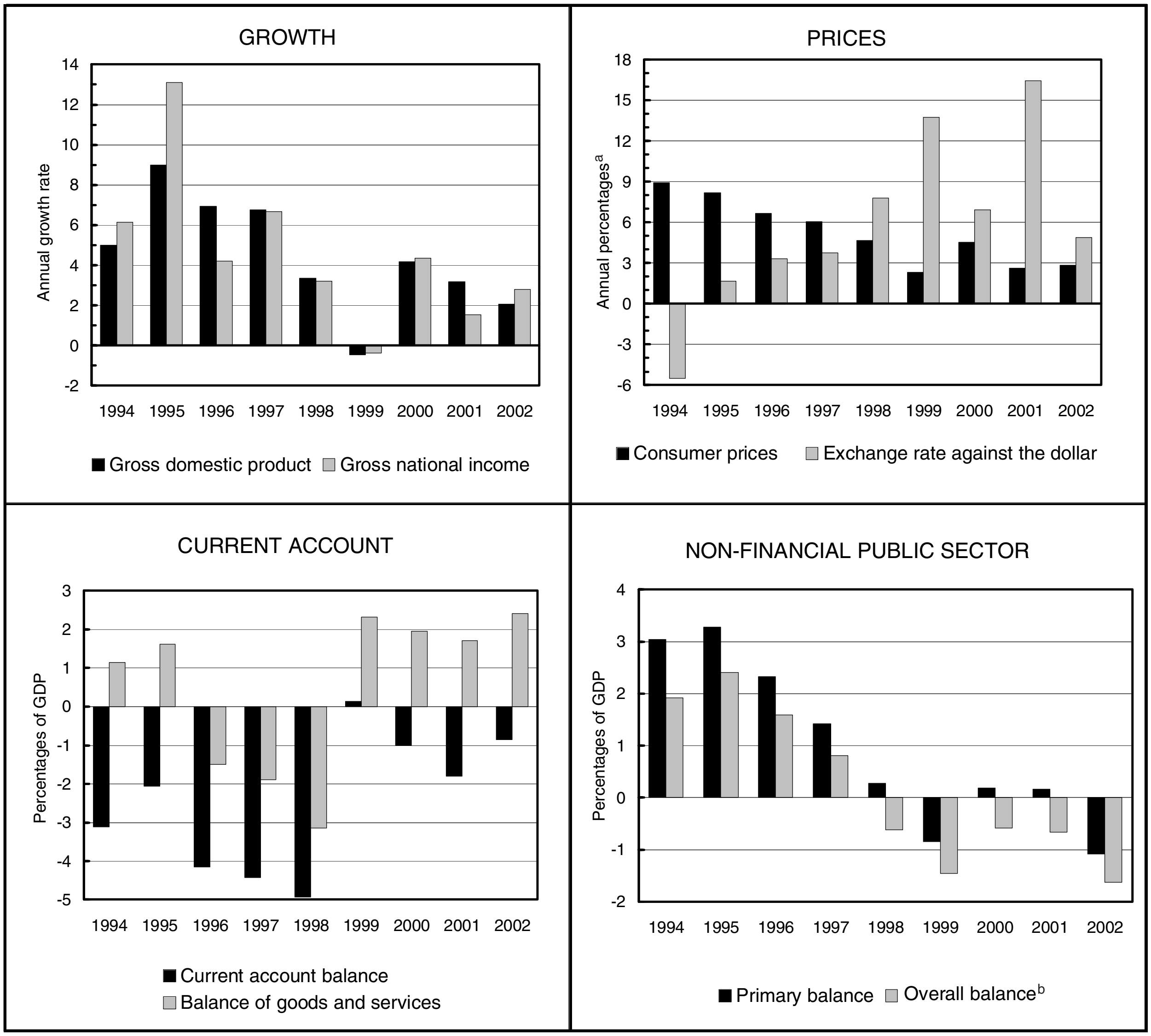
The Chilean economy has continued to grow at a modest rate, with GDP expanding by 2.1% in 2002 following its 3.2% rise in 2001. Although inflation displayed seasonal fluctuations and was sensitive to oscillations in the exchange rate and the international price of oil and petroleum products, the rate for the year as a whole ended around 3%, broadly in line with the target set by the monetary authorities. Since 2001, the worldwide economic slowdown, together with the regional crisis and heightened global risk, have conspired to dampen external trade, reduce capital inflows and worsen Chile's terms of trade, which in 2002 failed to recoup the previous year's deterioration of nearly 7%. While merchandise exports expanded by over 44% between 1996 and 2002 in volume terms, the fact that prices dropped by almost 25% is a clear indication of how external conditions have deteriorated over the past few years.

The outlook for 2003 is somewhat brighter, however. The economy is showing signs of rallying, and GDP is forecast to grow by over 3.5% during the year as a whole. The monthly indicator of economic activity rose by 3.2% between January and May with respect to the same period in 2002. During the first four months of 2003, merchandise exports were up by 8.1% compared to the same period a year earlier, which marked the strongest percentage rise since 1999. Exporters are banking on this rate of growth lasting throughout the year, which would bring in foreign-exchange earnings of between US$ 19 and US$ 20 billion, to set a new historical record.

This upturn reflects recovery among the main export products, and also an increase in volumes actually shipped. Expectations are that the price of copper (which accounts for 38% of merchandise exports) will rise from an annual average of US$ 0.71 per pound to US$ 0.76, in view of the steady rundown in inventories that has occurred in recent months. Forestry exports expanded by 14.1% during the first quarter and, together with woodpulp, are expected to grow by over 10% for the year overall. Salmon prices began to strengthen in the Japanese market, the main destination for this product, and exports rose by 33% in value terms. Wine exports have also performed robustly, posting a rise of 11% at the end of the first quarter. In addition to this generalized improvement, the lower oil price is likely to induce a terms-of-trade improvement of at least 2%.

One of the most significant developments for Chile's external trade is the free trade agreement signed with the United States on 6 June. This is scheduled to take effect in early 2004 following congressional ratification on both sides. This agreement will make it possible to improve trading relations between the two countries, by establishing regulations on dispute settlement, access to goods and services markets (including financial

Figure 1
CHILE: MAIN ECONOMIC INDICATORS



Source: ECLAC, on the basis of official figures.
[a] December-to-December variation.
[b] Includes interest.

services), and labour and environmental issues. An aspect of the agreement that caused controversy was Chile's reserve requirement on short-term capital (known as the "encaje"), which remains a potentially usable mechanism despite currently being set at a zero rate. The final agreement eliminates all restrictions on the free movement of capital between the United States and Chile, but allows for temporary capital controls to be imposed should conditions arise that are likely to have serious economic consequences.[1] These barriers are not expected to conflict with the other clauses of the agreement, however. As the United States absorbs over 20% of Chile's foreign sales, the agreement is expected to generate a major export expansion.

On 18 November 2002 Chile signed an association agreement with the European Union (EU), the trade

1 Nonetheless, any disputes arising on this point have to be resolved through a dispute settlement mechanism with special rules, that are favourable to Chile.

chapter of which came into effect on 1 February 2003. The European Union is Chile's largest trading partner, its main source of foreign direct investment (FDI) and its largest provider of international cooperation. Under the agreement, 85% of Chilean exports now enter EU tariff-free, while the remainder of the tariff universe will be gradually phased out over a maximum period of 10 years. Official estimates see agricultural exports doubling within five years, including substantial increases in exports of red and white meats. In the first three months after the agreement came into effect, the value of exports to EU rose by almost 30%, although this is probably also attributable to the appreciation of the euro against the dollar. Although it is too soon to evaluate the results, Chile's export industry will clearly be boosted as a result of this accord.

A free trade agreement has also been signed with the Republic of Korea, marking the first trans-Pacific trade agreement between Asian and Western economies. The Republic of Korea is one of Chile's major trading partners, currently ranking between fourth and sixth as an export destination in competition with Brazil and Mexico. When these agreements come fully into effect, 50% of Chile's exports will enjoy a zero tariff, and the overall average tariff faced will be around 2% –one of the lowest rates in the world.

2. Economic policy

Economic policy adopted an expansionary stance in 2002 in response to the economy's modest growth rate. In keeping with the government's structural surplus rule, fiscal policy was counter-cyclical, while the benchmark interest rate, known as the monetary policy rate (TPM) continued to drop to very low levels. The authorities also maintained their flexible exchange-rate policy.

a) Fiscal policy

The trade agreements signed by Chile mean that the Treasury will forgo revenue amounting to about US$ 430 million per year as from 2004, owing to the elimination or reduction of import duties. The authorities expect this loss of income to be temporary, however, since the additional economic activity generated by the agreements is expected to make up for the initial deficit (the joint economic impact of the agreements with the United States and EU is estimated at almost two percentage points of GDP, in equal proportions). The loss of government income will be compounded by social programmes costing US$ 320 million scheduled to come on stream in 2004. The financing formula approved by Congress includes a rise in VAT, from 18% to 19%, effective from 1 October 2003 through 1 January 2007. Congress has also authorized the sale of the State's minority stake in the water utilities, and certain spending items will also probably be trimmed back in order to preserve the structural surplus. Overall public spending declined by US$ 300 million.

In 2002 and 2003, fiscal policy has continued to be based on the principle of maintaining a central government structural surplus of 1% of GDP. This is calculated by forecasting the level of fiscal revenue, considering growth trends in economic activity and the long-term trend price of copper.

As macroeconomic conditions worsened, fiscal revenues came in under budget, yet the Government made no adjustments to projected public expenditure in real terms. The cyclical component of the public-sector balance thus turned even more sharply negative than in 2001, with the deficit widening from 1.5% to 2% of GDP.

In 2002 the non-financial public-sector (NFPS) deficit of 1.6% of GDP was financed by the proceeds of a US$ 900 million international sovereign bond issue made in April. The surplus left over from this operation was used to prepay older foreign loans carrying higher rates of interest, and to replenish the Copper Stabilization Fund. Nonetheless, the overall central government deficit was financed basically by drawing down financial assets rather than net borrowing. Revenues from copper totalled US$ 502 million, comprised of US$ 80 million in transfers from CODELCO in the form of taxes, and US$ 422 million in withdrawals from the Fund, whose balance at 31 December 2002 stood at US$ 277 million. In the same month, the gross financial debt of the central government amounted to 15.9% of GDP, of which only 5.8 percentage points was owed abroad.

In 2003, more vigorous GDP growth and an upturn in the copper price should narrow the central government deficit to about 0.7% of GDP. This will be financed by an external debt issue of US$ 1 billion placed in January, supported by the fiscal measures mentioned above. The budget law sets a borrowing limit of US$ 500 million

Table 1
CHILE: MAIN ECONOMIC INDICATORS

	1994	1995	1996	1997	1998	1999	2000	2001	2002[a]
				Annual growth rates[b]					
Gross domestic product	5.0	9.0	6.9	6.8	3.3	-0.5	4.2	3.2	2.1
Per capita gross domestic product	3.3	7.3	5.4	5.3	1.9	-1.8	2.9	1.9	0.8
Gross national income	6.1	13.1	4.2	6.7	3.2	-0.4	4.4	1.5	2.8
Gross domestic product by sector									
Agriculture	7.5	6.9	2.8	3.4	2.3	0.8	7.0	5.7	5.2
Mining	8.9	9.3	15.8	11.3	8.3	10.6	3.5	6.2	-0.3
Manufacturing	4.1	7.5	3.2	4.7	-2.3	-0.5	4.0	0.5	2.8
Electricity, gas and water	6.2	7.6	-3.8	8.3	4.4	-4.7	6.8	1.0	4.3
Construction	-1.1	9.9	8.6	6.3	1.9	-9.9	-0.9	3.0	2.1
Wholesale and retail commerce, restaurants and hotels	5.1	14.2	9.5	7.6	3.5	-4.4	3.8	2.5	2.0
Transport, storage and communciations	5.4	14.7	10.2	10.9	6.6	0.8	9.2	7.7	2.3
Financial establishments, insurance, real estate and business services	6.2	8.3	6.1	5.9	5.0	0.5	3.7	2.7	2.0
Community, social and personal services	3.1	2.7	4.7	4.9	2.8	1.8	2.8	2.5	1.9
Gross domestic product by type of expenditure									
Consumption	4.3	7.7	6.4	6.4	4.4	-0.2	3.4	2.8	1.7
General government	1.9	4.2	4.0	5.8	2.2	2.7	2.9	3.1	2.4
Private	4.7	8.4	6.9	6.5	4.7	-0.6	3.5	2.8	1.6
Gross domestic investment [c]	4.7	26.7	8.0	9.5	2.1	-20.3	13.2	0.1	2.3
Exports of goods and services	11.6	11.0	11.8	11.2	5.2	7.3	5.4	6.1	1.3
Imports of goods and services	10.1	25.0	11.8	13.2	6.7	-9.5	10.8	3.2	0.5
				Percentages of GDP					
Investment and saving									
Gross domestic investment [b]	22.5	26.2	26.4	27.1	26.8	21.4	23.3	22.6	22.7
Gross domestic investment [c d]	24.1	25.8	27.4	27.7	26.9	21.3	22.5	20.7	20.7
National saving [c]	21.1	23.8	23.1	23.1	21.8	21.2	20.7	19.6	20.2
External saving [c]	3.0	2.0	4.3	4.7	5.1	0.2	1.8	1.1	0.5
				Millions of dollars					
Balance of payments									
Current account	-1,586	-1,350	-3,144	-3,671	-3,918	99	-766	-1,192	-553
Goods balance	732	1,381	-1,042	-1,396	-2,040	2,427	2,119	2,054	2,513
Exports fob	11,604	16,025	16,657	17,902	16,323	17,162	19,210	18,466	18,340
Imports fob	-10,872	-14,644	-17,699	-19,298	-18,363	-14,735	-17,091	-16,411	-15,827
Services balance	-150	-324	-92	-179	-452	-737	-648	-918	-957
Factor income balance	-2,499	-2,714	-2,518	-2,617	-1,889	-2,233	-2,795	-2,757	-2,536
Current transfers balance	331	307	508	520	462	643	558	428	426
Capital and financial balance [e]	4,737	2,488	5,741	6,991	1,724	-837	1,103	596	752
Net foreign direct investment	1,672	2,205	3,681	3,809	3,144	6,203	-348	3,045	1,139
Financial capital [f]	3,064	283	2,060	3,182	-1,420	-7,040	1,451	-2,449	-388
Overall balance	3,151	1,139	2,597	3,320	-2,194	-738	337	-596	199
Variation in reserve assets [g]	-2,918	-740	-1,122	-3,320	2,194	738	-337	596	-199
Other financing [h]	-232	-399	-1,475	0	0	0	0	0	0
Other external sector indicators									
Real effective exchange rate (index 2000=100)[i]	106.6	99.8	97.3	91.8	94.5	99.3	100.0	112.4	112.7
Terms of trade for goods (index 1997=100)	101.3	120.4	97.2	100.0	88.2	88.6	88.6	82.5	82.5
Net resource transfer (% of GDP)	3.9	-1.0	2.3	5.3	-0.2	-4.2	-2.2	-3.2	-2.7
Gross external public debt (millions of dollars)	21,768	21,736	22,979	26,701	31,691	34,112	36,477	38,032	40,395
Gross external public debt (% of GDP)	42.7	33.3	30.3	32.2	39.9	46.7	48.3	57.2	62.5
Net interest and earnings (% of exports)[j]	-17.3	-14.0	-12.4	-11.9	-9.2	-10.5	-11.9	-12.1	-11.3

Table 1 (concluded)

	1994	1995	1996	1997	1998	1999	2000	2001	2002[a]
					Percentages				
Employment									
Labour force participation rate[k]	55.4	54.8	54.2	54.2	54.4	54.4	53.7	52.9	52.5
Open unemployment rate[l]	7.8	7.4	6.4	6.1	6.4	9.8	9.2	9.1	9.0
Visible underemployment rate[l]	...	...	3.8	5.2	4.0	4.9	5.4	6.4	5.6
					Annual percentages				
Prices									
Variation in consumer prices	8.9	8.2	6.6	6.0	4.7	2.3	4.5	2.6	2.8
Variation in wholesale prices	7.8	8.2	3.1	1.9	0.3	13.5	7.9	3.1	10.4
Variation in nominal exchange rate	-5.5	1.7	3.3	3.8	7.8	13.8	6.9	16.4	4.9
Variation in average real wage	4.7	4.0	4.1	2.4	2.7	2.4	1.4	1.6	2.1
Real deposit rate[m]	5.9	5.3	6.0	5.3	10.4	5.4	4.2	3.8	0.8
Real lending rate[n]	12.1	10.6	10.7	9.6	16.6	9.8	10.2	9.1	4.5
Equivalent deposit rate in foreign currency[o]	20.0	11.5	9.5	7.8	6.5	-4.5	3.0	-8.7	-0.7
					Percentages of GDP				
Non-financial public sector									
Current income	32.1	30.3	30.8	30.6	30.4	30.6	33.3	35.4	34.6
Current expenditure	26.5	24.1	24.4	24.7	25.6	27.2	29.1	31.0	30.7
Saving	5.6	6.2	6.5	5.9	4.8	3.5	4.2	4.4	3.8
Capital balance	-3.7	-3.8	-4.9	-5.1	-5.4	-4.9	-4.8	-5.1	-5.5
Primary balance	3.0	3.3	2.3	1.4	0.3	-0.8	0.2	0.2	-1.1
Overall balance	1.9	2.4	1.6	0.8	-0.6	-1.5	-0.6	-0.7	-1.6
Public debt	22.5	15.8	13.0	12.1	13.1	13.6	14.0	13.9	14.3
External	...	...	...	...	...	...	...	...	...
Domestic	...	...	...	...	...	...	...	...	...
Interest payments (% of current income)	3.5	2.9	2.4	2.0	2.9	2.0	2.3	2.3	1.6
Money and credit [p]									
Domestic credit [q]	45.9	45.1	47.0	50.0	55.6	58.5	57.9	61.5	62.3
To public sector	-1.1	-1.7	-1.5	-0.8	-1.3	-0.9	-1.1	-1.4	-1.3
To private sector	47.0	46.8	48.6	50.8	56.9	59.4	59.0	62.8	63.6
Liquidity (M3)	38.0	37.4	38.1	40.6	45.7	50.3	50.2	55.3	54.9
Currency in circulation and domestic currency deposits (M2)	34.6	35.0	36.2	39.0	43.4	46.3	45.8	47.9	48.7
Foreign currency deposits	3.3	2.4	1.9	1.6	2.3	4.0	4.4	7.5	6.1

Source: ECLAC, on the basis of official figures.
[a] Preliminary figures. [b] Based on constant 1995 dollars, at the official adjusted exchange rate. [c] Based on figures in local currency at current prices. [d] In the base year 1995, the difference with respect to calculation at constant prices arises from the use, for this purpose only, of an adjusted official exchange rate. [e] Includes errors and omissions. [f] Refers to the balance on the capital and financial accounts, minus net foreign direct investment plus errors and omissions. [g] A negative sign denotes an increase in reserves. [h] Includes the use of credit and loans from IMF and exceptional financing. [i] Annual average, weighted by the value of exports and imports of goods. [j] Refers to net investment income divided by exports of goods and services from the balance of payments. [k] Economically active population as a percentage of the working-age population, nationwide total. [l] Rates of unemployment and underemployment are percentages of the economically active population, nationwide total. [m] Non-readjustable 30- to 89-day deposits. [n] Non-readjustable 30- to 89-day loans. [o] Rate on deposits, deflated by the variation in the dollar exchange rate. [p] Average annual values were used for monetary figures. [q] Net credit to the public and private sectors extended by commercial banks and other financial and banking institutions.

above this, so domestic debt can be issued for this amount if necessary.

The structural surplus rule has meant that public finances have played a key stabilizing role in recent years, by softening the effects of adverse external conditions on domestic spending. In preparing the budget for 2003, the Government hired independent experts for the first time to estimate GDP and the price of copper for the coming year, thus making the fiscal rule less discretional.

b) Monetary and exchange-rate policy

After the prices of oil and petroleum products resumed a normal path and the exchange rate declined between the first and second quarters of 2003, the

Table 2
CHILE: MAIN QUARTERLY INDICATORS

	2001				2002[a]				2003[a]	
	I	II	III	IV	I	II	III	IV	I	II
Gross domestic product (change from same quarter of preceding year)[b]	3.2	4.1	2.9	2.0	1.3	1.7	2.4	3.2	3.5	...
Goods exports fob (millions of dollars)	5,141	4,934	4,188	4,203	4,721	4,932	4,118	4,568	5,188	5,172
Goods imports cif (millions of dollars)	4,742	4,520	4,547	3,972	4,014	4,408	4,503	4,167	4,534	4,682
International reserves (millions of dollars)	14,869	14,543	14,595	14,400	14,150	15,223	14,740	15,351	16,499	15,825
Real effective exchange rate (2000=100)[c]	104.0	107.5	117.9	120.3	110.9	108.1	115.9	115.9	123.0	122.1
Unemployment rate	8.8	9.7	10.1	7.9	8.8	9.5	9.7	7.8	8.2	9.1
Consumer prices (12-month variation, %)	3.5	3.6	3.9	2.6	2.6	2.0	2.3	2.8	4.5	3.6
Average nominal exchange rate (pesos per dollar)	574.0	606.4	670.5	688.9	669.8	659.5	708.5	718.0	738.1	709.6
Real average wage (change from same quarter of preceding year)	1.5	1.7	1.6	1.8	2.5	2.5	1.7	1.3	0.3	-0.1
Nominal interest rates (annualized percentages)										
Deposit rate[d]	5.0	7.5	5.4	6.2	5.2	4.0	2.9	2.8	2.6	2.7
Lending rate[e]	11.8	12.8	10.3	10.2	8.7	8.1	7.0	6.2	5.8	5.9
Interbank rate[f]	0.5	0.7	3.3	6.5	5.8	4.4	3.2	3.0	2.7	2.7
Sovereign bond spread (basis points)	175	168	193	163	153	166	238	191	195	162
Stock price indexes (indexes, June 1997=100)	63.0	65.7	54.4	61.6	62.1	53.8	46.0	52.5	52.5	65.6
Domestic credit[g] (change from same quarter of preceding year)	10.6	12.0	11.4	8.1	8.9	6.1	8.0	4.1	4.8	...
Mature credit as a porportion of total credit (%)[h]	1.8	1.8	1.8	1.6	1.7	1.8	1.9	1.8	1.9	1.9

Source: ECLAC, on the basis of official figures.
[a] Preliminary figures. [b] Based on figures in local currency at constant 1996 prices. [c] Quarterly average, weighted by the value of exports and imports of goods. [d] Non-readjustable 30- to 89-day deposits. [e] Non-readjustable 30- to 89-day loans. [f] Average non-readjustable overnight interbank rate. [g] Net credit to the public and private sectors extended by commercial banks and other financial and banking institutions. [h] Credit extended by the banking system.

projected inflation rate of returned to the centre of its target range of 3% for the following eight quarters, which is the Central Bank's usual horizon. A potentially favourable trend in these key prices, together with widespread tariff reduction as a result of the free trade agreements, could mean a sharp contraction in external costs. Commercial margins are expected to return to normal levels having narrowed in 2001 and 2002. Following a fairly low pass-through of the exchange-rate rise –around 18%– over a two-year period, the recent decline should not alter this coefficient nor, as a result, underlying inflation. In 2003 the nominal exchange rate has reflected international disturbances, especially fluctuations in the oil price; and after peaking at 750 pesos to the dollar, it has since stabilized around 700 pesos. Wage trends are not exerting inflationary pressure either, since the nominal indices of hourly wages and labour costs displayed 12-month variations of 3.8% and 4%, respectively, in March 2003.

With inflation under control, the main priority of monetary policy has been to invigorate domestic demand. Between January and August 2002, the Board of the Central Bank lowered its benchmark interest rate six times, by a total of 350 basis points. Following the latest 25 basis point cut in January 2003, the rate has remained at the historically low level of 2.75%. At present, Chile's monetary policy stance is highly expansionary.

Reductions in the benchmark interest rate have been slow to filter through to market operations, but have been passed on more rapidly to segments associated with larger and long-term loans.

One of the lessons to emerge from the long period of sluggish growth in the Chilean economy is that the combination of a fiscal policy based on a structural-balance target, together with a flexible exchange rate and an aggressively counter-cyclical monetary policy is not enough to offset the effects of persistent macroeconomic uncertainty when external shocks occur. The problem appears to lie in monetary policy transmission mechanisms, since their slowness (or non-existence) is related to market conditions. Recent studies have blamed a number of factors for the rigidity of market interest rates despite changes in the benchmark rate. These include the size of the bank in question, the type of clients it has and the credit risk involved. In this situation, the solution appears to consist of more active policies to mitigate the risk associated with small and medium-sized enterprises, in the form of debt restructuring and direct production incentives.

In addition, the steps taken in August 2001 to "nominalize" monetary policy, bringing to an end 16 years of monetary policy based on an indexed instrument, reduced the volatility of nominal rates and monetary aggregates, while deepening markets and assets denominated in pesos. As a counterpart to this, the rapid generalization of peso-denominated loans increased the risk of inflationary shocks to the financial system. Given the scant competition existing in the banking sector, financial institutions have covered this risk by keeping lending rates much higher than would be warranted exclusively by the inflation rate projected by the Central Bank. This seems to have hindered transmission of the reduction in the benchmark rate, to judge by the huge spread that exists between lending and deposit rates. Despite these problems, lending grew by 12.5% in the 12 months to March 2003; and one of the banking system's major assets is that the non-performing portfolio has held steady thus far at 1.9%, which is low by international standards.

c) Structural reform

The Government managed to steer a set of tax measures through Congress designed to stimulate growth and create the conditions for Chile to become an investment platform for the region. A special regime has been established whereby profits earned abroad that are being repatriated to the country in which the investment originated, are given tax-free status as they pass through Chile. More than 16 double taxation agreements are being negotiated, in addition to those that already exist with Argentina, Mexico and Canada. Expansion of the accelerated depreciation mechanism also enables firms to recoup their investment costs more quickly. The new legislation also eliminates stamp duty on the rescheduling of mortgage loans with over one year to run, granted for the purpose of acquiring, building or enlarging a dwelling. The new legislation on administrative procedure has also come into force, under which public procedures can be dealt with more quickly. This is of particular benefit to small and medium-sized firms, as it simplifies 35 basic procedures (if specified bureaucratic matters remain unresolved within 30 days, the respective requests are deemed to be approved).

A bill designed to raise funding for two programmes to which the Government attaches particular importance are currently making their way through Congress. These are a plan to give explicitly guaranteed universal access to healthcare (known by its Spanish acronym "AUGE") and the "Chile Solidario" programme. The AUGE plan consists of a broad legislative package intended to improve public healthcare and secure funding for the attendant reforms. The programme establishes a group of priority medical procedures, for which the public system will guarantee maximum waiting times. In August 2002 pilot plans began for five pathologies (child cancer, congenital heart conditions, renal insufficiency, cervical and uterine cancer and palliative care for terminal cancer patients). Given constraints on the budget and on the supply of services, the plan is expected to be phased in gradually. Another 17 priorities will be incorporated in 2004, with the aim of covering a total of 56 by 2005.

The Chile Solidario programme has been created to institutionalize a system of social protection for the country's 225,000 poorest households. This covers a number of aspects, such as family support, social protection payments contingent upon compliance with a contract signed with each family, traditional monetary benefits, preferential access to social advancement programmes and labour benefits. The corresponding bill is currently at the second stage of constitutional approval in the Senate.

3. The main variables

a) Economic activity

Growth of expenditure on final household consumption slowed from 2.8% in 2001 to 1.6% in 2002, while gross fixed capital formation expanded by 1.4%. A significant development during these years of slow growth has been the downturn in investment as a percentage of GDP, which has slumped from an average of almost 27% between 1996 and 1998 to 22.5% from 1999 to 2002. Gross national saving fell less steeply, from 22.5% of GDP in 1997 to 21.9% in 2002. The largest variation occurred in external saving, which slid from 5.1% of GDP in 1998 to 0.8% in 2002, reflecting the reversal of capital flows following the Asian crisis.

The downturn recorded in gross fixed capital formation was particularly steep in housing construction, which has shrunk by over 30% on a cumulative basis since 1998. This is explained by the failure of housing demand to rally, despite substantial reductions in the relevant real rates of interest and the award of large subsidies and significant tax credits. An incipient revival in house and apartment sales in recent months signals the start of a new expansionary cycle.

In 2002, the fastest growing sectors were fishing (8.2%), agriculture and forestry (4.2%) and electricity, gas and water (4.3%). Manufacturing; construction; commerce; financial services; and transport and communications all expanded by rates that reflected the economy-wide average of around 2%. Mining, by contrast, contracted by 0.3%.

b) Prices, wages and employment

The inflation rate came in at 2.8% in 2002, just two tenths of a percentage point above the 2001 figure. Price rises fluctuated during the course of the year, however, particularly in the last quarter. This volatility carried over into the early months of 2003, because of exchange-rate fluctuations exceeding 10%, and instability in international oil prices. Nonetheless, for 2003 as a whole, inflation is forecast at around 3%, which is within the Central Bank's target range.

The reluctance of growth to rebound has contributed to the persistence of unemployment, which remains one of the Government's most pressing pieces of unfinished business, although the job climate has been more optimistic since the latest unemployment figures were issued. At 9%, the nationwide unemployment rate in 2002 was just 0.1 percentage points lower than in 2001. More importantly, the number of persons employed grew by around 3.1%, the largest rise since the start of the slow growth cycle. The expansion in employment has been most vigorous in financial services, transport and communications, agriculture and manufacturing, with the private sector creating most of the new jobs. The winter months saw the largest absorption of unemployment by direct public employment programmes and subsidies for private employment (back-to-work and training benefits), which financed 160,000 jobs during the winter quarter of 2002.

c) The external sector

The trade balance posted a surplus of US$ 1.556 billion in 2002, US$ 420 million more than the previous year, with imports declining faster than exports (-3.2% and -1.2%, respectively), offset only slightly by growth in the services deficit. The current account balance was negative again, but only by US$ 553 million, or 0.9% of GDP, compared with a US$ 1.2 billion deficit in 2001. Smaller net factor payments abroad also helped reduce the deficit.

In the first quarter of 2003, the trade account registered a surplus of US$ 974 million, reflecting rises of 9.9% and 13.9% in the values of exports and imports, respectively. Exports to Asia (especially copper shipments to Japan and China) grew most strongly (by 43% in nominal terms over 12 months), followed by exports to the rest of Latin America which were up by 8.7%. The c.i.f. value of imports recorded a 12-month increase of 12.9% in the first quarter, with volume and unit values growing by 6% and 6.5% respectively. The latter was heavily influenced by an 83% rise in the price of crude oil. On the services front, the largest variations occurred in travel, where revenues were up by 21%, thanks to an increase in arrivals of European tourists, while outlays rose by 17%, reflecting larger numbers of Chileans travelling abroad, especially to Argentina.

Foreign direct investment (FDI) totalled US$ 1.603 billion –little more than a third of the 2001 figure. Projects in the pipeline, however, suggest this indicator should rally in 2003, and indeed the first quarter results bear out these projections. Direct contributions, such as equity purchases, other forms of capital participation and related credits all displayed positive flows, mainly targeting the mining, energy and telecommunications sectors. International reserves stood at US$ 15.653 billion as of 15 May 2003, which represents a substantial increase with respect to late 2002, largely reflecting replenishment of the Copper Stabilization Fund with foreign exchange generated from the sovereign bond issue in January.

An aspect that is causing concern is the level of external debt in the private sector, which has expanded from around US$ 18 billion in 1996 to just over US$ 33 billion in May 2003 –almost 51% of the previous year's GDP. The internationalization of many firms has generated a large number of FDI-related loans. The bulk of this debt is medium- and long-term, however, and nearly a third of the total corresponds to a single large enterprise in the electricity sector, which is in the process of restructuring its assets and liabilities. This would suggest that the steep climb in private-sector external debt seen in recent years can be expected to slacken in the near future.

Colombia

1. General trends

In 2003 the Colombian economy is showing signs of a moderate recovery, following annual growth of just 1.5% in 2001 and 2002. First quarter growth in 2003 came in at 3.8%, in contrast to a virtual standstill during the same period in 2002. The rate of expansion projected for the year as a whole is 2.5%, but data from the early months show better results. Inflation for the year as a whole is forecast at around 7%, similar to the 2002 figure. Although price increases trended upwards in the first four months of the year, they have eased off since May. With only a modest rise in activity levels, the employment situation remained problematic in 2002; nonetheless unemployment in 13 cities decreased by nearly a whole percentage point in the first half of 2003.

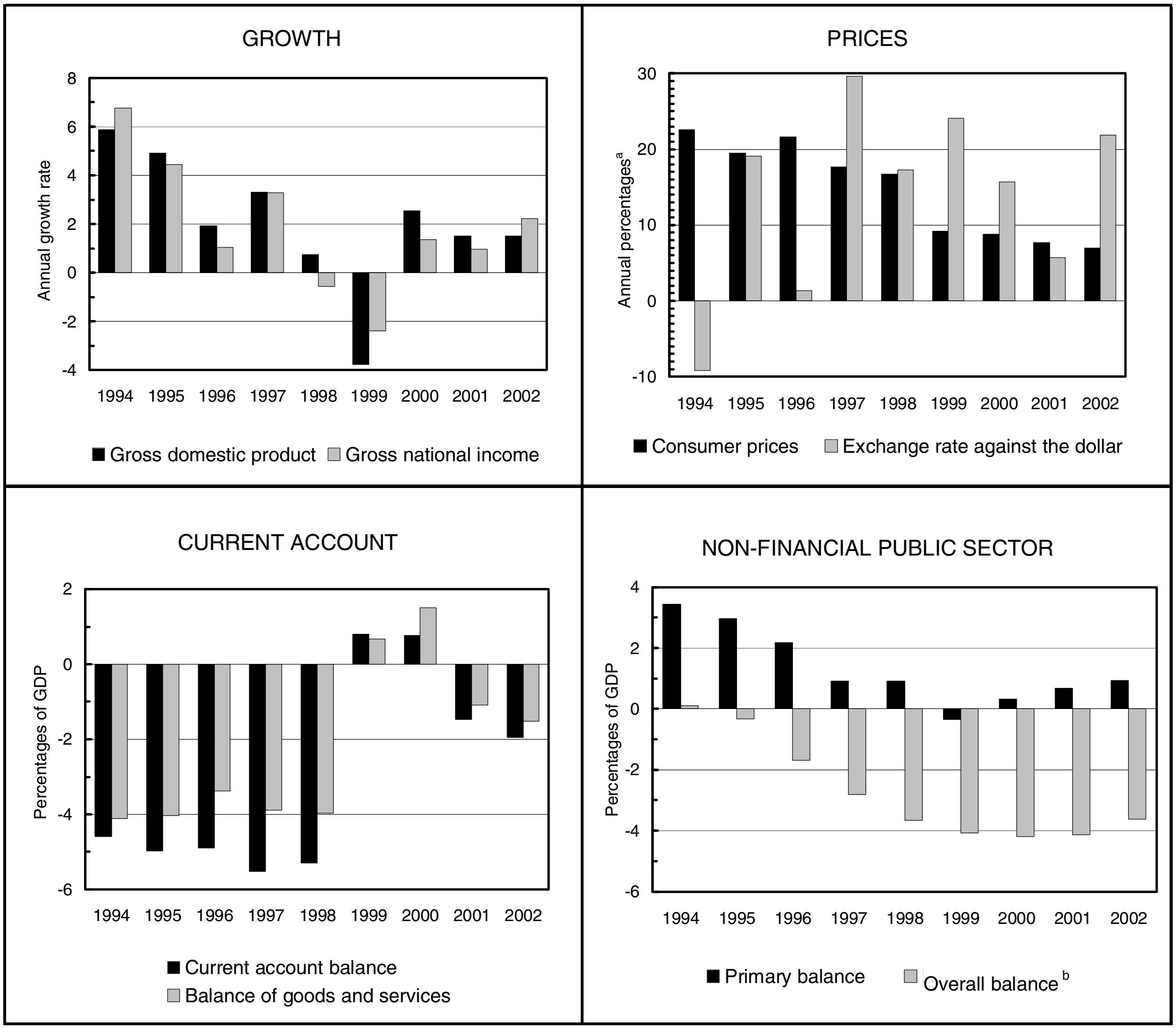
The current account deficit widened to 2% of GDP in 2002 and has deteriorated still further in 2003, owing mainly to poor results among non-traditional exports. These were badly hurt by the deep crisis unfolding in the Venezuelan economy, which is one of their main destinations. An overvalued exchange rate had a negative impact in 2002, but dwindling capital inflows and powerful international speculation exerted pressure for devaluation during the second half of the year. Although this increased Colombia's risk premium (as happened with other Latin American countries) it also allowed for a recovery of exchange-rate competitiveness. With no rapid turnaround foreseen in the Venezuelan economy, prospects for export growth depend on sales to the United States, which have benefited from renewal of the United States Andean Trade Promotion and Drug Eradication Act (ATPDEA).

The fiscal situation deteriorated because of a decline in receipts and an increase in both military spending and debt service. Nonetheless, the authorities expect the consolidated public-sector deficit to narrow in 2003, thanks to measures put in place in the second half of the previous year. The adjustment programme agreed upon with the International Monetary Fund (IMF) envisages a deficit of 2.5% of GDP. In January, the Fund extended a new two-year stand-by arrangement for 2003-2004.

Projections for 2003 are based on expectations of a strong performance from most sectors of the economy, particularly construction, industry and agriculture. In 2002 the economy was swayed by both domestic and external forces. Growth was driven by domestic spending which offset faltering external demand, particularly in the second half of the year. The interruption of the peace process in February 2002 undermined confidence in the economy during the first half of the year, thereby compounding the negative impact of persistent unemployment and sluggish credit expansion.

In 2002, Álvaro Uribe took office as President of the Republic, following a first-round election victory that was interpreted as a mandate to bring a rapid solution

Figure 1
COLOMBIA: MAIN ECONOMIC INDICATORS



Source: ECLAC, on the basis of official figures.
[a] December-to-December variation.
[b] Includes interest.

to the domestic armed conflict –which is perceived as the country's main problem. A few days into his term, the Government declared a "state of internal disturbance", giving the President special powers to enforce temporary public order measures. These included a 1.2% tax on the net worth of corporations and private individuals, to be used to finance higher spending on national security. In addition, Congress approved a tax reform designed to raise the revenues needed to place fiscal affairs on a sounder footing. The Legislature also sanctioned a labour reform, alterations to the pension scheme and the holding of a referendum which among other things would seek support for fiscal austerity measures.

2. Economic policy

The goal of economic policy has been to bolster the revival of productive activity, without endangering progress made on macroeconomic stabilization, such as reducing inflation. For this purpose the Government will attempt to rein in the public-sector deficit urgently. Monetary policy pursued ever-lower inflation targets while seeking to provide the liquidity needed to revive aggregate demand and boost growth.

a) Fiscal policy

One of the main objectives of the government's macroeconomic programme is to narrow the fiscal shortfall. The deficit of the consolidated public sector is targeted to fall to 2.5% of GDP in 2003, with a surplus of 2% in the decentralized sector (2.2% in 2002) and a central government deficit of 4.5% (6.3% in 2002). During the first quarter of 2003, central government finances posted a deficit of 1.7% of GDP, as against 1.1% in the same period a year earlier. Total revenues expanded by 30%, thanks to a 37% increase in tax receipts, largely reflecting revenues from the wealth tax and VAT, which was raised as part of the tax reform. At the same time, total spending rose by 46%, with increases of 63% in interest payments, 38% in operating expenses and 52% in investment expenditure.

The consolidated public-sector deficit came in at 3.6% of GDP in 2002, which represented a deterioration from the previous year and clearly revealed the difficulties involved in meeting the target of curtailing the deficit to 2.6%. Revenues failed to expand as expected, but spending grew. The non-financial public-sector (NFPS) deficit was 3.6% of GDP. This result was due to an increase in the surplus of the decentralized sector (2.2% of GDP compared to 1.9% in 2001) and to a central government deficit of 6.3% of GDP (5.7% in 2001). Total NFPS revenues at 29% of GDP were slightly down from their 2001 level of 29.2%, while tax receipts from domestic activity and external trade also came in below forecast. Total NFPS spending crept up to 32.5% of GDP, or 0.3 percentage points more than in 2001. The floating debt in this period, at 0.6% of GDP, also exceeded the 2001 figure. The central government deficit was covered in 2002 using the proceeds of external borrowing contracted in 2001 (34%), together with net domestic credit (47%) and profits earned by Banco de la República (9%).

The Government has acted rapidly to secure its external financing requirements in 2003, with funding from multilateral banks (US$ 2.6 billion from the World Bank, IDB and the Andean Development Corporation), bond issues of US$ 1 billion on international capital markets (half of which was issued in January 2003), and a swap of foreign bonds for TES Treasury bills.

In December 2002 a tax reform was passed to provide some leeway in the management of fiscal affairs. The measures included broadening the base and raising the rate of value-added tax (VAT), together with a temporary surcharge on income tax and an extension of the income tax base. Congress also approved a reform to the pension system, which lengthened the time that workers must contribute to the fund; mapped out future increases in contributions; and eliminated a number of special regimes. A labour reform was also introduced to make hiring and firing practices more flexible, with a view to facilitating job creation. In addition, Congress granted the President special powers to alter the organizational structure of government bodies and enterprises. There is also a programme for the renewal of public administration, involving an estimated 25% downsizing of the payroll at the central government level over a four-year period, which should save approximately 0.5% of GDP every year. Lastly, a referendum is to be held in 2003 to decide on a number of measures aimed at reducing public spending, which would increase the fiscal adjustment to 0.7% of GDP in 2003 and 1.3% in 2004. Some of these measures relate to a nominal freeze on operating costs in 2003 and 2004, including clauses relating to the middle and upper wage brackets, and pension reforms (minimum age, maximum pension and an end to special regimes as from 2008). Other provisions are of a political, institutional and penal nature. Over 6 million Colombians have to vote in the referendum for it to be valid. In June 2003 a Fiscal Responsibility Act was passed, establishing conditions to prevent regional and local governments from exceeding their borrowing limits.

b) Monetary policy

As meeting the inflation target became more problematic in early 2003, in January Banco de la República raised its whole interest-rate structure by 100 basis points for the first time since 1998, following this by a further 100 basis-point increase in April. In addition to the rise in interest rates, in February the Bank announced that it would intervene in the foreign-

Table 1
COLOMBIA: MAIN ECONOMIC INDICATORS

	1994	1995	1996	1997	1998	1999	2000	2001	2002[a]
	Annual growth rates[b]								
Gross domestic product	5.9	4.9	1.9	3.3	0.8	-3.8	2.5	1.5	1.5
Per capita gross domestic product	3.8	2.9	0.0	1.4	-1.1	-5.6	0.7	-0.3	-0.2
Gross national income	6.8	4.5	1.0	3.3	-0.6	-2.4	1.4	1.0	2.2
Gross domestic product by sector									
Agriculture	2.1	3.7	-1.2	0.7	0.0	0.0	3.8	0.7	0.5
Mining	4.1	14.6	7.3	3.7	15.6	18.5	-10.3	-9.7	-4.7
Manufacturing	1.4	5.9	-1.8	0.4	-0.3	-8.4	11.0	-1.3	1.1
Electricity, gas and water	9.1	2.6	4.9	1.0	1.8	-4.2	0.9	1.7	3.0
Construction	33.0	1.9	-12.9	2.2	-7.2	-27.0	-3.9	13.8	5.7
Wholesale and retail commerce, restaurants and hotels	7.8	3.4	-0.3	1.8	-1.5	-15.7	8.3	2.3	1.5
Transport, storage and communciations	6.7	6.5	3.8	5.8	2.5	-1.9	1.5	4.3	3.4
Financial establishments, insurance, real estate and business services	8.5	7.0	4.4	4.2	-0.3	-2.5	-3.1	-0.6	2.4
Community, social and personal services	0.5	9.0	16.2	7.2	1.8	3.3	0.6	1.7	0.9
Gross domestic product by type of expenditure									
Consumption	5.7	5.4	5.1	5.1	0.1	-3.2	0.9	1.9	1.7
General government	11.1	9.0	23.1	15.6	2.1	3.7	-0.2	1.7	0.6
Private	4.5	4.6	1.0	2.2	-0.5	-5.4	1.2	2.0	2.1
Gross domestic investment	24.9	6.1	-12.0	-0.6	-6.3	-36.0	12.3	9.3	5.2
Exports of goods and services	-0.3	3.6	9.6	3.2	7.4	5.9	6.1	2.7	-3.9
Imports of goods and services	22.8	7.3	2.3	6.2	-3.9	-24.7	5.9	11.6	0.1
	Percentages of GDP								
Investment and saving									
Gross domestic investment [b]	25.5	25.8	22.3	21.4	19.9	13.2	14.5	15.6	16.2
Gross domestic investment [c]	25.5	25.8	22.2	20.9	19.7	12.9	13.7	14.7	15.5
National saving [c]	19.1	18.4	15.0	13.4	12.5	13.6	15.1	12.2	12.5
External saving [c]	6.4	7.4	7.2	7.5	7.2	-0.7	-1.4	2.5	3.0
	Millions of dollars								
Balance of payments									
Current account	-3,673	-4,596	-4,755	-5,885	-5,225	690	641	-1,215	-1,579
Goods balance	-2,229	-2,545	-2,092	-2,638	-2,450	1,775	2,531	520	228
Exports fob	9,059	10,594	10,966	12,065	11,480	12,037	13,620	12,787	12,304
Imports fob	-11,288	-13,139	-13,058	-14,703	-13,930	-10,262	-11,090	-12,267	-12,076
Services balance	-1,054	-1,180	-1,193	-1,503	-1,463	-1,204	-1,273	-1,419	-1,453
Factor income balance	-1,458	-1,600	-2,067	-2,358	-1,758	-1,337	-2,286	-2,607	-2,729
Current transfers balance	1,069	729	597	614	446	1,455	1,669	2,292	2,377
Capital and financial balance [d]	3,855	4,591	6,484	6,163	3,827	-1,004	229	2,432	1,717
Net foreign direct investment	1,298	712	2,784	4,753	2,033	1,336	1,911	2,505	1,251
Financial capital [e]	2,557	3,879	3,700	1,410	1,795	-2,341	-1,682	-73	466
Overall balance	182	-5	1,729	278	-1,398	-315	870	1,217	138
Variation in reserve assets [f]	-182	5	-1,729	-278	1,398	315	-870	-1,217	-138
Other external sector indicators									
Real effective exchange rate (index 2000=100) [g]	90.8	87.5	82.6	77.5	83.1	91.8	100.0	104.3	106.0
Terms of trade for goods (index 1997=100)	100.4	95.8	99.4	100.0	91.7	98.3	111.0	104.6	102.7
Net resource transfer (% of GDP)	3.0	3.2	4.5	3.6	2.1	-2.7	-2.5	-0.2	-1.2
Gross external public debt (millions of dollars)	21,855	26,340	31,116	34,409	36,681	36,733	36,131	39,039	37,231

Table 1 (concluded)

	1994	1995	1996	1997	1998	1999	2000	2001	2002[a]
Gross external public debt (% of GDP)	27.3	28.5	32.0	32.3	37.2	42.6	43.1	47.4	46.1
Net interest and earnings (% of exports)[h]	-13.7	-13.0	-15.8	-16.6	-13.2	-9.7	-14.7	-17.6	-19.4
					Percentages				
Employment									
Labour force participation rate[i]	60.0	59.9	59.7	59.9	62.2	63.1	63.5	64.2	64.2
Unemployment rate[j]	8.9	8.8	11.2	12.4	15.3	19.4	17.2	18.2	17.6
Visible underemployment rate[k]	...	...	...	...	...	...	11.7	13.4	14.0
					Annual percentages				
Prices									
Variation in consumer prices	22.6	19.5	21.6	17.7	16.7	9.2	8.8	7.6	7.0
Variation in producer prices	20.7	15.4	14.5	17.5	13.5	12.7	11.0	6.9	9.3
Variation in nominal exchange rate	-9.2	19.1	1.4	29.6	17.3	24.1	15.7	5.7	21.9
Variation in average real wage	0.9	1.0	1.6	2.8	-1.3	5.8	3.9	0.3	4.1
Real deposit rate[l]	6.9	10.0	8.7	5.3	13.1	12.0	3.4	4.7	1.4
Real lending rate[m]	16.0	18.7	17.7	13.9	21.3	19.6	9.5	12.4	8.3
Equivalent deposit rate in foreign currency[n]	42.4	11.1	29.4	-4.2	13.0	-2.3	-3.0	6.4	-10.6
					Percentages of GDP				
Non-financial public sector									
Current income	24.5	25.9	28.6	28.8	28.3	32.9	32.4	35.2	35.2
Current expenditure	17.9	18.9	21.5	22.5	24.8	29.6	29.5	30.7	31.1
Saving	6.6	7.0	7.2	6.2	3.5	3.3	2.9	4.5	4.1
Capital balance	-6.5	-7.3	-8.8	-9.0	-7.2	-7.3	-7.1	-8.5	-7.6
Primary balance	3.4	3.0	2.2	0.9	0.9	-0.3	0.3	0.7	0.9
Overall balance	0.1	-0.3	-1.7	-2.8	-3.7	-4.1	-4.2	-4.1	-3.6
Public debt	...	...	23.7	23.7	27.9	36.3	42.3	47.9	49.2
External	...	...	13.3	12.9	16.6	20.3	22.9	26.8	26.8
Domestic	...	...	10.4	10.9	11.3	16.0	19.4	21.2	22.4
Interest payments (% of current income)	13.6	12.7	13.5	12.9	16.2	11.3	13.9	13.7	12.9
Money and credit[o]									
Domestic credit[p]	15.9	18.3	19.5	21.1	24.8	26.9	23.9	25.6	27.6
To public sector	2.7	2.8	3.0	3.6	4.1	5.7	5.8	7.2	8.4
To private sector	13.2	15.4	16.5	17.5	20.7	21.2	18.1	18.3	19.2
Liquidity (M3)	26.6	29.8	30.0	30.3	31.5	32.4	30.0	29.6	29.5

Source: ECLAC, on the basis of official figures.

[a] Preliminary figures. [b] Based on constant 1995 dollars. [c] Based on figures in local currency at current prices. [d] Includes errors and omissions. [e] Refers to the balance on the capital and current accounts, minus net foreign direct investment plus errors and omissions. [f] A negative sign denotes an increasein reserves. [g] Annual average, weighted by the value of exports and imports of goods. [h] Refers to investment income divided by exports of goods and services from the balance of payments. [i] Economically active population as a percentage of the working-age population, three cities; up to 1999, seven cities. [j] Unemployed as a percentage of the economically active population, thirteen cities; up to 1999, seven cities. Includes hidden unemployment. [k] Underemployed as a percentage of the economically active population, thirteen cities; up to 1999, seven cities. [l] Ninety-day fixed term deposit certificates. [m] System effective total lending rate. [n] Rate on deposits, deflated by the variation in the dollar exchange rate. [o] Annual average values were used for monetary figures. [p] Net credit to the public and private sectors extended by commercial banks and other financial and banking institutions.

Table 2
COLOMBIA: MAIN QUARTERLY INDICATORS

	2001				2002[a]				2003[a]	
	I	II	III	IV	I	II	III	IV	I	II
Gross domestic product (change from same quarter of preceding year)[b]	2.0	1.8	1.2	0.6	0.0	2.3	2.0	2.3	3.8	...
Goods exports fob (millions of dollars)	2,978	3,141	3,239	2,951	2,747	3,121	3,008	3,032	2,907	...
Goods imports cif (millions of dollars)	3,176	3,357	3,187	3,113	2,728	3,334	3,265	3,372	3,335	...
International reserves (millions of dollars)	9,283	9,270	9,765		10,229	10,817	10,727	10,841	10,616	10,495
Real effective exchange rate (2000=100)[c]	104.9	104.9	103.8	103.6	98.8	98.4	110.4	116.5	121.7	119.0
Urban unemployment rate	20.1	18.2	17.9	16.7	19.0	17.9	17.9	15.8	17.9	17.2
Consumer prices (12-month variation, %)	7.8	7.9	8.0	7.6	5.9	6.2	6.0	7.0	7.6	7.2
Average nominal exchange rate (pesos per dollar)	2,254	2,324	2,307	2,313	2,282	2,311	2,633	2,792	2,941	2,868
Real average wage (change from same quarter of preceding year)	1.4	0.1	-0.9	-1.9	5.4	2.7	3.8	3.0	0.2	...
Nominal interest rates (annualized percentages)										
Deposit rate[d]	13.3	12.7	12.3	11.4	10.9	9.2	7.9	7.8	7.7	7.8
Lending rate[e]	21.3	21.7	21.0	18.9	17.6	16.8	15.5	15.4	14.9	15.2
Interbank rate[f]	12.0	11.5	10.6	9.0	8.0	6.1	5.3	5.3	6.1	7.0
Sovereign bond spread (basis points)	559	392	475	380	370	412	1,080	553	560	460
Stock price indexes (indexes, June 1997=100)	27.1	31.5	29.2	31.1	31.3	32.7	28.1	34.1	33.2	38.7
Domestic credit[g] (change from same quarter of preceding year)	16.3	17.5	19.2	15.5	9.5	16.2	23.3	16.2	15.8	...
Mature bank credit as a porportion of total credit (%)[h]	11.4	10.7	10.7	9.7	10.6	10.1	9.4	8.7	8.6	8.4

Source: ECLAC, on the basis of official figures.
[a] Preliminary figures. [b] Based on figures in local currency at constant 1994 prices. [c] Quarterly average, weighted by the value of exports and imports of goods. [d] Fixed-term 90-day deposit certificates. [e] System total effective lending rate. [f] Expansion repos. [g] Net credit to the public and private sectors extended by commercial banks and other financial and banking institutions. [h] Refers to total credit extended by loan-providing establishments.

exchange market by auctioning call options in order to reduce foreign reserves by up to US$ 1 billion in 2003.

Monetary policy was expansionary throughout 2002. In the first half of the year, Banco de la República lowered interest rates by 3.25 percentage points, thereby taking most of them below the inflation rate, where they remained throughout the second semester. In 2002 the Bank sold dollars in exchange for public debt paper. Following the cut in the benchmark rate, and thanks to increased liquidity, market interest rates followed suit. The 90-day deposit rate stood at 7.7% at the end of 2002, which was 3.7 percentage points below the level recorded a year earlier, representing a real decrease from 3.5% to 0.7%. The lending rate (the average for consumer, preferential, ordinary and treasury loans) dropped by 2.4 percentage points in real terms to end the year at 7.4%. This downward trend was unaffected by a temporary rise in interest rates on public debt during the third quarter of 2002. In the final quarter of the year, when the country risk spread was returning to normal, the Government issued international bonds in the amount of US$ 500 million.

The money supply (M1) expanded by 21.3% in 2002, thereby interrupting the downward trend that had prevailed since late 2001. Cash in circulation was up by 21.7% and current account balances expanded by 21%; the opportunity cost of holding liquid assets dropped because of the decrease in inflation and the low rates of interest. The M2 aggregate expanded by 8.1%, while broad money supply (M3) grew steadily at around 8%. At the same time, the low level of interest rates reduced the volume of term deposits, and the supply of public debt paper increased.

The financial system portfolio showed signs of recovery in the second half of 2002, as the total loan portfolio expanded by 5.4% nominally, while contracting in real terms, but at an ever slower rate. The consumer credit portfolio grew by 1.4% in real terms, while the corporate loan portfolio shrank by 1.1%, and mortgage loans declined once more (13.5%). Although the quality of the consumer and corporate portfolios continued to improve, the mortgage portfolio deteriorated.

c) Exchange-rate policy

The continuous devaluation seen since the second half of 2002 continued into the first quarter of 2003. From April onwards, however, the measures taken by Banco de la República slowed this process. In 2002 the nominal exchange rate displayed two contrasting trends, one after the other. During the first half of the year the exchange rate was driven upwards by expectations of foreign-exchange abundance arising from the pre-financing of government's external borrowing requirements, supported by buoyant remittances, and lower interest rates in the United States. Then, in the second semester, the currency depreciated again, in the wake of devaluations elsewhere in the region, particularly Venezuela and Brazil; a weakening of exports to Venezuela; the fall in price of public debt during the first quarter; and speculative factors generated by electoral uncertainty.

This foreign-exchange market volatility forced Banco de la República to intervene in late July 2002 by selling dollar-denominated call options, and this was followed by further interventions in August and October. The nominal exchange rate reached 2,813 pesos to the dollar in December 2002, representing a 22% rise in relation to the same month a year earlier. The real exchange rate index stood at 131.2 in December 2002 implying a real devaluation of 14% for the year, and by June 2003 it had climbed further to a level of 136.

3. The main variables

a) Economic activity

The economy's promising performance in the first quarter of 2003 was fuelled by an upturn in construction (16%), especially civil works (25%) which had fallen sharply (17%) in the first quarter of 2002, and in industry and financial services, which expanded by 8.3% and 5.8%, respectively (compared with previous declines of 4.1% and 0.5%). Domestic demand and investment gathered momentum, while external demand sagged. Electricity sales were up by 3% during the first five months of 2003, and industrial output is moving in a positive direction, according to surveys conducted by the National Manufacturers' Association (ANDI) and the Foundation for Education and Development (Fedesarrollo). Meanwhile, data collected by the National Federation of Tradesmen of Colombia (FENALCO) reveal an upturn in commercial activity since April.

Output expanded by 1.5% in 2002 as a whole, matching the previous year's rate. The slowdown in 2001 lasted until March 2002; then in the second quarter the real sector began to rally, and the pace of economic expansion hovered around 2%. This trend gathered strength in the early part of 2003, to post a growth rate of 3.8% in the first quarter.

Growth in 2002 was driven by domestic demand, led by household consumption (2.1%), and investment (5.2%) associated with building work and transport equipment. Nonetheless, the overall rate of investment remained depressed. Total exports lost ground in value terms throughout 2002 to register an overall decline of 3.9%. This reflected the economic crisis and the strike in Venezuela, compounded by the slowness of recovery in the United States. The value of imports receded by 5.3% in the first semester but recovered by 5.5% in the second half of the year.

Construction was the fastest growing sector in 2002, expanding by 5.7% – especially building (21.5%), which made up for a downturn in civil works (7.9%). Strong performances were also recorded in following subsectors: transport, storage and communications

(3.4%), electricity, gas and water (3%), and financial establishments (2.4%). Industry took a positive turn with an expansion of 1.1% following its 1.3% contraction in 2001. Mining and quarrying was the only sector to shrink (4.8%), reflecting a downward trend in petroleum production.

b) Prices wages and employment

The annualized rate of inflation measured by the variation in the consumer price index (CPI) gathered pace in the early months of 2003, but began to ease off from May onwards. In June, the annual rate stood at 7.2%, compared to 6.2% at the same date a year earlier. In 2002 as a whole inflation came in at 7%, which, although 0.6 percentage points lower than in 2001, was above the Central Bank's target of 6%. The greater upward pressure on prices was generated by supply shocks, which particularly affected the price of foods (especially potatoes), and tradable goods with a high import content, reflecting the devaluation that has taken place since mid-2002.

The producer price index (PPI) rose by 9.3% in 2002 – 2.3 percentage points more than the previous year; price increases among imported goods soared from 4.6% in 2001 to 16% in 2002. In July 2003, the PPI posted a 0.2% rise, taking the variation over the year thus far to 4.5%, and to 10.2% over the previous 12 months.

Although the situation in the labour market showed some improvement, unemployment remained very high. The urban unemployment rate (covering 13 cities) was 17.6% in the first semester of 2003. This was lower than in the same period a year earlier (18.5%), however, thanks to the upswing in the economy driven by construction and stronger exports to the United States. The rate of employment (52.6%) grew by 0.5 percentage points, while the labour force participation rate (63.8%) and the rate of underemployment (31.3%) slipped by 0.1 and 0.3 points, respectively. For 2002 as a whole, the total number of persons employed had risen by 3%, although practically all of this increase apparently represented new underemployment, which expanded from 30% to 33% of the employed population, while the labour force participation rate had remained virtually unchanged at 64.2%.

In the first half of 2003, the nationwide rate of unemployment decreased from 16.1% to 14.6%, and underemployment fell from 34.2% to 30.7%, thanks to robust performances in the rural economy and small cities, while the rate of employment rose by one percentage point to 52.6%, and the participation rate edged up by two tenths of a percentage point to 61.6%.

The basic minimum wage (US$ 123) posted a real increase of 1% in 2002, while wages in manufacturing rose by 0.5%, also in real terms, following their 3% decline in 2001.

c) The external sector

In the early months of 2003 external trade has been showing signs of recovery, especially imports, following weak results in 2002. Even so, the merchandise balance continued to deteriorate and moved from a surplus of US$ 208 million in the first four months of 2002 to a deficit of US$ 172 million for the same period in 2003. The value of exports in 2002 fell faster than imports (-3.6% and -1.5%, respectively), which reduced the merchandise trade surplus from US$ 520 million in 2001 to US$ 228 million in 2002.

The factor-income account also deteriorated in 2002, but this was partly offset by an increase in current transfer inflows, mainly family remittances, which grew by US$ 413 million. Overall, the current account recorded a deficit of US$ 1.579 billion (2% of GDP), which was US$ 364 million more than in 2001 (1.5% of GDP). The financial account registered net revenues of US$ 1.172 billion (1.4% of GDP), US$ 1.233 billion less than the 2001 figure. Net international reserves expanded by US$ 648 million and the year closed out with a balance of US$ 10.841 billion, equivalent to 10.8 months' merchandise imports.

Exports grew by 4.2% during the first five months of 2003, after shrinking by 3.4% in the same period a year earlier; traditional exports expanded by 14% following their 11% contraction in 2002, while non-traditional exports declined by 3.1%, in the wake of a slump in sales to Venezuela (-63%) caused by the foreign-exchange controls adopted in that country and the difficult economic situation it is going through. Excluding sales to Venezuela, total exports would have risen by 12% and non-traditional exports by 11%. Non-traditional exports to the United States trended upwards by 32%, compared to a 16% drop in the same period of 2002, thanks to the effects of the United States Andean Trade Promotion and Drug Eradication Act. Entry into force of this legislation will benefit exports of new products, such as clothing and footwear, vacuum-packed tuna, oil and petroleum products, watches and watch parts, sugars and honeys (within established quotas) and leather manufactures, until 2005.

Traditional exports had dropped by 2.1% in 2002, owing to a downturn in coal exports (16%), and a decrease in the volume of oil exports (1.6%). Earnings from exports of hydrocarbons and coffee were both similar to their 2001 figures. Despite a more competitive exchange rate in the second semester, non-traditional exports contracted by 5% for the year as a whole, after growing by 7% in 2001. The hardest hit export sectors were industrial products (especially machinery and equipment), textiles and clothing, and chemicals. The key factors in this downturn were the sluggishness of economic recovery in the United States and the slump in economic activity in Venezuela. Exports to Venezuela were down by 35%, and the bilateral exchange rate fell by almost 20%. Exports to the United States weakened by 2%, despite a strong 28% upturn in the last quarter, while sales to Ecuador grew by 16%.

Merchandise imports were down by 1.5% in 2002 as a whole, having fallen by 7.8% in the first half of the year, and then recovering by 5.1% in the second, boosted by a slight upturn in aggregate demand towards the end of the year. The upward trend continued into 2003, with growth of 14% in the first four months, compared to a 9.6% decline in the same period a year earlier. The recovery was felt first in the consumer goods segment and then spread to intermediate goods. Capital goods imports retreated by 8% in 2002, especially items for manufacturing industry (-12%), but imports in this category expanded vigorously in 2003 (30%), particularly transport equipment and industrial machinery.

Net capital inflows in 2002 were significantly smaller than the year before, shrinking by US$ 715 million. Long-term capital recorded net outflows of US$ 1.56 billion, in contrast to a net inflow of US$ 5.047 billion in 2001. This reflected reduced government pre-financing (which had been substantial in 2001); increased amortization payments; and lower levels of private borrowing. At US$ 2.034 billion, net inflows of foreign direct investment (FDI) were US$ 488 million down on their 2001 level, mainly reflecting lower investment in the petroleum sector. Net short-term inflows totalling US$ 2.739 billion offset the net outflow of long-term capital.

Total external debt outstanding receded from US$ 39.039 billion in 2001 (47.3% of GDP) to US$ 37.231 billion in 2002 (45.7% of GDP). Public and private external borrowing also both decreased. In 2002 public external debt represented 28% of GDP, compared to 28.5% in the previous year; while private external debt amounted to 17.7% of GDP, compared to the 18.9% registered in 2001. In both sectors amortizations exceeded new borrowing, which reflected restricted access to international markets during several months of the year, in addition to the fact that the Government had covered part of its financing requirements in advance in 2001.

Costa Rica

1. General trends

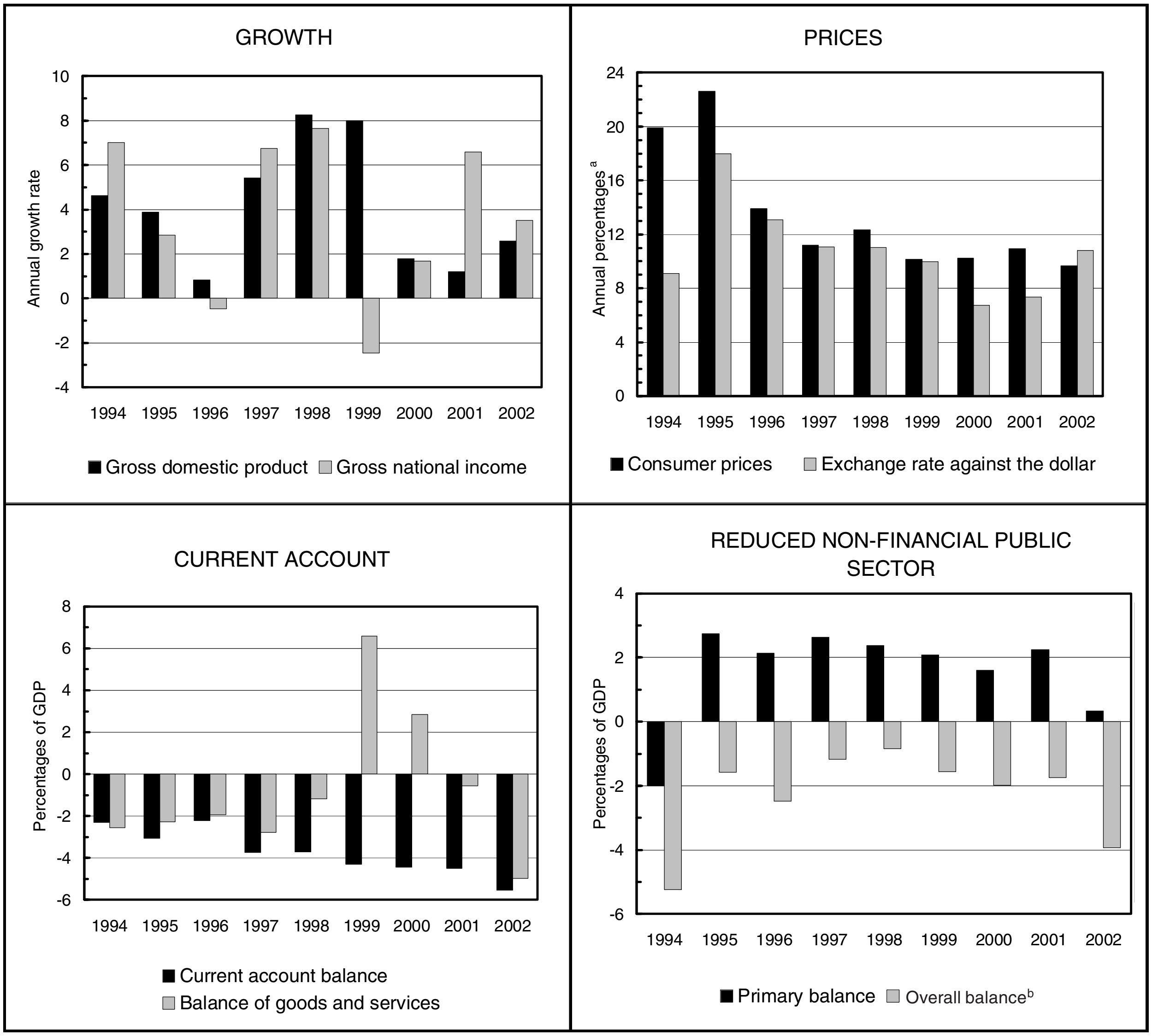
Economic activity in Costa Rica showed signs of recovery in 2002 after two straight years in which momentum flagged considerably. Gross domestic product grew by 2.6%, boosted by the expansion of domestic demand and an upsurge in exports after two years of decline. Per capita GDP grew by 0.6%, after having shrunk by 0.5% and 0.9% in 2000 and 2001, respectively. At the same time, per capita national income rose for the second year in a row (0.7%) as a result of the less drastic deterioration in the terms of trade and the sharp reduction in profit remittances by foreign firms. The recovery has been gathering strength in 2003 and output is expected to grow by over 4%.

Although the economy grew faster in 2002 and employment picked up by 2.2%, the high participation rate gave rise to a further increase in open unemployment, from 6.1% to 6.4%, the highest rate since 1985.

The significant expansion of public spending in 2002 helped to boost the economy, but also led to a substantial deterioration in the fiscal accounts. The consolidated public-sector deficit rose to 5.4% of GDP, far exceeding the previous year's gap of 2.9%. Fiscal policy thus heightened the pressures generated by increased spending towards the appreciation of the real exchange rate and the erosion of the international reserve position. The balance-of-payments current-account deficit increased from 4.5% of GDP in 2001 to 5.5% in 2002, while the total public debt as a percentage of GDP swelled to almost 60%. Because of high domestic borrowing costs, the authorities again resorted to bond issues on international markets with the intention of replacing domestic debt with external debt on more favourable terms. Monetary policy, meanwhile, was moderately restrictive. The central bank made use of available monetary control instruments to contain inflation (9.7%) and avoid a loss of international reserves. At the same time, in order to maintain the external competitiveness of the country's export sectors, it gradually stepped up its daily adjustments of the exchange rate, bringing about a real depreciation of the colón.

In the first five months of 2003 the monthly economic activity index recorded growth of 6.7%, almost two percentage points higher than the rate for the same period of 2002. Its positive trend reflects increased exports, faster growth in construction, transport and telecommunications and an upswing in tourism. Under the monetary programme for 2003, economic policy will focus on curbing inflation and reducing the fiscal gap and the balance-of-payments current-account deficit. Output growth has been estimated at just 2.2% in 2003, but the results posted in the first few months of the year suggest that the actual growth rate will be considerably higher. Inflation is expected to speed up slightly (10%), while unemployment is likely to remain at more or less the same level as in 2002. The fiscal adjustment process should bring the consolidated public-sector deficit down to 3.1% of GDP, and the balance-of-payments current-account deficit is expected to fall to 4.7% of GDP.

Figure 1
COSTA RICA: MAIN ECONOMIC INDICATORS



Source: ECLAC, on the basis of official figures.
[a] December-to-December variation.
[b] Includes interest.

2. Economic policy

Although income grew in real terms, the strong expansion of public expenditure fuelled an increase in the fiscal and external deficits. The fiscal deficit raised the cost of monetary adjustment to control the increase in liquidity. The measures taken to keep prices stable, forestall an increase in monetary substitution and preserve the level of net international reserves accentuated financial vulnerability by expanding the central bank's liabilities and quasi-fiscal deficit. The widening of the balance-of-payments current-account deficit and the increased need for financing heightened the economy's external vulnerability in a global environment of sluggish economic growth and high financial volatility.

a) Fiscal policy

Public finances deteriorated markedly. The consolidated public-sector deficit amounted to 5.4% of GDP in 2002, which was substantially higher than the previous year's level (2.9%). The central government deficit increased to 4.3% of GDP, compared to 2.9% in 2001.

This negative outcome was due in part to the slackening growth of total income as a result of a fall in non-tax revenue. The adoption of the Tax Simplification and Efficiency Act in 2001 slowed down the growth of receipts from income tax, excise taxes and sales tax, but this was partly offset by more efficient tax administration. In this context, the tax burden remained practically constant (13.2% of GDP).

However, most of the expansion of the central government's financial deficit was accounted for by the sharp rise in total expenditure (21.1%), which represented 16.4% of GDP in 2001 and 17.6% in 2002. While practically all items of expenditure rose faster than they had in 2001, the increase in current expenditure was especially pronounced (21.2%). This increase reflected the escalation of interest payments (21.4%) because of higher domestic interest rates and increased government debt. In addition, payroll expenses were higher (17.8%), owing mainly to the expansion of government employment and to existing incentive schemes. Current transfers grew by 22.8%, reflecting an increase in pension payments from the national budget and in financing for social programmes. Capital expenditure also soared as a result of investment in infrastructure.

The fiscal deficit was financed through an increase in net bond issues on the domestic market and the use of external resources, in particular through bond issues on international markets.

The net result posted by the rest of the non-financial public sector also showed a deterioration, as public enterprises and institutions saw their surplus shrink from 1.2% to 0.3% of GDP.

At the same time the central bank's quasi-fiscal deficit (1.4% of GDP) widened because of a decline in the income generated by external assets, due both to reduced yields on international markets and to an increase in the amount of interest paid out on monetary stabilization bonds.

In December 2002 the Legislative Assembly adopted a fiscal contingency plan designed to generate additional income in 2003 equivalent to 1% of GDP. The measures taken included the application of surcharges, for one year, on a number of taxes, such as those imposed on income and on profits derived from certain activities and transactions. In addition, some items of expenditure were scaled back and limits were set on the growth of expenditure at the central government and decentralized levels. The fiscal adjustment was intended to reduce the consolidated public-sector deficit to 3.1% of GDP. However, since the government eased the restrictions it had imposed on expenditure by the Costa Rican Electricity Institute, the deficit will probably amount to approximately 4% of GDP. In January 2003 the country issued US$ 450 million in bonds and placed them on international markets; of this amount, US$ 200 million will be used to redeem a previous issue and the rest, to finance the bulk of its fiscal requirements.

The total public debt balance stood at approximately 3.6 billion colones at the end of 2002, representing a 17.6% increase over the previous year's balance. Total public-sector debt expanded from 56.7% of GDP in 2001 to 59.2% in 2002. Public-sector domestic debt was equivalent to 39.7% of GDP, while external debt remained practically constant as a percentage of GDP (19.4%). Most of this debt consists of central government (67.6%) and central bank (24.9%) liabilities. In terms of its composition by currency, the relative share of public debt denominated in foreign currency expanded substantially, from 51% to 53.2% of the total.

b) Monetary policy

Monetary policy was moderately restrictive. In order to reduce both interest-rate spreads and the cost of loanable funds, the legal minimum reserve requirement was unified at 5% for deposits in either local or foreign currency. In an effort to stave off demand pressures that could affect domestic prices and undermine the country's external position, the authorities stepped up open-market operations. At the same time, the central bank began selling certificates of deposit in dollars with a view to improving the profile of its foreign-currency liabilities, especially in terms of maturities, and preventing sudden fluctuations in its net international reserves. To make up for the effect of the colón's faster devaluation against the dollar and prevent the rapid dollarization of investment portfolios, the monetary authorities sought to maintain an attractive premium for investments in colones. Thus, the benchmark deposit rate –the market reference rate– gradually edged upward from 16% to 17.5%, which pushed up interest rates.

Total liquidity (M3) expanded by 20.4% in 2002 as local-currency liquidity (M2) rose by 18.6% owing to

Table 1
COSTA RICA: MAIN ECONOMIC INDICATORS

	1994	1995	1996	1997	1998	1999	2000	2001	2002[a]
	Annual growth rates[b]								
Gross domestic product	4.6	3.9	0.8	5.4	8.3	8.0	1.8	1.2	2.6
Per capita gross domestic product	2.1	1.4	-1.7	2.8	5.6	5.4	-0.5	-0.9	0.6
Gross national income	7.0	2.8	-0.5	6.7	7.6	-2.4	1.7	6.6	3.5
Gross domestic product by sector									
Agriculture	3.3	7.3	1.8	1.5	8.2	4.5	0.7	0.7	-1.0
Mining	8.1	-3.7	-4.8	12.9	9.3	-6.1	6.3	6.4	0.4
Manufacturing	3.8	4.1	0.5	7.7	11.4	24.7	-2.9	-8.4	2.2
Electricity, gas and water	7.5	3.1	2.6	5.5	8.7	6.2	6.4	4.1	5.2
Construction	7.2	7.6	-17.9	6.1	17.4	-1.6	4.4	11.4	-1.0
Wholesale and retail commerce, restaurants and hotels	5.1	3.5	-0.6	6.1	8.5	2.4	1.5	2.1	2.2
Transport, storage and communciations	7.7	7.3	4.8	9.9	8.1	6.9	10.2	8.7	11.0
Financial establishments, insurance, real estate and business services	5.6	2.4	2.2	5.1	4.9	8.3	8.9	7.8	4.5
Community, social and personal services	3.3	2.1	1.4	2.6	4.6	3.0	2.6	2.1	1.9
Gross domestic product by type of expenditure									
Consumption	5.9	2.6	1.9	4.8	4.4	1.7	1.2	1.9	2.5
General government	1.9	-0.3	-0.6	4.6	2.2	1.8	1.4	3.5	4.5
Private	6.7	3.1	2.4	4.9	4.8	1.7	1.1	1.6	2.2
Gross domestic investment	1.8	-5.1	-10.9	24.4	25.8	-15.4	-1.2	27.2	11.3
Exports of goods and services	3.8	11.1	6.2	8.6	26.7	21.3	-0.3	-9.2	4.1
Imports of goods and services	5.2	2.9	2.7	14.7	25.2	0.4	-2.6	0.0	8.2
	Percentages of GDP								
Investment and saving									
Gross domestic investment [b]	20.0	18.2	16.1	19.0	22.1	17.3	16.8	21.1	22.9
Gross domestic investment [c]	20.0	18.2	16.0	18.1	20.5	17.1	17.1	20.1	22.0
National saving [c]	14.6	14.6	12.4	13.3	15.3	12.0	12.6	13.2	12.7
External saving [c]	5.4	3.6	3.5	4.8	5.3	5.2	4.5	6.9	9.3
	Millions of dollars								
Balance of payments									
Current account	-244	-358	-264	-481	-521	-681	-707	-737	-937
Goods balance	-606	-323	-249	-498	-399	580	-211	-821	-1,547
Exports fob	2,122	3,482	3,774	4,221	5,538	6,576	5,813	4,923	5,277
Imports fob	-2,728	-3,804	-4,023	-4,718	-5,937	-5,996	-6,025	-5,744	-6,825
Services balance	335	56	20	140	234	458	665	729	709
Factor income balance	-128	-226	-184	-249	-469	-1,822	-1,252	-793	-253
Current transfers balance	155	134	149	126	113	102	92	148	155
Capital and financial balance [d]	141	574	194	288	16	1,161	555	750	1,102
Net foreign direct investment	293	331	421	404	608	614	400	445	585
Financial capital [e]	-152	243	-227	-116	-592	547	155	305	517
Overall balance	-103	216	-69	-193	-504	480	-152	13	165
Variation in reserve assets [f]	66	-179	77	-216	150	-480	152	-13	-165
Other financing [g]	38	-37	-8	409	355	0	0	0	0
Other external sector indicators									
Real effective exchange rate (index 2000=100) [h]	102.6	100.6	101.1	101.6	100.1	101.8	100.0	97.3	98.9
Terms of trade for goods (index 1997=100)	93.3	99.4	94.3	100.0	103.2	102.2	95.2	93.9	92.5
Net resource transfer (*% of GDP*)	0.5	2.7	0.0	3.5	-0.7	-4.2	-4.4	-0.3	5.0
Gross external public debt (millions of dollars)	4,133	4,209	3,289	3,086	3,402	3,641	3,748	3,951	4,175
Gross external public debt (*% of GDP*)	39.1	35.9	27.8	24.1	24.1	23.0	23.5	24.1	24.7
Net interest and earnings (*% of exports)* [i]	-4.2	-5.1	-3.9	-4.8	-6.7	-22.0	-15.9	-11.3	-3.2

Table 1 (concluded)

	1994	1995	1996	1997	1998	1999	2000	2001	2002[a]
				Percentages					
Employment									
Labour force participation rate [j]	53.1	53.9	52.2	53.8	55.3	54.8	53.6	55.8	55.4
Open unemployment rate [k]	4.2	5.2	6.2	5.7	5.6	6.0	5.2	6.1	6.4
Visible underemployment rate [k]	8.9	10.0	12.0	11.0	11.7	12.0	9.7	9.5	11.2
				Annual percentages					
Precios									
Variation in consumer prices	19.9	22.6	13.9	11.2	12.4	10.1	10.2	11.0	9.7
Variation in nominal exchange rate	9.1	18.0	13.1	11.1	11.0	10.0	6.8	7.3	10.8
Variation in average real wage	3.7	-1.9	-2.1	0.8	5.6	4.7	0.8	1.0	4.0
Real deposit rate [l]	...	4.0	2.2	2.1	0.2	3.8	3.2	1.0	2.1
Real lending rate [m]	...	14.7	10.0	10.6	8.8	14.2	13.7	11.9	15.8
Equivalent deposit rate in foreign currency [n]	7.9	5.0	3.7	1.8	1.6	3.9	6.2	4.1	0.6
				Percentages of GDP					
Reduced non-financial public sector									
Current income	20.5	22.0	22.2	22.5	22.3	19.7	21.5	23.0	22.8
Current expenditure	21.0	20.0	20.8	19.5	19.0	17.5	19.5	21.0	22.2
Saving	-0.4	2.1	1.4	3.1	3.3	2.2	2.0	2.0	0.6
Capital balance	-4.9	-3.6	-3.9	-4.2	-4.2	-3.7	-3.9	-3.7	-4.5
Primary balance	-2.0	2.7	2.1	2.6	2.4	2.1	1.6	2.2	0.3
Overall balance	-5.2	-1.6	-2.5	-1.2	-0.8	-1.6	-2.0	-1.7	-3.9
Interest payments (% of current income)	15.8	19.6	20.9	16.9	14.3	18.5	16.6	17.3	18.8
Money and credit [o]									
Domestic credit p	12.6	10.4	14.9	15.5	18.1	19.0	24.3	28.0	32.0
To public sector	0.2	0.7	3.1	3.1	3.1	2.4	3.4	4.3	5.0
To private sector	12.4	9.8	11.8	12.4	15.0	16.6	20.9	23.7	27.0
Liquidity (M3)	...	28.1	28.1	28.2	28.8	28.8	31.5	32.7	33.8
Currency in circulation and domestic currency deposits (M2)	...	18.9	18.9	18.2	17.7	17.1	18.6	18.5	18.4
Foreign currency deposits	...	9.2	9.1	10.0	11.2	11.8	12.9	14.2	15.4

Source: ECLAC, on the basis of official figures.
[a] Preliminary figures. [b] Based on constant 1995 dollars. [c] Based on figures in local currency at current prices. [d] Includes errors and omissions. [e] Refers to the balance on the capital and financial accounts, minus net foreign direct investment plus errors and omissions. [f] A negative sign denotes an increase in reserves. [g] Includes the use of credit and loans from IMF and exceptional financing. [h] Annual average, weighted by the value of exports and imports of goods. [i] Refers to net investment income divided by exports of goods and services from the balance of payments. [j] Economically active population as a percentage of the working-age population, nationwide total. [k] Rates of unemployment and underemployment are percentages of the economically active population, urban total. [l] Thirty-day deposits at the four commerical state banks. [m] Rate for lending to the agricultural sector at the four commerical state banks. [n] Rate on deposits, deflated by the variation in the dollar exchange rate. [o] Average annual values were used for monetary figures. [p] Net credit to the public and private sectors extended by commercial banks and other financial and banking institutions.

an increase in sight and time deposits. The sharp upturn in time deposits (24.9%) was associated with the rise in local-currency interest rates and the consequent increase in the premium on investments in colones. Foreign-currency deposits (representing 50% of the total) continued to grow briskly (22.9%).

Net domestic credit grew by 18.5% in 2002, primarily because of the expansion of credit to the private sector (21.3%). The banking system continued to make most of its loans to households, in the form of housing and consumer credit (50% of total credit), and to the business and services sector (26% of the total portfolio). Foreign-currency loans continued to expand rapidly as a result of the differential between the cost of borrowing in local and foreign currency, and now account for more than 50% of total credit.

In 2003 the central bank continued to apply a tight monetary policy closely linked to the results of the measures being taken in the fiscal sphere. In the course of the first quarter it gradually raised the legal minimum reserve from 5% to 10%, which will reduce the amount of resources that banks can set aside for loans and will

Table 2
COSTA RICA: MAIN QUARTERLY INDICATORS

	2001				2002[a]				2003[a]	
	I	II	III	IV	I	II	III	IV	I	II
Gross domestic product (change from same quarter of preceding year) [b]	0.7	0.1	1.9	1.8	2.7	5.7	1.6	2.3	8.2	...
Goods exports fob (millions of dollars)	1,295	1,293	1,235	1,198	1,219	1,365	1,343	1,325	1,529	1,645
Goods imports cif (millions of dollars)	1,617	1,704	1,583	1,665	1,701	1,920	1,777	1,791	1,939	1,893
International reserves (millions of dollars)	1,401	1,359	1,370	1,330	1,490	1,452	1,402	1,497	1,750	1,688
Real effective exchange rate (2000=100)[c]	98.2	96.6	97.0	97.3	96.7	99.1	99.5	100.3	102.3	104.4
Consumer prices (12-month variation, %)	10.6	12.1	11.7	11.0	8.9	8.1	9.2	9.7	9.4	10.2
Average nominal exchange rate (colones per dollar)	321	326	331	338	346	355	364	374	383	393
Nominal interest rates (annualized percentages)										
Deposit rate[d]	12.2	11.7	11.6	11.6	11.6	11.8	11.0	11.5	11.1	10.9
Lending rate[e]	24.2	24.0	23.8	23.3	24.6	26.2	27.6	27.3	27.2	27.3
Interbank rate [f]	15.0	14.6	14.8	15.8	17.3	18.0	18.0	18.0	17.7	16.5
Domestic credit[g] (change from same quarter of preceding year)	31.6	27.8	19.7	26.9	26.8	27.2	33.9	26.5	25.0	...
Mature bank credit as a porportion of total credit (%)[h]	3.4	2.7	2.7	2.4	2.5	2.6	2.7	3.0	2.2	2.5

Source: ECLAC, on the basis of official figures.
[a] Preliminary figures. [b] Based on figures in local currency at constant 1991 prices. [c] Quarterly average, weighted by the value of exports and imports of goods. [d] Thirty-day deposits at the four commerical state banks. [e] Average rate for state and private bank lending. [f] Six-month benchmark rate for open-market operations. [g] Net credit to the public and private sectors extended by commercial banks and other financial and banking institutions. [h] Credit extended by the financial system.

make it easier to limit the losses attributable to interest payments on monetary stabilization bonds. In mid-March the central bank announced a reduction in the reference interest rates it offers on its bonds. Thus, the benchmark deposit rate –the market reference rate– was cut back from 17.5% to 16.75%. As a result of the prudent management of fiscal and monetary policy, credit and liquidity showed moderate growth and inflation rose at a rate consistent with the target set in the monetary programme.

c) Exchange-rate policy

Exchange-rate policy continued to be geared towards shoring up the relative profitability of the country's export sectors. The central bank gradually stepped up its daily adjustments of the exchange rate, which in 2002 brought the annual nominal increase to 10.8% and corrected the real appreciation recorded in 2001. In the first quarter of 2003 the rate of the daily increases in the nominal exchange rate was maintained and the colón showed a further real depreciation.

d) Trade policy

The year 2002 saw the entry into force of three free trade agreements (with Chile, Canada and the Dominican Republic) and two agreements for the reciprocal promotion and protection of investments (with the Republic of Korea and Switzerland). In addition, discussions continued for the conclusion of a free trade agreement with Panama and with the countries members of the Caribbean Community (CARICOM), and preparatory work was undertaken for the negotiation of a free trade agreement between Central America and the United States.

3. The main variables

a) Economic activity

In 2002 GDP grew by 2.6% on the strength of higher domestic demand and an upturn in exports of goods and services. The rapid growth of domestic demand was associated with increases in gross fixed capital formation and total consumption.

The increase in gross fixed investment (7.9%) was attributable mainly to high levels of public investment in telecommunications and electric power generation and distribution. Private investment also expanded, primarily in free-zone activities, the production of construction materials, tourism and building activity in the commercial and business segment. Consumer spending rose as real income in the private sector increased and credit became more readily available.

On the supply side, the goods-producing sectors picked up slightly (0.9%) after having contracted for two straight years. Their recovery was associated, to a large extent, with the performance of manufacturing (2.2%), which was bolstered by more vigorous growth in free-zone companies, including those in high-technology industries.

Agricultural activity was contractionary. Its value added declined by 1% as a result of the reduced output of coffee (6.6%), bananas (5.1%), corn (11.9%) and beef cattle (9%), which could not be offset by the upturns in the production of pineapples, flowers and foliage, roots, tubers and fresh fruit.

In the case of coffee, the slump was due to low international prices for coffee beans, which led to the neglect of some plantations and the abandonment of low-yield areas. The fall in banana production was due to weather conditions and to an oversupply on the world market, which discouraged production in low-yield areas. Low import prices for basic grains acted as a disincentive for local producers. With respect to beef cattle for slaughter, the fall in production was linked mainly to the reduction of total herd size.

Despite the buoyancy of public works in the energy and telecommunications sectors and in the improvement of road infrastructure, the value added of construction shrank by 1%. This result was attributable mainly to the decline in private housing construction due to the increase in real lending rates.

Service activities as a whole, which generated 57.4% of GDP, grew at a rate similar to that of the previous year (4.3%). Basic services were again among the most robust, growing by 9.7%. Telecommunications fared particularly well, especially in high-value-added services such as cellular telephone services, Internet access, international calls and data transmission. Transport services also expanded thanks to the stronger performance of external trade.

b) Prices, wages and employment

Inflation, measured according to the consumer price index (CPI), stood at 9.7%, coming in at less than the previous year's rate (11.0%) and undershooting the target set in the monetary programme (10%). In 2003 inflation has followed the pattern observed in 2002, with a rate of 10.2% for the 12-month period ending in June.

The factors contributing to this outcome included the tight monetary policy and the use of external resources to finance part of the fiscal deficit, as well as the drop in the prices of agricultural products and the more moderate increases in the prices of services and some imports, especially capital goods. To some degree, these factors counteracted the inflationary pressures generated by the increasingly large adjustments of the nominal exchange rate and the rise in fuel prices.

Although employment picked up significantly (2.2%), the nationwide rate of open unemployment increased further (to 6.4%) because of the high participation rate. At the same time, average real wages increased by 4%, owing mainly to wage increases in the autonomous institutions.

c) The external sector

The balance-of-payments current-account deficit widened to US$ 937 million in 2002, representing an increase of 27.1%. Consequently, the deficit as a percentage of GDP rose from 4.5% to 5.5%. Even so, private and official capital flows were sufficient to bridge this larger current-account gap and to fuel an increase in net international reserves, which at the end of the year totalled US$ 1.495 billion, equivalent to 2.6 months' worth of merchandise imports.

The increase in the balance-of-payments current-account deficit was due to the widening of the trade deficit, since the negative factor payments balance diminished and current transfers increased further.

The merchandise trade deficit expanded to 9.2% of GDP, considerably exceeding the previous year's level

(5.0%). This was attributable to the sharp upswing in imports, which overtook the rise in exports.

The f.o.b. value of merchandise exports totalled US$ 5.277 billion in 2002 (31.4% of GDP), exceeding the 2001 figure by 7.2%. This outcome marked a turning point in the wake of the 25% slump recorded in the 2000-2001 biennium owing to the adverse international economic environment and to specific problems that hurt external sales of traditional agricultural products.

This positive result was due for the most part to the performance of non-traditional exports, whose value increased by 6.5% in 2002. Foremost among them were exports produced by companies benefiting from special export regimes, which grew by 11% and came to represent 56.5% of total exports. This increase primarily reflected higher external sales of microprocessors produced by the telecommunications firm Intel (4.3%). Other contributing factors included the increase in shipments of medical equipment and pharmaceuticals as new companies began operations and the fact that some producers of food products were shifted from the regular regime to the free-zone regime. On the other hand, the maquila industry's loss of competitiveness caused its exports to contract by 4.9%.

Exports of non-traditional agricultural products rallied; the standouts in this regard were plants, flowers, foliage, pineapples and tubers. External sales of traditional products (13.2% of total exports) suffered a 6.3% contraction caused by a downturn in export volume. Except in the case of coffee, this decline was not offset by better international prices.

In 2002 the c.i.f. value of merchandise imports rose by 9.2% over the 2001 figure, reaching US$ 7.175 billion (42.6% of GDP). Imports increased considerably in all categories of goods except oil, fuels and lubricants. Particularly significant, however, was the upsurge in imports of capital goods (21.7%), due mainly to a 20.7% increase in those for the manufacturing industry. This development resulted primarily from higher public investment in telecommunications, electric power generation and oil refining, as well as investments by firms located in the free zones. This reversed the downswing in capital goods imports over the preceding three years.

Imports of raw materials and consumer goods grew at slower rates (6.3% and 9%, respectively). In the case of raw materials, most of the increase was due to purchases by the manufacturing sector and imports of construction materials in response to the expansion of public investment and the build-up of inventories, and for new building activity in the commercial and business segment. It should be noted that the slump in the import value of fuels and lubricants reflected the recommissioning of operations at the oil refinery of the State-owned oil company RECOPE.

In the case of consumer goods, imports of consumer durables, especially vehicles and articles for the home, continued to grow briskly (12.7%) thanks to the increase in real wages and the wider availability of credit.

In 2002 the balance of trade in services with the rest of the world posted a surplus (4.2% of GDP) that was slightly smaller than the one observed in 2001 (4.5%). Exports of services grew by 2.2% after having contracted by 2% the previous year. Most of this recovery was related to the tourism sector, which netted income of US$ 836 million, exceeding the previous year's intake by 3.3%. The income generated by other activities such as medical services and the production of computer software also improved.

The deficit on the income account shrank from US$ 793 million in 2001 to US$ 253 million in 2002; in terms of GDP, this represents a decline of more than three percentage points (from 4.8% to 1.5%). One important factor behind this result was the decline in the repatriation of profits and dividends linked to foreign direct investment.

External capital inflows amounted to US$ 1.11 billion in 2002, which represents a 48.2% jump in relation to their 2001 level. Most importantly, foreign direct investment climbed to the unprecedented figure of US$ 642 million. This development mainly reflected the purchase of a 25% stake in Florida Bebidas S.A., a subsidiary of the Costa Rican firm Florida Ice and Farm, by Heineken International of the Netherlands, at a cost of US$ 218 million. At the same time, foreign firms reinvested a bigger proportion of their profits. In addition, private capital inflows strengthened thanks to the direct financing of companies and the repatriation of Costa Rican deposits in response to attractive interest rates at home. The remaining capital inflows were related to public-sector operations, primarily the placement on international markets of US$ 250 million in 10-year sovereign bonds at an interest rate of 8.11%.

In the first four months of 2003 the trade deficit narrowed significantly (-20.4%), thus helping, in conjunction with high capital inflows, to consolidate international reserves. This improvement reflected an upsurge in exports (24.5%) due mainly to increased sales from the free zones, especially of microprocessors. After dipping slightly in the last quarter of 2002, imports picked up, buoyed by the more vibrant economy, which encouraged external purchases of capital goods and of oil, fuels and lubricants. This recovery, together with the marked increase in the factor income balance in the first quarter (in relation to its abnormally low levels in 2002), could hinder the country's efforts to bring the balance-of-payments current-account deficit below 5.5% of GDP, the level it reached in 2002.

Cuba

1. General trends

Beset by external shocks and bad weather conditions, the Cuban economy lost momentum for the second consecutive year in 2002, and gross domestic product grew by just 1.1%. Per capita GDP increased for the fourth straight year (0.8%), while unemployment again declined (3.3%), and real wages fell by 3% as a result of an upturn in inflation (7%). With the international scenario plagued by uncertainties, growth for 2003 is forecast to be as low as 1.5%. The modest performance of these two years is partly explained by deterioration in the terms of trade (-9.1%), a fall-off in international tourism since September 2001, and damage caused by hurricanes Michelle in 2001 and Isidora and Lily in 2002.

This more constrained international scenario limited the Government's room for manoeuvre in terms of economic policy and added to the serious problems caused by cumulative past imbalances, such as an acute shortage of foreign exchange, and the obsolescence of most of the capital goods supplied by the former socialist countries, compounded by a lack of spare parts to maintain them. These disequilibria are largely due to the prolonged embargo imposed by the United States, the sudden dissolution of the special links with the socialist countries, and an almost total lack of access to international capital markets.

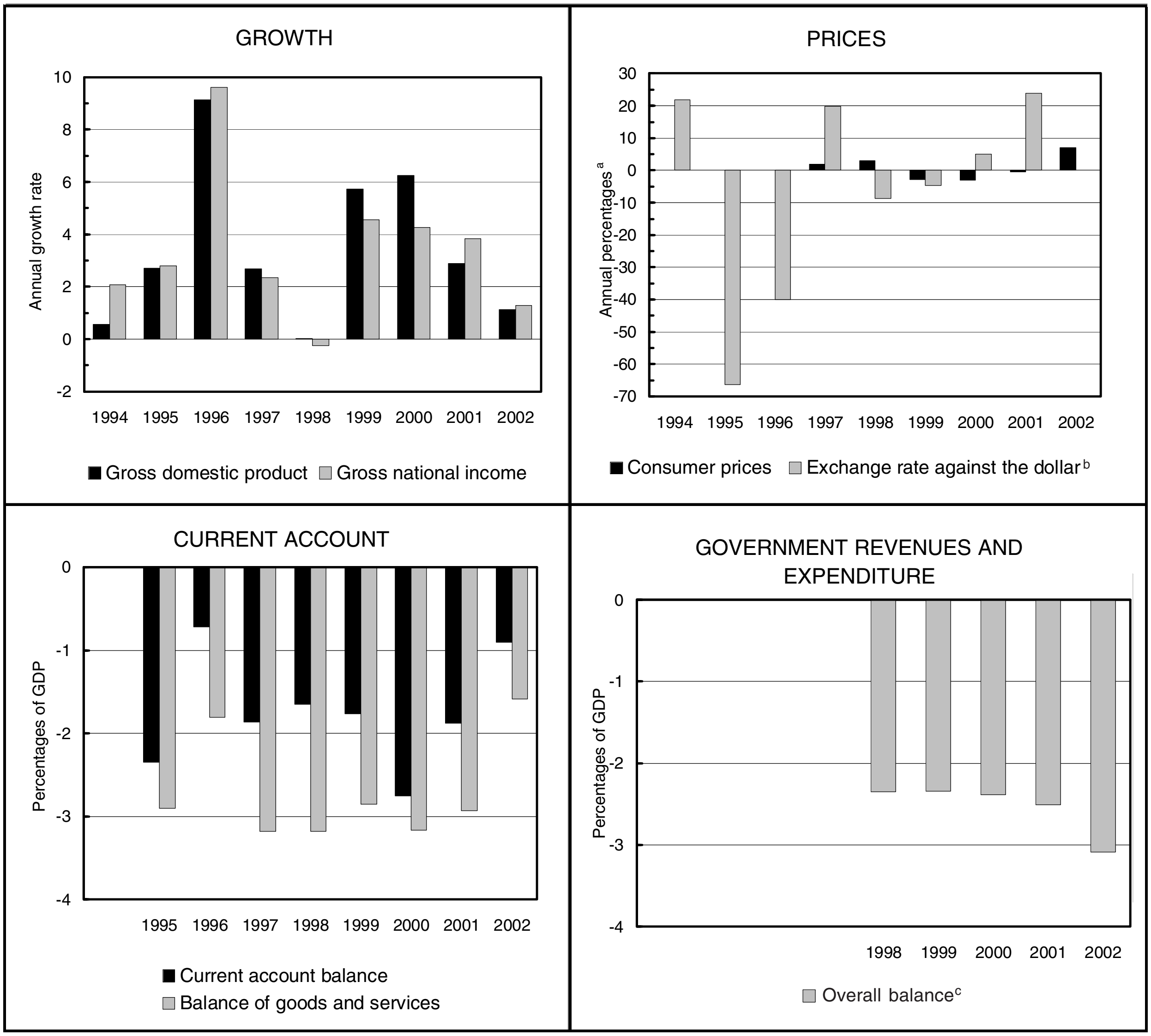
In terms of productive activity, priority was given to developing international tourism and high technology industries involved in the production of biotechnological, and pharmaceutical goods and medical equipment; and to reducing energy dependency and restructuring the sugar agribusiness. Despite the modest economic performance, the Government maintained the social orientation of its economic policy geared to continuously raising the well-being of the population at large.

In the face of weakening external demand (10.7%) which accentuated the lack of foreign exchange, the meagre GDP growth was based on higher government consumption (4.9%), reflecting an increase in current fiscal expenditure. Predictably, government services were the most buoyant component of production, and the fiscal deficit widened to 3.1% of GDP in comparison with the previous year's 2.5%, thereby slightly breaching the 3% limit established in the economic policy programme.

The expansionary fiscal policy implemented to compensate for the demand weakness widened the budget deficit, which in turn was financed through money creation. As a result, money in circulation (M2) rose to 45.4% of GDP from 42% in 2001. Unlike what normally happens in market economies, excess monetary issuance did not fuel galoping inflation because domestic prices are under administrative control. Nor, however, did the injection of purchasing power revitalize the domestic market, the behavour of which in planned economies basically depends on supply possibilities.

In terms of the different sectors, there was an expansion in national extraction of oil and gas (20%; 4.1 million tons of oil equivalent), which made it possible to reduce imports. As a result, nationally produced fuel

Figure 1
CUBA: MAIN ECONOMIC INDICATORS



Source: ECLAC, on the basis of official figures.
[a] December-to-December variation.
[b] Unofficial.
[c] Includes interest.

covered 90% of consumption by power stations (compared to 52% in the previous year), 100% of consumption for cement production, and almost 20% of crude oil refining requirements. Consequently, the output of national crude has almost tripled over the last four years and is now meeting half of the country's needs.

Investment again retreated (8.9%) in the wake of adjustment measures introduced in response to the acute shortage of foreign exchange in the country. Although the decline in investment implies lower growth potential in the medium term, its natural counterpart is a reduction in the balance-of-payments current account deficit (i.e., external savings), which in 2002 narrowed to 0.9% of GDP from 1.9% in the previous year.

For 2003, the most buoyant activities are expected to be national oil and gas extraction (17%) and nickel production (4.5%), while non-cane agriculture is forecast to grow by 3% and the non-sugar industry by 4.6%.

2. Economic policy

a) Fiscal policy

Government spending increased by 8.1% while total revenue rose by only 6.8%, thereby widening the fiscal deficit to 3.1% of GDP. Current revenue grew by 6%, reflecting improved tax collection (7.6%), while non-tax revenue edged up slightly (0.6%). Within overall fiscal revenues, indirect taxes grew faster (12.4%) than direct taxes, which expanded by a modest 1.5%.

Among direct taxes, larger receipts were obtained from social security contributions (8.2%) the labour force utilization levy (6%) and personal income tax (5.9%), while corporate tax revenues were down by 1.7% reflecting the production slowdown. Circulation and sales taxes, the country's main source of tax revenue, increased by 14.7%, while service taxes declined (6.8%) mainly because of the rise in wholesale fuel prices which was not passed on to the consumer.

Current expenditure grew by 10.8%, while capital expenditure slipped 10.5%. In the current expenditure category there were increases in social assistance (118.4%) –which benefited 245,800 people– culture and the arts (32%), sports (19.3%) and education (17.8%). Social security expenditure accounted for 6.6% of GDP, compared to 6.3% in 2001, benefiting 1.41 million people or 12.6% of Cuba's total population. The expansion in current expenditure was basically due to a deepening of programmes designed to raise the cultural and educational level of the population.

The deterioration of public finances was further compounded by the following: exceptional expenditure on reconstruction and repair work following the damage caused by the three hurricanes mentioned above; the campaign to control the Aedes Aegypti mosquito, which had caused an epidemic of dengue fever among the population; restructuring in the sugar agribusiness; and higher subsidies (142%) arising from losses incurred by State-owned agricultural businesses. These transfers to Ministry of Agriculture and Sugar enterprises were due firstly to weather-related events, mainly hurricanes, and secondly to the agricultural restructuring process. Nonetheless, economic assistance to basic cooperative production units (UBPCs) was down for the fourth consecutive year (20%), thanks to the increased efficiency achieved by these units.

The balance of public external debt grew slightly, to reach 36.5% of GDP, reflecting appreciations of the euro and the yen against the United States dollar, the main currencies in which the island's debts are denominated.

b) Monetary and exchange-rate policy

The monetary aggregate M2 grew by 9.8% following expansions in M1A (10.1%) and fixed-term and time deposits (7%). The narrow money supply (M1A) again expanded in relation to GDP (41.9% compared to 38.6% in 2001) following increases in its components of cash in circulation and instant-access savings accounts. Fixed-term and time savings also grew, boosted by rises in annual interest rates (from 4.5% to 5.5% on 12-month deposits, from 6% to 7% on those of two-year terms, and from 7.5% to 8% on three-year instruments).

The size of these monetary aggregates had little macroeconomic impact, since unlike the situation in a market economy, production levels in Cuba are influenced more by supply constraints than by the behaviour of demand. In economies dominated by the programming of material balances, monetary policy usually lacks autonomy and has few instruments for action, which renders it subordinate to fiscal management and the administration of State-owned enterprises. Indirect monetary control instruments (interest rates, bank cash reserve ratios, rediscount) are either non-existent or underdeveloped, having proved non-functional under the previous institutional arrangements and the prevailing division of labour between State and market. In Cuba, such instruments have only been in use since 1998 and then only on a partial basis. This explains the peculiarities of the Cuban financial system, along with the relatively limited development of the banking system and mechanisms for attracting savings, not to mention the backwardness of capital markets. Meanwhile, there is a lack of non-bank financing mechanisms to cover public deficits. Nevertheless, when more private actors enter the market, autonomy is granted to State-owned enterprises and incentives are created for labour productivity or production, which inevitably results in the quantitative guidelines of the economic plan gradually giving way to monetary controls and incentives.

In recent years, major reforms have been introduced in the financial system, in order to promote greater enterprise autonomy and support incipient non-State activities. Results have been very limited, however, so monetary policy can be considered largely irrelevant.

Table 1
CUBA: MAIN ECONOMIC INDICATORS

	1994	1995	1996	1997	1998	1999	2000	2001	2002[a]
	Annual growth rates [b]								
Gross domestic product	0.6	2.7	9.1	2.7	0.0	5.7	6.3	2.9	1.1
Per capita+A68 gross domestic product	0.0	2.2	8.6	2.2	-0.4	5.3	5.9	2.5	0.8
Gross national income	2.1	2.8	9.6	2.4	-0.3	4.5	4.3	3.8	1.3
Gross domestic product by sector									
Agriculture	-4.9	4.1	17.5	2.3	-14.1	11.6	9.1	-7.3	-9.5
Mining	1.1	56.0	16.6	2.8	-11.7	2.7	33.2	-2.3	0.6
Manufacturing	7.6	6.4	7.9	6.2	-8.1	7.2	5.1	-1.2	-1.1
Electricity, gas and water	4.4	9.8	3.6	7.0	3.7	8.1	12.8	0.8	0.6
Construction	-0.5	7.3	30.7	3.0	-2.6	7.5	8.4	1.6	0.3
Wholesale and retail commerce, restaurants and hotels	0.0	1.7	8.9	-0.2	5.8	0.7	7.6	4.1	3.1
Transport, storage and communciations	-3.4	5.6	8.7	3.1	15.6	17.6	5.0	14.8	2.6
Financial establishments, insurance, real estate and business services	-4.1	-1.7	7.2	1.7	5.1	12.7	0.9	3.5	1.0
Community, social and personal services	-1.8	-3.6	1.8	3.6	0.2	4.7	3.5	4.9	4.2
Gross domestic product by type of expenditure									
Consumption	1.5	1.3	8.3	2.6	0.5	5.0	4.2	4.0	1.6
General government	-1.9	-0.6	4.0	2.3	0.1	5.2	2.9	10.4	4.9
Private	2.9	2.1	9.8	2.6	0.6	5.0	4.7	1.8	0.3
Gross domestic investment	-1.4	39.8	22.2	7.2	-9.8	0.0	11.2	-3.9	-8.9
Exports of goods and services	9.1	4.3	24.6	-4.9	5.8	12.8	14.1	-7.2	-10.7
Imports of goods and services	19.2	11.5	24.3	-1.9	1.4	2.4	-0.2	-3.9	-15.0
	Percentages of GDP								
Investment and saving									
Gross domestic investment [b]	5.4	7.3	8.2	8.6	7.7	7.3	7.6	7.1	6.4
Gross domestic investment [c]	12.7	17.0	17.2	16.2	14.3	12.9	13.5	11.4	10.7
National saving [c]	12.4	15.8	16.5	14.3	12.6	11.1	10.8	9.6	9.8
External saving [c]	0.3	1.2	0.7	1.9	1.7	1.8	2.8	1.9	0.9
	Millions of dollars								
Balance of payments									
Current account	...	...	-167	-437	-392	-462	-776	-552	-293
Goods balance	...	...	-1,790	-2,265	-2,689	-2,909	-3,200	-3,176	-2,724
Exports fob	...	...	1,866	1,823	1,540	1,456	1,677	1,662	1,436
Imports fob	...	...	3,657	4,088	4,229	4,365	4,877	4,838	4,160
Services balance	...	...	1,372	1,519	1,932	2,163	2,306	2,313	2,211
Factor income balance	...	...	-493	-483	-449	-514	-622	-502	-600
Current transfers balance	...	...	744	792	813	799	740	813	820
Capital and financial balance [d]	...	...	174	457	409	485	805	595	300
Net foreign direct investment	...	...	82	442	207	178	448	39	...
Financial capital [e]	...	...	92	15	203	307	357	556	...
Overall balance	...	...	8	21	17	23	30	42	7
Other external sector indicators									
Terms of trade (index 1989=100)	65.9	73.9	66.7	67.0	64.2	53.2	47.4	47.3	43.0
Official exchange rate (pesos per dollar)	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00
Average informal exchange rate (pesos per dollar)	95	32	19	23	21	20	21	26	26
Total gross external debt (millions of dollars) [f]	9,083	10,504	10,465	10,146	11,209	11,078	10,961	10,893	10,900
Gross disbursed external debt *(% of GDP)* f	44.6	45.6	42.7	41.1	43.3	40.1	36.7	35.1	36.5

Table 1 (continued)

	1994	1995	1996	1997	1998	1999	2000	2001	2002a
				Percentages					
Employment									
Unemployment rate	6.7	7.9	7.6	7.0	6.6	6.0	5.5	4.1	3.3
Prices									
Consumer prices (variation December-December)	0.0	-11.5	-4.9	1.9	2.9	-2.9	-3.0	-0.5	7.0
				Percentages of GDP					
State income and expenditure									
Total income	...	...	...	...	50.5	49.6	51.7	50.2	48.4
Total expenditure	...	...	...	...	48.3	45.8	49.1	46.9	47.2
Overall balance	...	...	...	...	-2.4	-2.3	-2.4	-2.5	-3.1
Money									
Currency in circulation	...	...	...	...	...	...	18.0	22.1	23.8
M1	...	...	...	...	...	...	34.6	38.6	41.9
M2	...	...	...	...	...	...	37.2	42.0	45.4

Source: ECLAC, on the basis of official figures and ECLAC, “Cuba: Evolución económica durante 2001”. LCMEXL.525.
[a] Preliminary figures. [b] Based on constant 1995 dollars. [c] Based on figures in local currency at current prices. [d] Includes errors and omissions. [e] Refers to the balance on the capital and financial accounts, minus net foreign direct investment plus errors and omissions. [f] Calculations based on the official rate of 1 peso per dollar.

Nor has there been much progress towards exchange-rate unification, so a major distortion persists owing to the huge difference between the official and informal exchange rates (1 to 26).

In mid-2002, the euro started to circulate in the tourist resort area of Varadero. This process then extended to tourist destinations in Jardines del Rey and Cayo Largo, and it is expected to spread progressively to the rest of the country. This is an important development given the extent of Cuba’s economic relations with Europe through foreign direct investment (FDI) and trade in goods and services.

Lastly, neither the official exchange rate (US$ 1 = 1 Cuban peso) nor the commercial rate (US$ 1 = 26 Cuban pesos) showed any variation.

c) Structural reforms

Further improvements were made in State-owned enterprises, as greater autonomy in productive management was extended to 400 entities (10% of the existing total accounting for 40% of the country’s overall production), compared with 205 entities the year before.

While the FDI openness policy was maintained, the number of joint ventures remained virtually the same as in the previous year (around 405 enterprises in partnership with foreign capital). The funds committed amounted to some US$ 5.93 billion, half of which has already been disbursed. Meanwhile, no economic reforms were implemented in the non-State sector.

3. The main variables

a) Economic activity

Aggregate supply contracted by 1.2% as a direct consequence of a drop in imports of goods and services (15%) and domestic output growth of just 1.1%.

Domestic demand expanded by 0.5% while external demand fell back (10.7%). Total consumption grew by 1.6% as a result of stronger growth in government consumption (4.9%), while private consumption edged up by 0.3%. In 2002, per capita daily consumption levels reached 2,916 kilocalories and 76.8 grams of protein; in both cases these are similar levels to those recorded in 1989.

In terms of individual sectors, government services grew (4.2%) along with commerce (3.1%), while agriculture and manufacturing both contracted, by 9.5% and 1.1%, respectively, and construction stagnated (0.3%). Mining expanded moderately (0.6%), thanks to oil and gas extraction, while nickel and cobalt production declined (1.7%). Although national production of crude oil and gas increased, the effects of the smaller volume of imported crude were felt by the population especially through power supply, domestic fuel provision and public transport.

Government services expanded with the deepening of social development programmes (especially health, education, culture, the arts and sports), while commerce –especially State-owned restaurant services– expanded.

The standstill in the construction sector reflected the net outcome of the investment freeze caused by the acute shortage of foreign exchange, and reconstruction work in the aftermath of the hurricanes –basically restoration of 272,000 damaged dwellings, of which 35,700 had been totally destroyed. The hotel infrastructure development programme continued with the addition of 2,300 new rooms for international tourism.

Apart from investments to expand hotel capacity for international tourism, some 1 billion Cuban pesos were invested between 1990 and 2002 (with an import component of 36.3% in dollar terms) in the development of technical infrastructure, including electricity services, water pipelines, sewerage systems, road communications and causeways. Further amounts of 500 million and 783 million pesos were invested in airport infrastructure and non-hotel support and services respectively (with a total import component of 23.4% in dollar terms).

b) Prices, wages and employment

Having registered deflation during the last three years the consumer price index rose by 7%, and the rate of unemployment dropped to 3.3% from 4.1% in 2001, while the average wage rose (4%; 262 pesos). The resurgence of inflation is due mainly to higher prices on agricultural markets (16%) and on the informal market (5%). In foreign currency stores, the prices electrical appliances rose, while food and toiletries became cheaper.

Although economic growth was sluggish, some 158,000 new jobs were created in 2002, mainly in activities linked to urban agriculture (22%) and basic services for the population (19%), and among trainee and fully qualified primary school teachers, computer instructors, social workers, nurses, and video and television technicians. Total employment absorbed 40.7% of the population nationwide.

As part of the human resource policy, both in the budgeted and in the business sector, the average monthly wage increased in nominal terms (6.9%; 262 pesos per worker). Of workers engaged in the business sector 79% now have a pay regime based on productivity. In addition, 1,432,185 workers (31.4% of the total) benefit from the system of foreign exchange incentives. In the case of self-employment, the number of own-account workers remained at around 200,000.

c) The external sector

The balance-of-payments current account deficit narrowed from US$ 552 million in 2001 to US$ 293 million in 2002, thanks to a reduction in the goods and services trade deficit (from US$ 863 million to US$ 513 million), and despite larger net factor service payments (up from US$ 502 million to US$ 600 million). The latter basically reflected the repatriation of profits on direct investments in the island and interest payments on the external debt. The narrower trade deficit (goods and services) reflected the fact that merchandise imports fell more steeply (14%) than service exports (4%) especially tourism (2.8%), while the values of merchandise exports and imports declined at similar rates, and current transfers remained broadly stable (US$ 820 million). The surplus on the capital account (US$ 300 million) was sufficient to finance the current deficit and marginally boost the level of international reserves.

Although merchandise imports fell more sharply in volume terms (15%) than goods exports (6%), the country's terms of trade also worsened (9.1%) in the wake of lower international prices for sugar and an upturn in oil prices, while nickel prices also rallied slightly. Despite a smaller volume purchased, the oil bill (fuels and lubricants) grew to approximately US$ 875 million because of the rise in crude prices, while food imports increased to US$ 832 million. As a result, oil and foodstuffs accounted for 21% and 20% of total goods purchased abroad, in that order.

There has been an increase in external sales of non-traditional products based on ultramodern technologies, such as biotechnological and pharmaceutical products, medical equipment and advanced diagnostic methods. Progress was made in seeking new markets for these products and 200 health ministry registrations have been approved in 52 countries. In this endeavour, the products manufactured by the Centre for Genetic Engineering and Biotechnology are of particular interest.

Ecuador

1. General trends

Economic growth in Ecuador faltered during 2002, slipping to 3.8% from its 2001 level of 5.5%. This downward trend carried over into the first quarter of 2003, despite an upturn in oil prices; for although output expanded by 2.4% in relation to the first quarter of 2002, it shrank by 0.3% with respect to the fourth quarter. Demand cooled as the confidence generated by dollarization in 2000 and the energizing effect of the construction of the heavy crude oil pipeline both wore off, while hydrocarbons production shrank, particularly in the State oil company, Petróleos del Ecuador (PETROECUADOR).

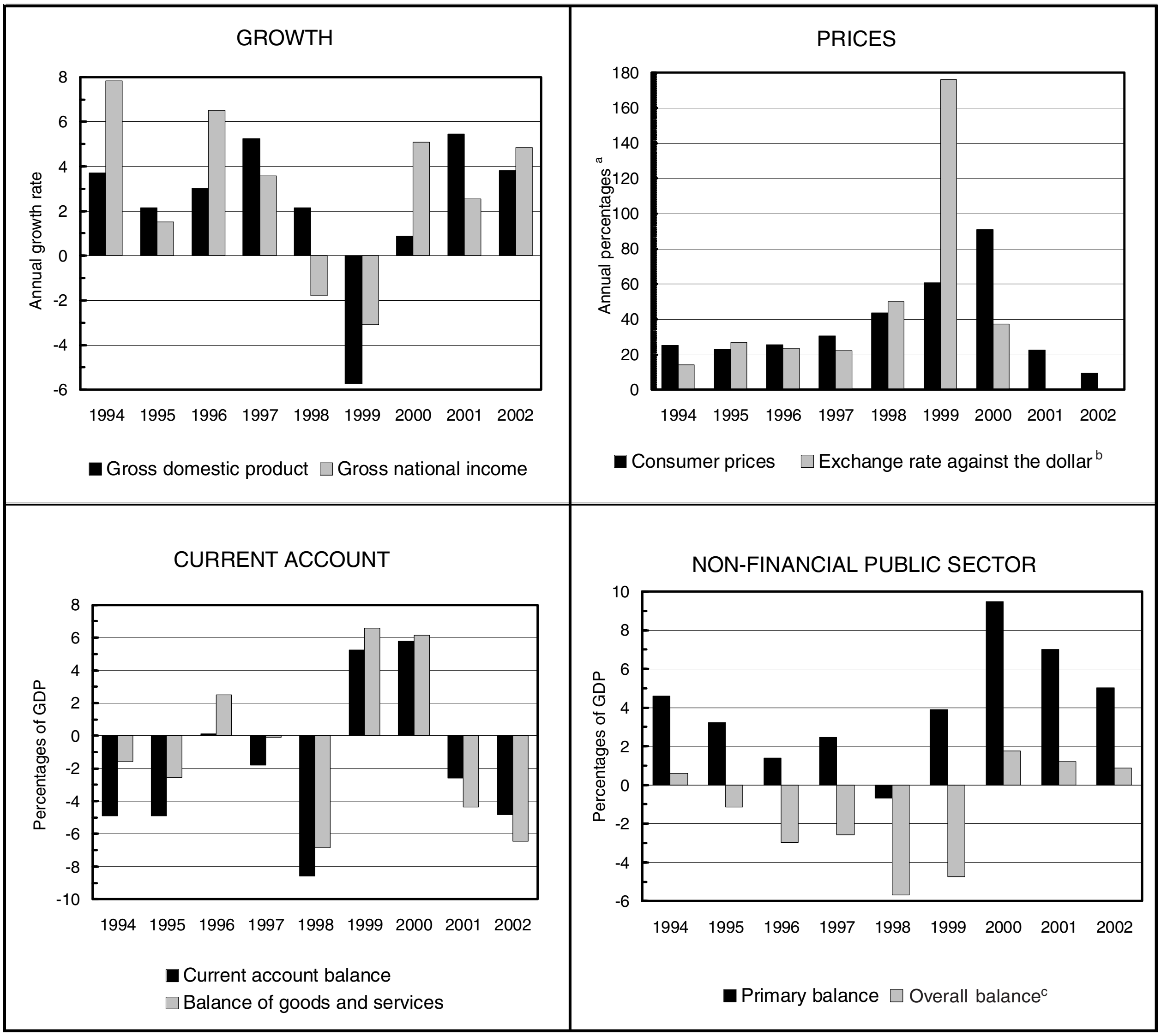
The pace of inflation continued to slow, from an annual rate of 22.4% in December 2001 to 7.6% in June 2003, as inflationary inertia steadily dissipated and the economy gradually cooled. Nonetheless, as prices still rose faster than in the United States the real exchange rate appreciated strongly during 2001-2003. The effects of this were further heightened by real depreciations among Ecuador's main Latin American trading partners.

On the credit side, although the asset position of the financial sector strengthened thanks to a rapidly shrinking non-performing portfolio, this was not enough to allow for credit expansion, given high (though gradually falling) rates of interest. The Government hopes that sovereign debt buybacks, using funds generated by the export of heavy crude oil through the new pipeline, will serve to narrow the sovereign spread and thus bring down domestic interest rates.

The overall fiscal surplus of the non-financial public sector (NFPS) in 2002 was larger, at 0.6% of GDP, than the previous year's 0.4%, despite a smaller primary surplus, which slipped from 5.1% to 4.2% of GDP during the 2001-2002 biennium. This was largely attributable to civil-service wage increases awarded in 2002. So far in 2003, tax revenue has slowed, reflecting a cooling of domestic demand and the retreat of oil prices from the highs recorded in the first quarter of 2003 (as a result of the war in Iraq), while spending increases decreed by the authorities have pushed up current outlays. The Government of the day has agreed to implement a series of measures in the framework of the stand-by arrangement signed with the International Monetary Fund in the first quarter of 2003, whose fiscal targets for that year include an NFPS primary surplus of 5.25% of GDP.

The balance of payments deteriorated in 2002, with the current account deficit widening from 2.6% to 4.8% of GDP, mainly as a result of strong import growth that far outstripped the expansion in exports. Since the level of remittances from Ecuadorians living abroad remained unchanged from the previous year and foreign direct investment (FDI) declined, the wider deficit was covered by drawing on foreign reserves and incurring arrears. Between January and May 2003, the value of exports grew almost entirely as a result of a rise in oil prices, supported by strong banana sales, while imports slowed in the wake of completion of the heavy crude pipeline and slackening demand.

Figure 1
ECUADOR: MAIN ECONOMIC INDICATORS



Source: ECLAC, on the basis of official figures.
[a] December-to-December variation.
[b] As of January 2002, the country adopted the United States dollar as its currency unit.
[c] Includes interest.

2. Economic policy

a) Fiscal policy

The year closed with an overall NFPS surplus equivalent to 0.6% of GDP, slightly higher than the 0.4% posted in 2001.

Total NFPS revenues expanded by 27.1% in dollar terms, increasing from 23.5% to 25.7% in relation to GDP. Oil revenues expanded slightly (2.8%) in dollar terms in 2002, while non-oil income grew by 35.1%, rising from 16.5% to 19.2% of GDP, thanks to increases in social-security contributions and VAT receipts, the latter partly reflecting improvements made to the collection mechanism.

On the expenditure side, in 2002 total NFPS outlays grew by 26.1% in nominal terms, rising from 23.1% to 25.1% of GDP. Current spending was up by 31.2%, largely because expenditure on wages rose by 51.5%, expanding from 24% to 28.8% of total expenditure, and from 5.5% to 7.2% of GDP. Capital expenditure climbed by 13.3% in dollar terms, and NFPS gross fixed capital formation rose by 22.1% to represent 5.8% of GDP.

The Fiscal Accountability and Transparency Act was passed in 2002. This legislation restricts growth in the central government's real primary spending to a maximum of 3.5% per year; imposes an obligation to reduce public debt and the fiscal deficit, excluding oil revenues; and stipulates that 70% of fiscal revenues generated by the start-up of the heavy crude pipeline are to be used to redeem public debt.

The Government has set itself the goal of reducing sovereign debt, to help bring interest rates lower (by reducing the sovereign spread) and to lighten the heavy fiscal burden implied by public debt interest payments. In 2002, these absorbed 3.6% of GDP (of which 2.7% was interest on external debt). Sovereign debt outstanding stood at 46.6% of GDP in December 2002.

In 2003, fiscal policy will be guided by the targets agreed upon with IMF in the framework of the stand-by arrangement signed in the first quarter of the year. These targets, and the measures the Government adopted before signing the agreement, are premised on two key goals: first, to enhance the solvency of the public sector, by curbing fiscal spending and using the bulk of fiscal revenues earned from hydrocarbon activity to reduce the volume of sovereign debt; and, second, to put structural reforms in place that will strengthen or complement the fiscal effort. The first group of measures includes the following:

- Approval of the 2003 budget, which contains a wage freeze and is premised on a price of US$ 18 per barrel of Oriente crude petroleum (Ecuador's benchmark price).
- Adjustment of fuel prices and electricity and telephone rates.
- Implementation of a series of fiscal adjustment measures to increase the primary surplus to 5.25% of GDP in 2003.

Measures in the second group include:

- Implementation of a tax reform, aimed at reducing the large number of earmarked taxes, since these severely limit the flexibility of fiscal policy; and reduction or removal of tax exemptions. The draft legislation also contemplates a rise in vehicle tax.
- Reform of the public-sector wage regime and extension of its tax base for income-tax and social-security contribution purposes.
- Reform of public enterprises in the electric-power, petroleum and telephony segments.

In the period January-May 2003 central government income was up by 4.7%, but in April-May it fell back by 10.5%, mainly because of a slump in oil revenues (-28.5%), which in turn was attributable to a fall in the price of crude oil following the end of the war with Iraq and a drop in production caused by a rupture in the Trans-Ecuadorian Pipeline System (SOTE) in May. In addition, weaker aggregate demand meant that VAT receipts were down by 5% and the take from import taxes fell by 7.5%, while revenue growth from income tax slowed to a meagre 1.6%. On the other hand, central government spending rose by 5% between January and May 2003, largely as a result of higher spending on public-sector wages following a pay rise awarded in 2002.

b) Monetary policy

Ecuadorian Government does not have the scope to operate monetary policy in the traditional sense under the dollarization scheme, it can influence the extent of monetization and credit in the economy, help to restore confidence in the financial sector, and take steps to bring interest rates lower.

In 2002 the financial sector continued to gather strength after the crisis of 1999. The percentage of non-

Table 1
ECUADOR: MAIN ECONOMIC INDICATORS

	1994	1995	1996	1997	1998	1999	2000	2001	2002[a]
	Annual growth rates[b]								
Gross domestic product	3.7	2.1	3.0	5.2	2.2	-5.7	0.9	5.5	3.8
Per capita gross domestic product	1.5	0.0	0.9	3.1	0.2	-7.5	-1.0	3.5	2.0
Gross national income	7.8	1.5	6.5	3.6	-1.8	-3.1	5.1	2.6	4.8
Gross domestic product by sector									
Agriculture	7.1	3.7	7.6	10.0	-3.0	9.1	-0.1	0.7	7.2
Mining	11.7	2.1	0.8	-1.9	-1.6	1.4	8.0	1.7	-3.5
Manufacturing	3.7	-1.4	-2.8	8.5	8.3	-23.5	-32.4	20.8	-0.3
Electricity, gas and water	3.8	-18.8	11.9	6.8	8.5	23.0	2.6	4.6	2.4
Construction	7.0	0.4	1.3	2.7	-0.2	-24.9	18.3	4.0	14.7
Wholesale and retail commerce, restaurants and hotels	4.5	0.2	5.2	4.4	1.1	-11.3	3.8	4.3	3.7
Transport, storage and communciations	-0.5	4.6	3.2	8.2	9.4	-0.3	7.7	1.7	1.3
Financial establishments, insurance, real estate and business services	6.6	9.5	6.7	1.6	-5.0	-20.6	2.3	15.0	2.7
Community, social and personal services	-3.4	-1.2	1.1	3.4	5.1	-1.3	5.8	1.6	1.3
Gross domestic product by type of expenditure									
Consumption	0.6	5.0	3.2	4.8	1.8	-5.2	0.5	6.1	6.1
General government	1.0	4.5	-5.2	4.7	-2.2	-5.5	4.7	0.5	3.2
Private	0.5	5.1	4.8	4.9	2.5	-5.2	-0.2	7.1	6.6
Gross domestic investment	12.1	-2.6	-8.8	12.5	14.2	-49.4	29.0	36.8	21.8
Exports of goods and services	8.7	5.0	3.6	4.3	-3.2	-0.4	-0.2	5.0	-2.0
Imports of goods and services	6.0	9.9	-5.9	8.8	5.5	-39.0	18.7	33.7	20.2
	Percentages of GDP								
Investment and saving									
Gross domestic investment [b]	22.6	21.6	19.1	20.4	22.8	12.2	15.7	20.3	23.8
Gross domestic investment [c]	21.9	21.6	19.7	21.5	25.3	14.7	20.1	25.7	27.7
National saving [c]	17.0	16.6	19.7	19.7	16.7	20.0	25.9	23.0	22.9
External saving [c]	4.9	4.9	0.0	1.8	8.6	-5.3	-5.8	2.6	4.8
	Millions of dollars								
Balance of payments									
Current account	-912	-994	3	-427	-2,001	877	921	-550	-1,178
Goods balance	138	-66	962	523	-1,035	1,545	1,399	-397	-1,004
Exports fob	3,925	4,468	4,940	5,371	4,319	4,516	5,057	4,781	5,192
Imports fob	-3,787	-4,535	-3,978	-4,849	-5,353	-2,971	-3,657	-5,179	-6,196
Services balance	-432	-445	-427	-543	-563	-451	-420	-523	-566
Factor income balance	-940	-924	-1,023	-1,027	-1,171	-1,307	-1,411	-1,269	-1,262
Current transfers balance	322	442	492	621	767	1,089	1,352	1,639	1,654
Capital and financial balance [d]	138	-458	-74	-89	1,216	-1,822	-6,628	320	1,050
Net foreign direct investment	576	452	500	724	870	648	720	1,330	1,275
Financial capital [e]	-439	-911	-574	-813	346	-2,470	-7,348	-1,010	-225
Overall balance	-774	-1,452	-71	-515	-785	-945	-5,707	-230	-127
Variation in reserve assets [f]	-583	178	-246	-251	460	492	-307	106	66
Other financing [g]	1,357	1,274	317	767	326	453	6,014	124	62
Other external sector indicators									
Real effective exchange rate (index 2000=100)[h]	66.1	66.6	68.0	66.0	64.9	89.1	100.0	70.7	62.4
Terms of trade for goods (index 1997=100)	97.3	89.3	97.9	100.0	89.0	94.9	110.6	102.0	104.7
Net resource transfer (% of GDP)	2.9	-0.5	-3.5	-1.3	2.0	-16.3	-12.7	-3.2	2.3
Gross external public debt (millions of dollars)	14,589	13,934	14,586	15,099	16,400	16,282	13,564	14,411	16,236
Gross external public debt (% of GDP)	78.6	69.0	68.6	63.9	70.5	97.6	85.1	68.5	66.8
Net interest and earnings (% of exports)[i]	-20.4	-17.8	-18.1	-16.9	-23.4	-24.9	-23.9	-22.3	-20.4

Table 1 (concluded)

	1994	1995	1996	1997	1998	1999	2000	2001	2002[a]
					Percentages				
Employment									
Labour force participation rate [j]	55.6	55.8	55.8	57.3	58.4	60.0	56.8	55.6	54.1
Unemployment rate [k]	7.8	7.7	10.4	9.3	11.5	15.1	14.1	10.4	8.6
Visible underemployment rate [l]	...	...	...	...	13.6	15.2	13.8	11.3	9.3
					Annual percentages				
Prices									
Variation in consumer prices	25.3	22.8	25.6	30.7	43.4	60.7	91.0	22.4	9.4
Variation in producer prices	...	...	...	...	...	186.9	64.9	-5.6	17.7
Variation in nominal exchange rate	14.1	26.8	23.4	22.2	50.1	176.0	37.3	m	m
Variation in average real wage	8.9	10.0	5.4	-2.3	-4.0	-8.3	-4.7	12.5	...
Real deposit rate [n]	5.3	17.3	8.2	0.3	-2.1	-38.2	-39.3	-8.5	-4.2
Real lending rate [o]	13.5	27.5	18.3	12.0	5.0	-34.6	-34.9	-0.9	4.5
Equivalent deposit rate in foreign currency [p]	17.1	12.8	14.5	4.8	-7.2	-60.1	-21.0	6.6	5.5
					Percentages of GDP				
Non-financial public sector									
Total income	24.4	25.6	24.5	23.8	20.4	25.7	30.3	26.9	30.3
Current expenditure	17.3	20.2	19.8	20.1	20.2	23.1	22.7	19.5	21.9
Capital balance	-6.5	-6.6	-7.6	-6.3	-5.9	-7.3	-5.8	-6.1	-7.6
Primary balance	4.6	3.2	1.4	2.5	-0.7	3.9	9.5	7.0	5.0
Overall balance	0.6	-1.1	-3.0	-2.6	-5.7	-4.7	1.7	1.2	0.9
Public debt	77.6	64.7	64.4	56.6	61.9	92.0	79.7	63.4	55.6
External	69.9	57.4	55.6	49.6	51.4	73.9	62.0	50.1	44.2
Domestic	7.7	7.3	8.8	7.0	10.5	18.1	17.8	13.3	11.4
Interest payments (% of total income)	16.4	17.1	17.9	21.1	24.5	33.7	25.5	21.6	13.7
Money and credit [q]									
Domestic credit [r]	19.6	25.4	26.6	27.0	34.1	41.1	29.3	24.6	23.4
To public sector	0.3	0.4	0.8	1.2	2.4	4.5	2.4	-1.3	-1.7
To private sector	19.4	25.1	25.9	25.8	31.6	36.6	26.9	26.0	25.2
Liquidity (M3)	19.6	22.8	24.3	26.2	25.8	41.1	22.1	22.0	23.1
Currency in circulation and domestic currency deposits (M2) [s]	19.6	22.8	24.3	26.2	25.8	41.1	22.1	22.0	23.1

Source: ECLAC, on the basis of official figures.
[a] Preliminary figures. [b] Based on constant 1995 dollars. [c] Based on figures in local currency at current prices. [d] Includes errors and omissions. [e] Refers to the balance on the capital and financial accounts, minus net foreign direct investment plus errors and omissions. [f] A negative sign denotes an increase in reserves. [g] Includes the use of credit and loans from IMF and exception financing. [h] Annual average, weighted by the value of exports and imports of goods. [i] Refers to net investment income divided by exports of goods and services from the balance of payments. [j] Economically active population as a percentage of the working-age population in three cities; up to 1998, urban total. [k] Unemployed as a percentage of the economically active population in three cities; up to 1998, urban total. Includes hidden unemployment. [l] Underemployed as a percentage of the economically active population in three cities; up to 1998, urban total. [m] In January 2000, the country adopted the United States dollar as its currency. [n] Up to 1998: 30- to 83-day deposits in sucres. From 1999 on: 30- to 83-day deposits in dollars. [o] Up to 1998: 92- to 172 day loans in sucres. From 1999 on: 92- to 172 day loans in dollars. [p] Rate for deposits, deflated by the variation in the dollar exchange rate. [q] Average annual values used for monetary figures. [r] Refers to net credit to the public and private sectors extended by commercial banks and other financial and banking institutions. [s] Includes foreign-currency deposits.

performing loans declined from 43.6% in December 2001 to 24.1% a year later, but between January and May 2003 it crept up again to 25.7%. This could exacerbate the already highly cautious stance among lending institutions, as the banks strive to maintain the required degree of solvency, and the country moves towards adoption of the Basel Core Principles for Effective Banking Supervision.

The base rate on weekly bond auctions by the Central Bank held steady at an annual rate of around 5% in 2002 and during the first half of 2003. Nominal lending rates fell throughout the year, from 16% in January 2002 to around 13.8% in May 2003, in line with the reduction in cumulative inflation. As was the case throughout 2002, nominal deposit rates remained low

Table 2
ECUADOR: MAIN QUARTERLY INDICATORS

	2001				2002[a]				2003[a]	
	I	II	III	IV	I	II	III	IV	I	II
Gross domestic product (change from same quarter of preceding year) [b]	8.1	5.2	2.7	4.6	1.3	3.9	5.0	3.5	2.4	...
Goods exports fob (millions of dollars)	1,227	1,249	1,181	1,021	1,100	1,297	1,312	1,320	1,499	1,350
Goods imports cif (millions of dollars)	1,171	1,347	1,357	1,487	1,434	1,730	1,680	1,587	1,549	1,602
International reserves (millions of dollars)	733	976	912	840	777	904	901	715	770	1,111
Real effective exchange rate (2000=100) [c]	74.5	71.0	70.0	67.3	64.1	62.9	61.8	60.7	59.7	60.3
Urban unemployment rate	11.8	11.2	10.5	8.6	8.7	8.8	8.7	8.3	9.9	10.2
Consumer prices (12-month variation, %)	58.8	33.2	27.2	22.4	13.2	13.3	11.3	9.4	9.2	7.6
Average nominal exchange rate (sucres per dollar)	d	d	d	d	d	d	d	d	d	d
Nominal interest rates (annualized percentages)										
Deposit rate [e]	7.2	6.7	6.3	6.2	5.8	5.2	5.3	5.5	5.6	5.5
Lending rate [f]	16.4	15.2	15.4	14.8	15.5	14.9	15.0	14.9	14.8	13.8
Interbank rate	4.0	3.5	2.8	2.2	1.9	1.4	1.2	1.1	1.1	0.9
Sovereign bond spread (basis points)	1,341	1,287	1,530	1,254	1,037	1,253	1,980	1,794	1,371	1,208
Domestic credit [g] (change from same quarter of preceding year)	14.0	13.8	17.2	13.7	14.2	16.6	-6.9	-8.8	3.3	3.0
Mature bank credit as a porportion of total credit (%) [h]	47.9	44.7	44.5	43.6	42.7	39.6	24.6	24.1	25.7	25.7

Source: ECLAC, on the basis of official figures.
[a] Preliminary figures. [b] Based on figures in local currency at constant 2000 prices. [c] Quarterly average, weighted by the value of goods exports and imports. [d] In January 2000, the country adopted the United States dollar as its currency. [e] Average for freely transacted dollar deposits in private banks, at 30 to 83 days. [f] Average for freely transacted dollar loans extended by private banks, at 92 to 175 days. [g] Refers to net credit to the public and private sectors extended by commercial banks and other financial and banking institutions. [h] Refers to total credit extended by the banking system.

during January-May 2003, making real interest rates negative from early 2002 through the first half of 2003. As inflation continues to slow, however, real deposit rates should continue to rise, given the stability of nominal deposit rates, which hovered around 5% per year in the second half of 2002 and until May 2003. The rate spread has also been narrowing gradually since mid-2002, largely reflecting the drop in lending rates; nonetheless in May 2003 it was still at high levels around 7%.

The persistence of high interest rates in the Ecuadorian financial system can be attributed to a number of factors. First, financial institutions keep a large share of their reserves invested in highly liquid assets abroad, to enable them to respond in the event of a surge in demand for liquidity from depositors, and this makes credit more expensive. Second, Ecuador's country-risk rating remains high, at almost 1,100 basis points as of mid-2003.

Total credit to the private sector receded by 8.8% in 2002, for although the performing loans portfolio expanded by US$ 608 million, the non-performing portfolio shrank by almost double that amount (US$ 1.115 billion). Nonetheless, this credit contraction represents an improvement in the solidity of the system. Total credit to the private sector has slipped again in 2003, albeit only slightly (0.9%), but the two components behaved very differently than the year before: up to May 2003 the performing loans portfolio contracted by 2.5% while the non-performing portfolio increased by 6.1%. The establishment of an agency to collect information on private credit could, if successful, reduce the cost of consumer credit, since it would make it cheaper for borrowers to switch between lending institutions.

c) Exchange-rate policy

Ecuador's real exchange rate has been appreciating against the dollar and against most of its largest trading partners since the dollar was adopted as the national currency in January 2000. Nonetheless, the gradual lowering of inflation rates and the relative appreciation of the currencies of some of those trading partners in relation to the dollar has slowed the appreciation of the Ecuadorian exchange rate. Moreover, the strengthening of the euro against the dollar has had a positive effect on Ecuador's competitiveness.

Although inflation at a rate above the United States figure brought about a real exchange-rate appreciation of 6.3% in 2002, there was a 6.7% real depreciation against the euro during the same period. This trend continued in the first half of 2003, with a real appreciation of 3.6% against the dollar and real depreciation of 10.5% against the euro between December 2002 and June 2003. Real currency appreciation against the dollar has thus far outweighed the effects of the heavy depreciation of the sucre in 1999, placing Ecuador's real exchange rate at a level comparable to that of late 1998, before the crisis.

Perhaps the most significant development on the foreign exchange front is the real appreciation of Ecuador's currency against those of its main Latin American trading partners.[1] As these currencies have generally appreciated during 2003, the relative appreciation of Ecuador's currency with respect to its partners has been mitigated, and real bilateral depreciations have even been recorded in a few cases. In June 2003, however, the real effective exchange rate was close to its lowest level for the last 10 years.

3. The main variables

a) Economic activity

Ecuador's GDP expanded by 3.8% in 2002, compared to 5.5% the year before. On the demand side, GDP growth can be attributed to a 17.6% increase in gross fixed capital formation, a 4.8% rise in final household consumption, and an expansion of 3.2% in government consumption. Exports, measured in constant prices, grew by just 0.9% in 2002. On the supply side, the most dynamic sector was construction, which expanded by 14.7%, while financial intermediation rebounded by 9.7% and agriculture also rallied (7.2%). Among the five sectors to display negative growth rates in 2002, mining and quarrying fell particularly sharply (-3.5%) reflecting the downturn in oil production.

During the first quarter of 2003 GDP has trended below official projections, expanding by 2.4% with respect to the same quarter of 2002 but shrinking by 0.3% in relation to the fourth quarter. These results point to growth of 1.5% for the year as a whole.

Government consumption rose by 0.8% in the first quarter of 2003, but fiscal expenditure on consumption and investment is expected to remain subdued for the rest of the year, in line with the requirements of the IMF programme. Public investment will thus be restricted by both public expenditure constraints and the austere budget approved for PETROECUADOR. Private consumption growth slowed from the second quarter of 2002 on, in parallel with the stagnation of credit and employment, posting a value of 3.7% for the first quarter of 2003. In the same period, gross fixed capital formation, which has also been slowing, grew by 5.1%. Expansion of this indicator for 2003 as a whole could be less than in 2002, as the economy cools down and the expansionary effect of construction of the heavy crude pipeline wears off. Investments by private oil companies are expected to increase, however, as they seek to build up production to take advantage of the additional crude transport capacity that the pipeline will provide from the third quarter of 2003 on.

Construction was the most buoyant sector during first quarter of 2003, posting growth of 8%. Even so, this and other sectors are showing signs of a slowdown with respect to 2002, although investment in the petroleum sector and, to a lesser extent, in housing construction is expected to have a positive impact. Nevertheless, construction is unlikely to drive growth as strongly as in 2002 once the "pipeline effect" has

1 In 2002, the real appreciation amounted to 31.7% against the Venezuelan bolívar, 19.7% against the Colombian peso and 9.3% against the Peruvian new sol.

faded. During the first quarter of 2003 manufacturing also displayed a satisfactory rate of expansion (3.8%), while another six sectors declined in the same period and most grew less than in the fourth quarter of 2002. The steepest fall (9.2%) occurred in the financial intermediation sector, which has now run up three consecutive quarters of negative growth.

Mining and quarrying, the largest sector in the Ecuadorian economy, accounting for 19.4% of GDP, has now recorded zero or negative growth for three straight quarters and shrank by 1.9% between the first quarter of 2002 and the same period in 2003. Crude oil production was 54.8 million barrels between January and May 2003, at an average of 362,700 barrels per day. This is 7.3% down on total production for the first five months of 2002, although part of this decline is due to closure of the SOTE pipeline for a week during May 2003. It is significant that both oil production and the share of PETROECUADOR in the total have been declining over the past 10 years: the State company's production has decreased by a third since 1993, while Ecuador's overall production has expanded by 14.2% in the same period.

Given the investment budget approved for PETROECUADOR in 2003, expansion of production at its five main fields (Shushufindi, Sacha, Auca, Cononaco and Libertador) will depend mainly on agreements to be reached with private firms for investment in restoring the production capacity of those fields. When the heavy crude pipeline comes into operation, which should be by the end of the third quarter of 2003, it will immediately add 450,000 barrels per day in transport capacity and is expected to lead to an increase in oil investments.[2] With regard to the expansion of hydrocarbon and gas reserves, the ninth round of auctions for exploration concessions in four offshore blocks, held in April, failed to attract any bids. In the medium term, oil production could increase substantially when the Government and private firms reach an agreement with respect to the latter's stake in the development of the Ishpingo-Tambococha-Tiputini (ITT) project.

b) Prices, wages and employment

Inflation in Ecuador has been falling steadily –from 22.4% in December 2001 to 9.4% in December 2002 and 7.7% in the 12 months to July 2003. The rate should continue to drop further as inflationary inertia is dissipated, provided aggregate demand continues to slacken. In 2002, inflation was driven mainly by increases of 10% or more in the cost of certain services (non-tradables), while food, beverages and tobacco (almost a third of the index) rose by 6%. In the first semester of 2003, these same services, together with transport, continued to exert upward pressure on the CPI, while the prices of tradable goods either rose little or actually fell. Rate adjustments implemented in January 2003, and their knock-on effects, gave a temporary boost to the inflation rate early in the year, after which it resumed its downward path for the rest of the first semester.

Non-tradable goods prices rose much faster than tradables during 2002 and in January-May 2003. This shows that domestic relative prices have shifted heavily in favour of non-tradable sectors of the economy, possibly as a result of the appreciation of the real exchange rate. It should be borne in mind that Ecuador's economy is characterized by a super-fixed exchange rate (dollarization), inflationary inertia, large inflows of foreign exchange from hydrocarbons exports and trade liberalization.

On the employment front, an upturn in levels of activity in a number of labour-intensive sectors, such as commerce and construction, generated new jobs in the modern sector, whose share in urban employment rose slightly. Nonetheless, the slowdown in aggregate economic growth compared to 2001 produced a slight fall in the overall employment rate from 49.8% to 49.5%, while unemployment dropped from 10.4% to 8.6%, owing to a sharp fall in labour supply, which may partly be explained by continuing labour emigration. The minimum wage, which in Ecuador serves as an important benchmark for the evolution of the entire wage structure, edged up by 1.2% in real terms, thus continuing its rally following major losses between 1996 and 2000. No improvement in the employment situation is forecast for 2003, given the slow pace of economic growth and the fact that the sectors with the best prospects for expansion –those linked to hydrocarbons– are not labour-intensive.

c) The external sector

Ecuador closed 2002 with a balance-of-payments current account deficit of 4.8% of GDP, compared to the 2.6% recorded in 2001. This result was chiefly due to a deterioration in merchandise trade, for while exports expanded by 8.6%, imports grew by 19.6%, partly

2 At least two private firms have publicly expressed intentions to invest heavily in the production of heavy crude, although part of this investment may take place in 2004 rather than 2003.

reflecting the capital goods needed for construction of the heavy crude pipeline. Although broadly unchanged from their 2001 level, emigrant remittances, representing 5.9% of GDP, went a long way towards financing the deficit on the goods and services accounts. Foreign direct investment (FDI) retreated from 6.3% to 5.2% of GDP, and overall balance-of-payments financing requirements amounted to a modest half point of GDP, which the authorities covered by drawing down reserves and incurring arrears. The current account deficit has narrowed from US$ 276 million in the first quarter of 2002 to US$ 60 million in the first quarter of 2003, largely a result of a major reduction in the trade deficit over this period –itself attributable to a sharp rise in the prices of exported oil and a modest increase in imports.

In the first five months of 2003, the total value of exports was showing a 13.6% increase, of which 97.8% corresponded to just two products: crude oil and bananas (which accounted for 82.9% and 15%, respectively). Ecuador's export performance basically depends on the behavior of production and prices in a basket of commodities, among which petroleum, bananas, shrimp, flowers and, to a lesser extent, cacao are the most important items. Exports of canned fish are also significant.

The total value of crude oil exports soared to US$ 863 million between January and May 2003, representing a 35.3% increase in relation to the same period in 2002. This was due exclusively to a rise in the international price of crude oil: in February 2003 the price per barrel was double the figure recorded in the same month of 2002, as a result of the conflict in Iraq. Although the price of exported crude oil rose by 41% on average with respect to the period January-May 2002, the volume dropped by 4.9%, reflecting a downturn in production during this period. Exports can be expected to strengthen in the fourth quarter of 2003, once the heavy crude pipeline comes on stream.

Among other primary products, shrimp exports have not yet recovered from the recent drop in output caused by the outbreak of white spot virus. Bananas continue to account for about a third of non-oil exports (and one fifth of the total). Cacao has benefited from stronger international prices, although in 2003 the expansion of areas under cultivation is unlikely to increase output to any significant extent.

Import growth slowed in 2002 and early 2003 with respect to the 2001 rate. Between January and May 2003, the value of total imports was up slightly (1.1%) in relation to the same period of 2002. This is wholly attributable to the performance of consumer goods imports, which expanded by 4.5%, while the value of raw material imports slipped by 0.3% (reflecting the production slowdown), and capital goods imports contracted by 10.5% (as the heavy crude pipeline neared completion). It is interesting to note that the share of consumer goods in total imports has risen significantly over recent years. In 2000 (the year the economy was dollarized), consumer goods accounted for 22.1% of total imports, but the proportion increased rapidly to 26.5% in 2001 and 28% in 2002. This trend may be related to a shift in relative prices towards non-tradable goods, as a result of the effective exchange rate appreciation seen since dollarization.

El Salvador

1. General trends

Economic growth in El Salvador remained sluggish in 2002. Gross domestic product (GDP) increased by 2.2%, which, while it represented a slight upturn with respect to the 1.9% growth recorded in 2001, resulted in the virtual stagnation of per capita GDP, for the third straight year, at just under US$ 2,000. Family remittances edged slowly upward and continued to play an important role in bolstering private consumption and the external accounts. The almost complete dollarization of the money supply helped to keep interest rates and inflation low.

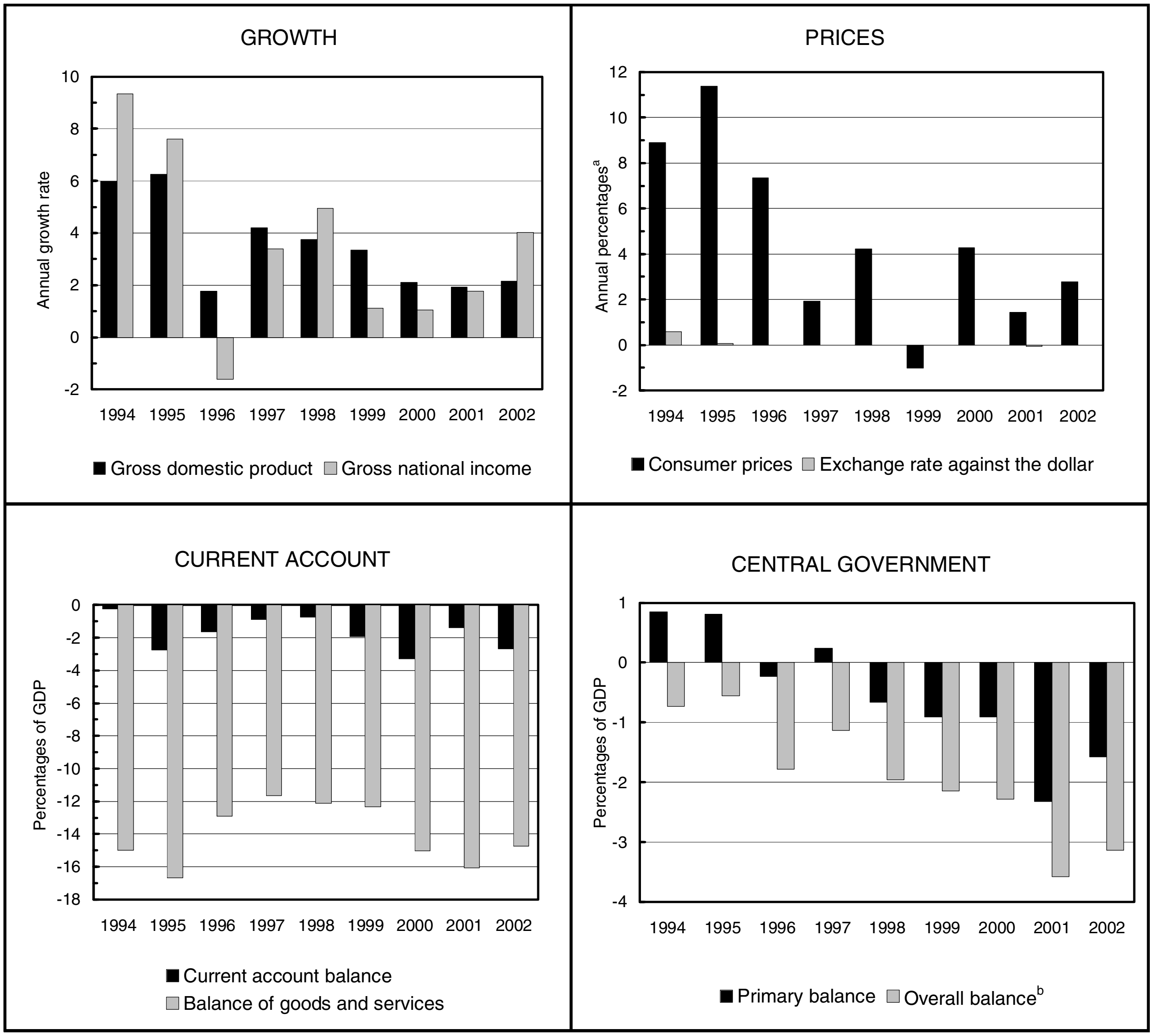
Notwithstanding the relative abundance of liquidity and low interest rates, private investment was down for the second consecutive year as a result of factors such as fewer profit-making opportunities, the deterioration of the political climate owing to the resurgence of social conflict, and the uncertainty surrounding the elections scheduled for 2003 and 2004. On the other hand, public investment expanded, owing in part to the rebuilding of infrastructure damaged by the earthquakes that struck in 2001. Even so, the central government deficit shrank to 3.1% of GDP thanks to efforts to control current expenditure and an increase in tax revenue. At the same time, the government had to cope with other public liabilities linked to the change in the pension system. External public borrowing grew considerably, reflecting the policy of converting domestic debt into external debt to ease short-term financial pressures.

The Salvadoran economy's short-term prospects are closely linked to the recovery of the United States economy. Official estimates project a real 3% rise in GDP and annual inflation of 2%. The fiscal deficit of the non-financial public sector is to be brought down to 1.6% of GDP and the central government deficit, to 1.5% of GDP. Since reconstruction requirements have declined, public investment is expected to diminish and borrowing is to be kept below 45% of GDP. In announcing the implementation of fiscal adjustment measures, the authorities also announced new measures for improving the economic situation of households.

In the first quarter of 2003 the economy grew by 1.7%, falling short of the 2% growth recorded in the same period of 2002. This outcome was influenced by the flat growth in the industry which, in any event, was partially offset by the expansion of construction, agriculture and services. In the fiscal sphere, some progress was made in the first four months. The accounts of both the non-financial public sector and the consolidated central government (including grants) were virtually balanced.

Other factors that will affect economic performance in 2003 are the prospective advances in the negotiation of a free trade agreement between Central America and the United States and the important political implications of the legislative and municipal elections of March 2003 and the presidential election of March 2004.

Figure 1
EL SALVADOR: MAIN ECONOMIC INDICATORS



Source: ECLAC, on the basis of official figures.
[a] December-to-December variation.
[b] Includes interest.

2. Economic policy

The main objectives of economic policy in 2002 were to control the public deficit –in a context of large capital outlays to rebuild the infrastructure damaged in the 2001 earthquakes– and to administer the dollarization process, which has practically done away with the local currency.

These objectives were maintained in 2003, but higher priority was given to reducing the fiscal deficit. As in the rest of the Central American countries, the negotiation of a free trade agreement with the United States will probably take centre stage on the economic agenda.

a) Fiscal policy

Modest progress was made in controlling the fiscal deficit at a time of increased investment in economic and social infrastructure. Slight reductions were achieved in the deficits of both the non-financial public sector (3.3% of GDP) and the central government (3.1% of GDP). These advances resulted from the central government's policy of reining in current expenditure and from an increase in tax revenue thanks to the implementation of monitoring and control measures throughout the year, which made up for the slow expansion of economic activity and imports.

Another factor that helped to improve fiscal income was the full implementation of the Road Maintenance Fund for the upkeep of the road network, which is financed through a special tax of US$ 0.20 per gallon paid by motorists on fuel purchases. The tax burden amounted to 11.2% of GDP, which was higher that the previous year's percentage (10.5%) but lower than the original target (12%). However, since fuel consumption has gone down as a result of higher oil prices in recent months, the Fund's receipts in 2003 may fall as much as US$ 2.2 million short of the amount originally projected.

The efforts to curb spending did not affect real investment by the non-financial public sector, which rose by 1.2% over the previous year's level to reach US$ 610 million, equivalent to 4.3% of GDP. Despite the strides it has made, El Salvador is far from achieving the fiscal soundness it needs to cope with the pressures generated by investment requirements following the earthquakes, the enhancement of the coverage and quality of basic social services and the cost of social security reform, which represented 1.1% of GDP in 2002 and will continue to weigh down public finances in the coming years.

Between January and May 2003 the non-financial public sector's income, including grants, was 10.7% higher than it had been in the same period of 2002, thanks mainly to the increase in tax receipts. On the other hand, its expenditure was 0.8% higher, owing mainly to increased outlays for consumption and interest payments. Thus, the non-financial public sector posted a fiscal surplus (including grants) of US$ 36 million.

Since the central government cut back the amount of resources set aside for the National Reconstruction Programme, public investment between January and May 2003 totalled US$ 160 million, which was 6.4% less than the amount for the same period of 2002.

Total debt (external and domestic) in 2002 swelled to 45% of GDP owing to a sharp rise in external liabilities, which increased by 26.7% over the previous year's level to reach US$ 3.99 billion, equivalent to 28% of GDP. This was due in part to the aggressive policy of substituting external debt for domestic debt in order to reduce short-term pressure on public finances.

In 2002 the government placed US$ 1.25 billion in bonds on foreign markets under conditions that were favourable to the country. External debt servicing increased by 37% to reach US$ 730 million, or 5.2% of GDP, and raised the ratio of total external debt to exports of goods and services from 87.8% in 2001 to 105% in 2002. Domestic public debt increased by 1.6% to stand at US$ 2.45 billion, or 17% of GDP. The public sector's borrowing requirements went down in the first few months of 2003. Between January and May the government made use of US$ 366 million in net external financing; this figure was 27% lower than the one for the same period of 2002. Domestic financing also declined (-25%), since it amounted to US$ 346 million in the same period.

b) Monetary and exchange-rate policy

The completion, without major setbacks, of the second year of the dollarization process improved El Salvador's country risk and fortified its financial stability. This, together with the significant drop in interest rates on international markets, helped to bring about a substantial reduction in local interest rates, both nominal and real. With respect to average nominal rates, both the one-year lending rate and the 180-day deposit rate declined by more than two percentage points to stand at 7.1% and 3.4%, respectively. With respect to real rates, both lending and deposit rates fell, given the slight increase in inflation.

The drop in interest rates stimulated the demand for credit, so that bank loans to the private sector expanded by 6% in real terms, in contrast to the 6% contraction recorded the previous year. Increased competition from international banks that have managed to incorporate large companies into their loan portfolios seems to have slowed down the growth of domestic demand for credit. Given this situation, and taking advantage of the benefits of dollarization, the banking system adapted by increasing its investments in external markets. In fact, the buoyancy observed in the banking system stemmed from the intensification of transactions abroad through external debt, the issuance of bank debt instruments on international markets and investments and loan operations in other countries. In addition, the increased liquidity in the financial system generated a surfeit of liquid assets in commercial banks and a consequent increase in their treasury operations, which limited the system's role in financial intermediation.

Table 1
EL SALVADOR: MAIN ECONOMIC INDICATORS

	1994	1995	1996	1997	1998	1999	2000	2001	2002[a]
	Annual growth rates[b]								
Gross domestic product	6.0	6.2	1.8	4.2	3.8	3.4	2.1	1.9	2.2
Per capita gross domestic product	3.7	4.0	-0.3	2.1	1.6	1.3	0.1	0.0	0.3
Gross national income	9.3	7.6	-1.6	3.4	5.0	1.1	1.0	1.8	4.0
Gross domestic product by sector									
Agriculture	-2.4	4.5	1.3	0.4	-0.7	7.7	-3.1	-2.1	0.2
Mining	10.9	6.7	1.0	6.5	5.3	0.4	-4.7	12.0	7.0
Manufacturing	7.4	6.9	1.7	8.0	6.6	3.7	4.1	4.2	3.0
Electricity, gas and water	4.7	5.0	17.1	4.2	6.1	2.7	-2.3	4.2	5.6
Construction	11.5	6.1	2.7	6.2	8.5	-1.8	-3.4	10.0	4.6
Wholesale and retail commerce, restaurants and hotels	8.6	9.9	0.4	2.9	4.0	2.0	3.3	1.6	1.0
Transport, storage and communciations	6.0	5.5	1.9	7.7	4.2	9.5	6.1	2.9	3.7
Financial establishments, insurance, real estate and business services	5.4	5.2	2.2	4.4	3.8	3.0	2.7	-0.6	3.4
Community, social and personal services	3.6	5.1	2.4	3.4	1.2	1.0	1.1	0.8	-0.7
Gross domestic product by type of expenditure									
Consumption	6.9	8.3	1.8	2.2	2.1	3.4	2.7	0.6	1.9
General government	3.0	7.9	2.8	2.8	2.5	0.4	0.9	1.1	-1.2
Private	7.3	8.3	1.7	2.1	2.1	3.7	2.9	0.6	2.2
Gross domestic investment	14.0	14.0	-20.5	6.4	22.3	-4.1	1.4	-5.2	6.8
Exports of goods and services	8.4	13.9	8.7	30.2	6.2	7.1	17.2	11.0	-4.9
Imports of goods and services	15.0	21.1	-6.1	16.8	9.2	2.7	14.5	3.6	-2.6
	Percentages of GDP								
Investment and saving									
Gross domestic investment [b]	18.7	20.0	15.7	16.0	18.8	17.5	17.4	16.2	16.9
Gross domestic investment [c]	19.7	20.0	15.2	15.1	17.6	16.4	16.9	16.0	16.4
National saving [c]	18.7	17.5	13.2	14.2	16.6	14.5	13.8	11.0	11.8
External saving [c]	1.0	2.6	2.0	0.9	0.9	1.9	3.1	5.0	4.6
	Millions of dollars								
Balance of payments									
Current account	-18	-262	-169	-98	-91	-239	-431	-190	-384
Goods balance	-1,170	-1,462	-1,242	-1,143	-1,306	-1,356	-1,740	-1,905	-1,906
Exports fob	1,252	1,651	1,787	2,437	2,460	2,534	2,963	2,891	3,017
Imports fob	-2,422	-3,113	-3,030	-3,580	-3,765	-3,890	-4,703	-4,796	-4,922
Services balance	-42	-121	-90	-152	-149	-183	-235	-303	-194
Factor income balance	-95	-67	-90	-163	-163	-282	-253	-266	-287
Current transfers balance	1,288	1,389	1,254	1,361	1,527	1,582	1,797	2,284	2,003
Capital and financial balance [d]	131	410	334	460	394	447	385	12	260
Net foreign direct investment	0	38	-7	59	1,103	162	178	260	234
Financial capital [e]	131	372	341	401	-709	285	207	-248	26
Overall balance	113	148	165	363	303	208	-46	-178	-124
Variation in reserve assets [f]	-113	-148	-165	-363	-303	-208	46	178	124
Other external sector indicators									
Real effective exchange rate (index 2000=100) [g]	118.6	114.4	106.3	103.8	103.4	101.0	100.0	100.0	100.8
Terms of trade for goods (index 1997=100)	86.1	106.2	99.5	100.0	97.5	92.3	87.9	85.2	84.5
Net resource transfer (*% of GDP*)	0.5	3.6	2.4	2.7	1.9	1.3	1.0	-1.8	-0.2
Gross external public debt (millions of dollars)	2,056	2,168	2,517	2,689	2,632	2,789	2,831	3,148	3,987
Gross external public debt (% of GDP)	25.4	22.8	24.4	24.2	21.9	22.4	21.6	22.9	28.0
Net interest and earnings (% of exports) [h]	-6.1	-3.4	-4.1	-5.6	-5.3	-9.1	-6.8	-7.1	-7.4

Table 1 (concluded)

	1994	1995	1996	1997	1998	1999	2000	2001	2002[a]
	Percentages								
Employment									
Labour force participation rate [i]	53.4	52.4	51.3	50.9	53.5	52.6	52.2	53.3	51.2
Open unemployment rate [j]	7.7	7.6	7.7	8.0	7.5	7.0	6.7	7.0	6.2
Visible uneremployment rate [k]	4.0	...	...	...	3.2	3.5	3.4	3.4	4.1
	Annual percentages								
Prices									
Variation in consumer prices	8.9	11.4	7.4	1.9	4.2	-1.0	4.3	1.4	2.8
Variation in nominal exchange rate	0.6	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Variation in real minimum wage	-1.8	0.4	-3.6	-4.3	3.4	2.3	-2.2	-3.7	-1.7
Real deposit rate [l]	5.6	1.9	6.0	10.1	7.0	11.4	3.6	...	...
Real lending rate [m]	10.7	6.1	10.3	14.3	11.5	16.1	8.0	...	...
Equivalent deposit rate in foreign currency [n]	12.9	14.2	14.0	11.8	10.3	10.8	9.3	...	...
	Percentages of GDP								
Central government									
Current income	11.5	12.2	12.8	11.5	11.5	11.2	11.3	11.6	12.2
Current expenditure	11.2	10.4	11.7	10.5	10.8	11.1	11.8	11.3	11.4
Saving	0.3	1.8	1.0	1.0	0.8	0.1	-0.4	0.1	0.8
Capital balance	-2.3	-3.0	-3.2	-2.6	-2.9	-2.4	-2.7	-4.1	-4.3
Primary balance	0.9	0.8	-0.2	0.2	-0.7	-0.9	-0.9	-2.3	-1.6
Overall balance	-0.7	-0.6	-1.8	-1.1	-2.0	-2.1	-2.3	-3.6	-3.1
Public debt	...	...	...	...	...	...	...	...	...
External	...	...	...	...	...	...	...	...	...
Domestic	...	...	...	...	...	...	...	...	...
Interest payments (% of current income)	13.8	11.1	12.1	11.9	11.3	11.0	12.1	10.8	12.8
Money and credit [o]									
Domestic credit [p]	3.1	3.5	3.9	4.1	4.3	4.5	4.6	5.0	4.5
To public sector	...	0.0	-0.1	-0.1	-0.2	-0.2	-0.1	0.0	0.0
To private sector	3.1	3.6	3.9	4.2	4.5	4.7	4.8	5.0	4.4
Liquidity (M3)	38.4	39.4	41.1	42.1	44.3	47.3	45.1	44.7	42.7
Currency in circulation and domestic currency deposits (M2) [q]	38.4	39.4	41.1	42.1	44.3	47.3	45.1	44.7	42.7

Source: ECLAC, on the basis of official figures.
[a] Preliminary figures. [b] Based on constant 1995 dollars. [c] Based on figures in local currency at current prices. [d] Includes errors and omissions. [e] Refers to the balance on the capital and financial accounts, minus net foreign direct investment plus errors and omissions. [f] A negative sign denotes an increase in reserves. [g] Annual average, weighted by the value of exports and imports of goods. [h] Refers to net investment income divided by exports of goods and services from the balance of payments. [i] Economically active population as a percentage of the working-age population, nationwide total. [j] Unemployed as a percentage of the economically active population, nationwide total. [k] Underemployed as a percentage of the economically active population, urban total. [l] 180-day deposits in the financial system. [m] One-year loans in the financial system. [n] Rate for deposits, deflated by the variation in the dollar exchange rate. [o] Average annual values used for monetary figures. [p] Refers to net credit to the public and private sectors extended by commercial banks and other financial and banking institutions. [q] Includes foreign-currency deposits.

In the first five months of 2003 lending interest rates continued to trend downward. The weighted average rate for terms of up to one year went from 6.8% in December 2002 to 6.3% in May 2003. Meanwhile, deposit rates went up slightly, since the weighted average for 180-day deposits rose from 3.4% in December to 3.5% in May.

c) Structural reforms

Trade policy focused on preparations for the negotiations on a possible free trade agreement between Central America and the United States. Since the strategy for El Salvador's international reintegration is based on flows of trade and migration to the United States, the

Table 2
EL SALVADOR: MAIN QUARTERLY INDICATORS

	2001				2002[a]				2003[a]	
	I	II	III	IV	I	II	III	IV	I	II
Gross domestic product (change from same quarter of preceding year) [b]	1.6	1.4	1.6	2.0	2.0	2.2	2.2	2.1	1.7	...
Goods exports fob (millions of dollars)	736	714	743	671	706	747	780	760	800	759
Goods imports cif (millions of dollars)	1,212	1,301	1,275	1,238	1,158	1,312	1,333	1,388	1,417	1,412
International reserves (millions of dollars)	1,863	1,953	1,837	1,741	1,800	1,702	1,571	1,623	1,800	1,652
Real effective exchange rate (2000=100) [c]	99.3	99.9	100.1	100.6	100.2	100.4	100.9	101.9	101.4	102.7
Consumer prices (12-month variation, %)	4.9	3.5	3.3	1.4	1.7	2.3	1.4	2.8	2.4	1.5
Average nominal exchange rate (colones per dollar)	8.8	8.8	8.8	8.8	8.8	8.8	8.8	8.8	8.8	8.8
Nominal interest rates (annualized percentages)										
Interbank rate [d]	5.9	5.8	4.9	4.6	5.2	4.3	3.8	4.3	3.6	2.9
Domestic credit [e] (change from same quarter of preceding year)	17.5	15.2	13.3	-4.2	-7.7	-8.4	-10.9	-1.5	-4.8	...
Mature bank credit as a porportion of total credit (%)[f]	5.5	5.2	5.2	4.4	4.4	4.1	4.1	3.5	3.5	3.6

Source: ECLAC, on the basis of official figures.
[a] Preliminary figures. [b] Based on figures in local currency at constant 1990 prices. [c] Quarterly average, weighted by the value of goods exports and imports. [d] Money market rate in dollars. [e] Refers to net credit to the public and private sectors extended by commercial banks and other financial and banking institutions. [f] Total credit extended by the banking system.

trade negotiations are strategically important and the government has given them top priority. Accordingly, the United States Senate's decision to authorize the President to use trade promotion authority in negotiating the agreement and the commitment to begin negotiations have raised great expectations in government spheres and the business sector, since it is hoped that the start-up of the process will make the country more attractive to foreign investors. In mid-2003 the debate and negotiations on trade liberalization intensified with the presentation of two different proposals for negotiation, one prepared by Guatemala and the other by El Salvador, Honduras, Nicaragua and Costa Rica.

In June 2002 the free trade agreement with Chile entered into force and the negotiations with Canada made significant progress, although the process was not completed as scheduled owing to major differences between the Canadian and Central American parties concerning the maquila industry and agricultural products. Nevertheless, negotiations are expected to be completed in the course of 2003.

In addition, the government sought to forge ahead with the structural reorganization of the health care sector by restructuring the social security system. Its efforts were thwarted, however, by strong opposition from the doctors and workers of the Salvadoran Social Security Institute, who accused the government of seeking to privatize health care and maintained a prolonged strike that was backed by other social and political sectors. In view of the growing strength of the strikers and the loss of political support in the Congress, the government had to adopt a more flexible position vis-à-vis the strike, abandon the social security reform, refrain from vetoing a draft law banning service concessions and create a follow-up commission to study changes in the Institute.

Different sectors in El Salvador more or less agree that the country has made progress over the last decade in terms of structural reform, but also that much remains to be done. In particular, little has been achieved in terms of institutional reform to create a climate more conducive to foreign and national investment. This is a cause for concern in view of the growing perception, in recent years, that El Salvador is plagued by waning respect for the law, an inefficient legal system and increasing legal and personal insecurity. In this regard, another of the challenges faced by El Salvador is that of moving forward with the institutional reforms needed to resolve these problems.

3. The main variables

a) Economic activity

Output expanded by 2.2% in real terms, indicating that the country was having trouble returning to its high growth rates of the first half of the 1990s. Domestic demand rose by 2.2%, boosted by a 10% increase in public investment, while private investment contracted for the second year in a row and consumption recorded a moderate upturn of 1.5%. External demand, meanwhile, continued to flag. The most robust sectors were electricity, gas and water, which increased by 5.6%; housing development, which expanded by 5%; and construction, which advanced by 4.6%. The agricultural sector stalled, while manufacturing picked up by 3%.

In El Salvador the most important engines of economic growth in 2002 were investment (especially public investment) and, to a lesser extent, private consumption. Although private consumption rose slightly with respect to its 2001 level, its growth was constrained by the limited expansion of family remittances, which are an important component of national income and thus have a significant impact on consumption patterns.

The stagnation of agricultural output was due to a 1.3% decline in crop production as a result of the 15% contraction in coffee output, which in 2002 represented only 86% of the 1990 figure. This fall in coffee production adversely affected agricultural employment and income, with an especially harmful impact on the poorest inhabitants of rural areas, who earn their livelihood from coffee harvesting activities.

By contrast, livestock production (together with forestry, hunting and fishing) expanded by 2.5% over the previous year's level, maintaining the positive trend observed in recent years and increasing its share of agricultural GDP. The manufacturing sector grew by 3%. The best-performing segments were paper and paper products and rubber products, which increased by more than 10%. The strong performance of these products was due to higher demand both domestically and within Central America. Maquila manufacturing services increased by 3%, evincing a sharp slowdown from their rates of recent years.

b) Prices, wages and employment

El Salvador remains the country in Central America (apart from Panama) with the lowest rate of inflation. In 2002 prices rose by just 2.8%, although this was more than one percentage point higher than the previous year's rate. This low inflation was due in part to the policy of dollarization and the existence of an ample supply of dollars, which made it possible to overcome sectoral bottlenecks by purchasing imported goods. It also reflected the strong output of staple foods during the year, which caused their prices to fall considerably.

In 2003 inflation resumed its downward trend. Between January and July 2003 annual inflation and cumulative inflation reached 1.5% and 1%, respectively. The industrial price index recorded a rise of 1.4% for the 12-month period ending in June, whereas the 12-month rate to December 2002 had been 4.7%. The main reason for this decline in inflation was the downturn in international oil prices.

As part of the effort to reduce inflation to international levels, the authorities have made no nominal changes to official minimum wages in agriculture, industry, commerce or services since 1998, in sharp contrast to the active policy implemented in the first half of the 1990s. Consequently, real minimum wages have fallen systematically (by 5.4% in the last two years), eroding domestic demand. In particular, minimum wages in the construction sector –the only ones that increased in 2001– stayed frozen under a labour agreement signed between builders and unionized workers. The employers belonging to the Salvadoran Chamber of Construction (CASALCO) and the construction workers' union agreed in September 2002 that no increases would be introduced until June 2003, when a new labour agreement would be negotiated.

According to official data, open unemployment in 2002 reached 6.2%, which was slightly lower than the previous year's 7.0%. The rate for urban areas was very similar to the one for rural areas. Underemployment rose by one percentage point to reach 29.1% owing to increases in both its visible and invisible components. The total participation rate for the whole country declined from the previous year's level to stand at 51.2%; the downturn was due basically to the slide in the male participation rate from 69.2% in 2001 to 65.8% in 2002. The female participation rate showed a smaller decline (from 39.5% to 38.6%) over the same period. These trends reflect the loss of job opportunities, especially for men, in rural areas.

c) The external sector

In 2002 the external sector posted mixed results. Exports performed well (up by 4.4%), boosted by an increase in non-traditional products (6.5%) in both the maquila and non-maquila sectors. The maquila industry accounts for 59% of all merchandise exports and is therefore the country's most important export sector. Since imports showed only a small increase, the country's trade deficit shrank slightly in relation to GDP to stand at 14.8%. The inflow of family remittances amounted to US$ 1,935,200,000, or 13.6% of GDP, but other transfers diminished. The current-account deficit swelled to twice its level of 2001, although it remained within manageable limits (2.7% of GDP). Net international reserves contracted for the third consecutive year to stand at 11.2% of GDP, or 3.8 months' worth of imports. In the early months of 2003 both exports and remittances continued to trend upward.

Traditional exports performed weakly, slumping by 21% in 2002 compared to their 2001 level. Sugar and shrimp exports plummeted and coffee exports fell for the second year in a row, although, in terms of percentages, the decline recorded in 2002 (7.1%) was much less drastic than the 61.4% drop posted in 2001. Exports to other Central American countries went up by only 2.3%, reflecting the slow growth of the subregion's economies, while exports to the rest of the world, which accounted for 75.3% of total exports, were more buoyant and expanded by 5.2%.

Although maquila exports were up, total value added in the maquila industry was down from the previous year's figure. The higher maquila sales in 2002 were due basically to the increased use of imported inputs, largely because of the expansion of the benefits of the Caribbean Basin Initiative (CBI), which promotes the use of United States inputs.

Between January and May 2003 exports continued to post robust growth, totalling US$ 1.31 billion, which was 9% higher than the figure for the same period of 2002. In the short term, the possibility of progress in the maquila industry will hinge on economic recovery in the United States and on the steps being taken by this business sector to include its products in the free trade agreements being negotiated with Canada and the United States.

In 2002 imports rose by 2.6% over their 2001 level owing to a 7.3% increase in consumer goods and a 10.5% increase in maquila imports. On the other hand, imports of intermediate and capital goods dipped by 2% as a result of the country's sluggish economic performance. Between January and May 2003 the value of imports amounted to US$ 2.37 billion, or 16.5% more than in the same period of 2002. Purchases in all three main categories of goods (consumer, capital and intermediate) rose significantly.

Family remittances in 2002 amounted to US$ 1.935 billion, or 13.6% of GDP, but these flows grew more slowly than they had the previous year. These resources were the country's single most important source of foreign exchange, as they have been for the last decade, and became the cornerstone of financial and exchange-rate stabilization. On account of this situation, the future of Salvadorans residing illegally in the United States is now a constant concern for the authorities. In this respect, one positive development was the United States government's 18-month extension of the temporary protected status (TPS) previously granted to Salvadoran immigrants, which will, it is hoped, enable them to obtain better jobs and higher pay.

In the first five months of 2003 El Salvador received family remittances for a total of US$ 830 million, or 3.3% more than the amount received in the first five months of 2002. The Federation of Credit Unions (Fedecrédito) intends to set up offices in the United States to attract some of the remittances that emigrants send back to their relatives in El Salvador, which could have a favourable effect on these flows. In addition to reducing remittance costs by creating economies of scale, this measure also seeks to promote local investment in the recipient communities.

Foreign direct investment totalled US$ 234 million in 2002, which was US$ 26 million less than the amount received the previous year. This investment was channelled primarily into telecommunications, manufacturing, commerce, electricity generation and, to a lesser extent, the maquila industry.

Capturing more of these flows, which in 2002 fell short of the authorities' expectations, is one of the central aims of the economic reforms introduced by the Salvadoran government since the 1990s, as such investment is expected to become the principal engine of economic growth for the country. Although developments in this area have not been promising, the authorities are still hoping that the opening of free-trade negotiations between Central America and the United States and the eventual entry into force of an agreement will help to bring in larger investment flows. This cannot happen, however, unless the country's investment climate improves significantly (through the strengthening of the rule of law and the improvement of legal and personal security, among other factors) and unless productivity increases, especially in those sectors and activities that are likely to be involved in international trade.

Guatemala

1. General trends

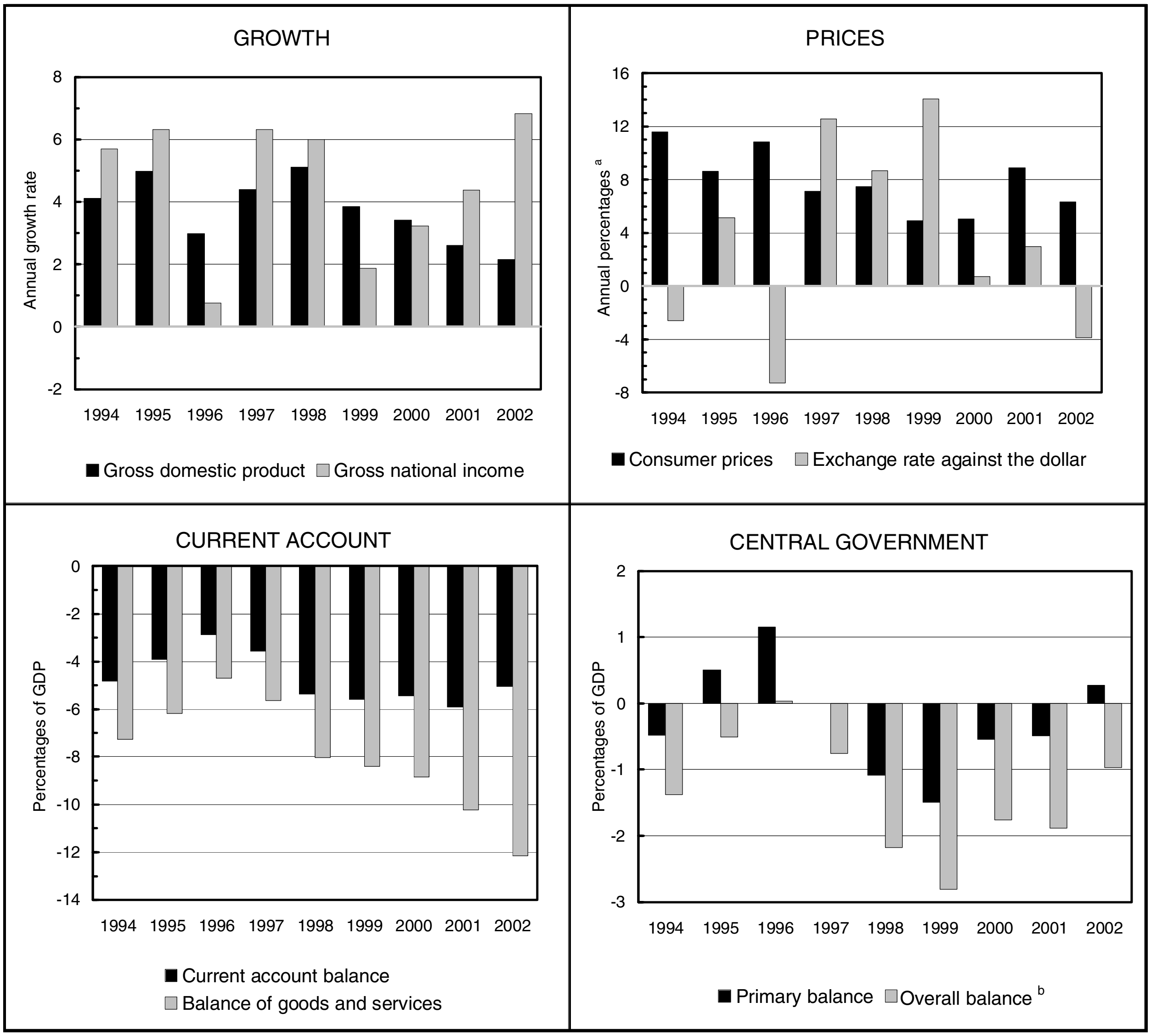
Guatemala's economic performance showed marked contrasts in 2002. Significant macroeconomic imbalances were corrected as inflation went down and the fiscal deficit narrowed, but GDP growth, at 2.2%, slowed down for the fourth year running, while the trade deficit widened to 12% of GDP. The current-account deficit contracted thanks to the extraordinary flow of remittances. In addition, the influx of short-term capital and loan disbursements increased international reserves.

The drop in inflation (6.3% compared to 8.9% in 2001) and the decrease in the fiscal deficit to 1% of GDP were mainly due to the application of the stabilization programme agreed upon with IMF and the implementation of the tax reform adopted in 2001. The loss of momentum in economic activity resulted from the sluggishness of external demand and of gross domestic investment, and, to some degree, from the procyclical fiscal policy. Trade deteriorated as a consequence of the drop in exports and growing import penetration, in view of the real appreciation of the currency.

In 2003 the picture has been complicated by the slow growth of the United States economy, unfavourable changes in the terms of trade and the failure to include Guatemala on the list of countries cooperating with the United States to combat drug trafficking. Also problematic are the uncertainty concerning the forthcoming presidential elections (in November) and the continuing conflict between certain business groups and the government. These circumstances suggest that the growth rate will be lower (2%) than the official estimate.

In view of the particular political and electoral context of 2003 and the economic vulnerability that could result from the high trade deficit, the government hopes to consolidate the progress made in strengthening public finances and to continue to boost tax capacity. One favourable development was the extension to 15 March 2004 of the stand-by arrangement with the International Monetary Fund (IMF) providing a credit line of US$ 120 million, of which US$ 75 million may be disbursed immediately. The goals established for the current year under the agreement with IMF are GDP growth of 2.4%, annual inflation of between 4% and 6% and a fiscal deficit of 1.7% of GDP. Efforts will also be made to strengthen the regulatory and prudential framework of the financial sector (especially its offshore segment) in order to help prevent money laundering. The renewal of the agreement provides greater certainty of prudent economic policy management for the rest of the year. The growth target for 2003 will be difficult to achieve unless a persistent real appreciation of the currency can be avoided and external demand makes a quick and significant recovery. Otherwise the economic growth rate in 2003 will be similar to that of 2002.

Figure 1
GUATEMALA: MAIN ECONOMIC INDICATORS



Source: ECLAC, on the basis of official figures.
[a] December-to-December variation.
[b] Includes interest.

2. Economic policy

The entry into force, in April 2002, of the agreement with IMF to support a stabilization programme was significant for economic policy and provided the government with access to US$ 105 million from IMF and additional financing from other sources. The targets included economic growth of 2.3%, inflation of between 4% and 6% and a fiscal deficit of 1.5% of GDP. In practice, the authorities applied a very austere policy that enabled them to cut the public deficit beyond the target. In May 2003 the government submitted a letter of intent to IMF requesting an extension of the agreement for another year. The extension was approved in June and included the following targets for 2003: inflation of between 4% and 6%, a fiscal deficit of 1.7% of GDP, tax revenue equivalent to 12% of GDP and GDP growth of 2.4%. This economic programme included the placement of government bonds on the international financial market for a total of US$ 550 million, but as of June 2003 this operation had not yet taken place.

a) Fiscal policy

The fiscal deficit in 2002 (not including quasi-fiscal losses) was equivalent to 1% of GDP, compared to 1.9% in 2001. This reduction was achieved by means of greater government saving, which was more than enough to cover the increase in capital expenditure made possible by the rise in revenue (14%) and the controlled growth of current expenditure (1.9%, compared to 19.3% in 2001). External resources were sufficient not only to cover the deficit, but also to reduce domestic public debt for the first time in several years.

The application of the fiscal reform, and especially the two-point increase in the VAT rate (to 12%), resulted in a 21.1% rise in tax revenue, both direct (32%) and indirect (17.8%). The tax burden went from 9.7% of GDP in 2001 to 10.6% in 2002. In contrast, non-tax revenues fell by 39% as payments for the privatization of the telephone company were completed and the corresponding interest payments accordingly ceased. The containment of current expenditure was the result of a moderate wage increase (8.2%) and a cutback in government procurement (-18.7%) and interest payments (-1%). The increase in capital expenditure (15.7%) reflected the settlement of outstanding expenses incurred in 2001.

In the first quarter of 2003 the fiscal deficit increased as the expansion of public spending (16.6%) far outpaced that of income (8%) in relation to the same period of 2002. The increase was financed mainly from domestic resources, although loans were also received from the Central American Bank for Economic Integration and the Inter-American Development Bank, of US$ 13.5 and US$ 11.8 million, respectively.

In November 2002 the Congress adopted a budget for 2003 based on a fiscal deficit of 3% of GDP, which was three times the previous year's level. Soon afterwards, however, it decided on a more austere fiscal approach (a deficit of 1.7% of GDP) to control inflationary pressures and strengthen macroeconomic stability. In principle, the target was increased over its 2002 level so that the authorities could meet certain commitments under the Peace Agreements, restructure public debt and cure the ills of the financial sector. Part of the financing will depend on the placement of US$ 550 million in bonds on the international market; these instruments form part of a scheme known as the Peace Bonds, which, according to various analysts, face an uncertain future. In September, when the certification is reviewed, a further attempt will probably be made to launch them on the international market. If that proves to be the case, the authorities have announced that US$ 150 million out of the total amount will be used to meet commitments under the Peace Agreements, with the allocation of US$ 50 million to demobilize the army and the rest to advance the agenda for peace and reconciliation.

b) Monetary policy

In 2002 monetary policy was again geared to promoting price stability and reducing money market volatility. In addition, the Bank of Guatemala Organization Act, the Monetary Act, the Banks and Financial Groups Act and the Financial Supervision Act were passed in order to strengthen the central bank's autonomy, broaden the power to impose penalties and conduct supervision and establish an acceptable risk profile for financial intermediation.

The central bank continued its efforts to control liquidity by participating in open-market operations, in view of the effects of flows from abroad and the fiscal deficit. As local demand was strong, the average maturity of such instruments was extended and their yield was reduced. As of 31 December 2002 the balance of securities placed in open-market operations in the private sector was 16% higher than it had been 12 months previously. More than 80% of these instruments had maturities of more than 180 days (a year earlier 94% had had maturities of less than 30 days) and the weighted average annual interest rate had gone down from 10.27% to 7.9%. This reduction in the domestic rate was mainly due to the large-scale repayment of domestic debt during the year, for which the government used resources from the placement of international bonds.

These central bank interventions kept money creation down to only 7.5% for the year (less than the 8% limit prescribed in the monetary programme). Over that period, the basic aggregate (M1) grew by 13.9% in nominal terms, which was just under the 14.6% recorded in 2001, and broad money (M3) expanded by 11.2%, compared to 17.8% the year before. Despite the slower expansion of liquidity, local interest rates continued to decline. The nominal deposit rate averaged 6.91% a year, compared to 9.7% in 2001. The real return on this rate was negative (-1.1%, compared to 2.2% the year before). The nominal lending rate was 17% a year (19% in 2001), or 8.2% in real terms. This persistently wide spread is

Table 1
GUATEMALA: MAIN ECONOMIC INDICATORS

	1994	1995	1996	1997	1998	1999	2000	2001	2002[a]
				Annual growth rates [b]					
Gross domestic product	4.1	5.0	3.0	4.4	5.1	3.9	3.4	2.6	2.2
Per capita gross domestic product	1.4	2.2	0.3	1.7	2.4	1.1	0.7	0.0	-0.5
Gross national income	5.7	6.3	0.7	6.3	6.0	1.9	3.2	4.4	6.8
Gross domestic product by sector									
Agriculture	2.4	3.5	2.6	2.9	3.7	2.1	2.6	1.2	1.8
Mining	3.8	14.5	23.4	24.6	21.0	-1.9	-8.5	0.8	9.8
Manufacturing	3.0	3.2	1.9	2.7	3.6	2.5	1.9	1.1	0.8
Electricity, gas and water	5.7	8.6	6.0	14.7	5.8	11.0	17.4	-3.0	9.1
Construction	-0.2	8.9	3.1	10.0	9.3	7.8	-18.3	12.2	-15.3
Wholesale and retail commerce, restaurants and hotels	5.7	6.0	2.7	3.7	5.3	3.2	4.1	2.7	2.8
Transport, storage and communciations	4.2	7.6	3.6	5.9	7.5	6.8	7.6	6.8	5.7
Financial establishments, insurance, real estate and business services	5.0	6.9	4.4	4.7	5.9	4.6	3.1	0.3	2.2
Community, social and personal services	4.7	2.7	2.4	4.7	4.1	4.7	4.6	3.5	1.2
Gross domestic product by type of expenditure									
Consumption	5.2	6.6	2.5	5.7	3.7	2.2	2.7	5.6	4.2
General government	3.0	1.3	0.0	6.2	9.7	5.2	10.4	5.4	-2.1
Private	5.4	6.9	2.7	5.6	3.3	2.0	2.1	5.6	4.7
Gross domestic investment	1.8	-1.6	-15.8	21.6	38.7	-0.5	4.2	4.5	14.7
Exports of goods and services	2.5	7.5	8.1	13.7	11.6	8.0	9.7	3.2	-6.1
Imports of goods and services	5.4	8.5	-5.9	26.5	22.7	-0.4	6.6	12.2	8.0
				Percentages of GDP					
Investment and saving									
Gross domestic investment [b]	16.1	15.1	12.3	14.3	18.9	18.1	18.3	18.6	20.9
Gross domestic investment [c]	15.7	15.1	12.7	13.7	17.4	17.4	17.8	17.7	17.9
National saving [c]	10.8	11.6	9.8	10.2	12.0	11.8	12.4	11.8	12.9
External saving [c]	4.9	3.5	2.9	3.6	5.4	5.6	5.4	5.9	5.0
				Millions of dollars					
Balance of payments									
Current account	-625	-572	-452	-634	-1,039	-1,026	-1,049	-1,238	-1,173
Goods balance	-997	-875	-643	-940	-1,409	-1,445	-1,660	-2,278	-2,950
Exports fob	1,550	2,158	2,237	2,603	2,847	2,781	3,082	2,864	2,629
Imports fob	-2,547	-3,033	-2,880	-3,543	-4,256	-4,226	-4,742	-5,142	-5,578
Services balance	53	-29	-101	-62	-152	-91	-48	133	125
Factor income balance	-130	-159	-230	-239	-184	-205	-209	-90	-291
Current transfers balance	449	491	523	607	705	715	868	997	1,942
Capital and financial balance [d]	632	420	666	863	1,275	901	1,692	1,712	1,194
Net foreign direct investment	65	75	77	84	673	155	230	456	110
Financial capital [e]	566	345	589	779	602	746	1,462	1,257	1,084
Overall balance	6	-152	214	230	235	-125	643	474	22
Variation in reserve assets [f]	-47	157	-199	-258	-263	125	-643	-474	-22
Other financing [g]	41	-6	-15	28	28	0	0	0	0
Other external sector indicators									
Real effective exchange rate (index 2000=100) [h]	101.2	98.7	94.8	89.8	88.8	98.9	100.0	96.4	89.3
Terms of trade for goods (index 1997=100)	94.8	105.4	92.5	100.0	99.4	91.9	89.3	87.5	86.6
Net resource transfer (% of GDP)	4.2	1.7	2.7	3.7	5.8	3.8	7.7	7.7	3.9
Gross external public debt (millions of dollars)	2,895	2,947	3,026	3,197	3,618	3,831	3,929	4,100	4,200
Gross external public debt (% of GDP)	22.3	20.1	19.2	18.0	18.7	20.9	20.4	19.6	18.1
Net interest and earnings (% of exports)[i]	-6.6	-5.6	-8.2	-7.5	-5.3	-5.9	-5.8	-3.1	-8.2

Table 1 (concluded)

	1994	1995	1996	1997	1998	1999	2000	2001	2002[a]
	Percentages								
Employment									
Labour force participation rate [j]	...	...	...	...	...	...	...	...	60.8
Open unemployment rate [k]	3.5	3.9	5.2	5.1	3.8	...	...	...	3.6
	Annual percentages								
Prices									
Variation in consumer prices	11.6	8.6	10.9	7.1	7.5	4.9	5.1	8.9	6.3
Variation in nominal exchange rate	-2.6	5.2	-7.3	12.5	8.7	14.1	0.7	3.0	-3.9
Variation in average real wage	0.6	12.0	9.7	2.7	3.7	5.7	3.8	0.5	-0.9
Real deposit rate [l]	0.3	-1.7	-2.8	-1.4	-0.8	2.5	3.9	-0.1	0.7
Real lending rate [m]	12.4	10.4	10.8	10.6	9.7	13.5	14.0	9.3	10.0
Equivalent deposit rate in foreign currency [n]	12.6	2.6	16.1	-6.0	-3.0	-5.3	9.4	5.6	11.2
	Percentages of GDP								
Central government									
Current income	7.9	8.8	9.4	9.9	10.3	10.5	10.4	11.1	11.4
Current expenditure	6.9	6.7	6.7	6.7	7.9	8.1	8.5	9.2	8.6
Saving	1.0	2.2	2.7	3.2	2.3	2.4	1.9	1.8	2.8
Capital balance	-2.4	-2.7	-2.7	-3.9	-4.5	-5.2	-3.7	-3.7	-3.8
Primary balance	-0.5	0.5	1.2	0.0	-1.1	-1.5	-0.5	-0.5	0.3
Overall balance	-1.4	-0.5	0.0	-0.8	-2.2	-2.8	-1.8	-1.9	-1.0
Public debt	15.6	13.5	13.7	13.7	13.7	16.6	16.5	17.0	15.8
External	9.0	8.4	8.3	8.4	9.0	11.1	10.7	11.4	11.3
Domestic	6.6	5.1	5.4	5.3	4.7	5.4	5.8	5.5	4.5
Interest payments (% of current income)	11.3	11.5	11.8	7.6	10.7	12.6	11.7	12.6	10.9
Money and credit [o]									
Domestic credit [p]	16.4	18.3	19.2	20.1	20.0	20.5	19.8	19.6	18.8
To public sector	3.7	1.8	1.4	2.4	2.3	1.0	0.8	1.1	0.4
To private sector	12.8	16.6	17.8	17.7	17.7	19.6	19.0	18.6	18.4
Liquidity (M3)	...	...	...	...	...	...	...	...	...
Currency in circulation and domestic currency deposits (M2)	23.2	23.9	22.8	24.2	19.6	20.8	25.2	27.1	28.4
Foreign currency deposits	...	...	...	...	...	...	...	...	...

Source: ECLAC, on the basis of official figures.
[a] Preliminary figures. [b] Based on constant 1995 dollars. [c] Based on figures in local currency at current prices. [d] Includes errors and omissions. [e] Refers to the balance on the capital and financial accounts, minus net foreign direct investment plus errors and omissions. [f] A negative sign denotes an increase in reserves. [g] Includes the use of credit and loans from IMF and exceptional financing. [h] Annual average, weighted by the value of exports and imports of goods. [i] Refers to net investment income divided by exports of goods and services from the balance of payments. [j] Economically active population as a percentage of the working-age population, nationwide total. [k] Unemployed as a percentage of the economically active population, urban total; up to 1998, nationwide total. [l] Average rate for savings and time deposits in the banking system. Before 1997, top rate. [m] Average lending rate in the banking system. Before 1997, top rate. [n] Rate on deposits, deflated by the variation in the dollar exchange rate. [o] Annual average values were used for monetary figures. [p] Refers to net credit to the public and private sectors extended by commercial banks and other financial and banking institutions.

indicative of the local financial sector's still-incipient development, which to some extent limits the provision of credit to the private sector.

In contrast to the situation the previous year, the central bank's monetary balance showed a significant use of government deposits to finance its deficit. At the same time, the central bank's domestic credit to the private sector as a whole fell by 0.8% in nominal terms. Accordingly, the banking sector cut by half the nominal rate of expansion of credit to the private sector (8% overall, 4.9% for local-currency loans and 21% for foreign-currency loans, although this last rate started from a very low level), so that such credit remained virtually stagnant in real terms.

This development reflects a difficult situation in bank intermediation. Although credit demand is weak in view of the systematic slowdown of economic growth, supply is also limited by distortions caused by the banking system's preference for government bonds, to the detriment of higher-risk productive activities. The

Table 2
GUATEMALA: MAIN QUARTERLY INDICATORS

	2001				2002[a]				2003[a]	
	I	II	III	IV	I	II	III	IV	I	II
Goods exports fob (millions of dollars)	628	661	530	644	595	554	541	548	618	...
Goods imports cif (millions of dollars)	1,337	1,350	1,445	1,473	1,413	1,654	1,441	1,569	1,548	...
International reserves (millions of dollars)	1,765	1,763	1,744	2,292	2,188	2,231	2,274	2,299	2,361	...
Real effective exchange rate (2000=100) [b]	97.1	96.6	95.9	95.9	92.0	90.2	88.6	86.6	87.6	88.8
Consumer prices (12-month variation, %)	5.4	6.3	9.0	8.9	9.1	9.1	7.1	6.3	5.8	5.2
Average nominal exchange rate (quetzales per dollar)	7.7	7.8	7.9	8.0	8.0	7.9	7.8	7.7	7.8	7.9
Nominal interest rates (annualized percentages)										
Deposit rate [c]	9.7	9.2	8.3	7.8	7.5	7.1	6.7	6.4	5.5	4.9
Lending rate [d]	19.7	19.2	18.8	18.1	17.5	17.1	16.6	16.3	15.8	15.3
Interbank rate [e]	10.3	11.3	10.5	10.2	9.7	9.5	8.7	8.6	7.6	6.2
Domestic credit [f] (change from same quarter of preceding year)	9.4	12.6	10.1	12.1	6.2	8.2	5.7	2.6	2.8	...
Mature credit as a porportion of total credit (%) [g]	5.6	7.0	9.0	8.2	9.0	10.4	10.7	10.3	10.4	9.6

Source: ECLAC, on the basis of official figures.
[a] Preliminary figures. [b] Quarterly average, weighted by the value of goods exports and imports. [c] Average rate on savings deposits in the banking system. [d] Average lending rate in the banking system. [e] Money market rate. [f] Refers to net credit to the public and private sectors extended by commercial banks and other financial and banking institutions. [g] Refers to total credit extended by the banking system.

balance of non-performing loans in the local banking system grew by 33% in 2002, and at 31 December was equivalent to 9.7% of the current portfolio (two points higher than the 2001 proportion).

As of 12 June 2003 money creation showed a year-on-year variation of 10.7% (exceeding the target of 8.7%); the broader aggregate M2 expanded by 11.8%, also exceeding the stipulated target. Interest rates on deposits and loans continued to fall in the first half of 2003. As of 12 June they averaged 15.08% and 5.24%, respectively (compared to 16.20% and 6.91% a year earlier). Domestic credit to the private sector, however, increased by only 2.3% from December 2002 to 12 June 2003. This was due to the reduction in the private sector's demand for credit and to a change in the banks' net position in relation to the government, and may have also been influenced by more prudent behaviour on the part of banks in the wake of the new banking law of 2002. The intensity of open-market operations was maintained so that the reduction in credit demand and the high rate of money creation would not result in excess liquidity.

c) Exchange-rate policy

Guatemala continued to let its currency float, with occasional intervention by the central bank in the foreign-exchange market to moderate exchange-rate volatility. The quetzal's exchange rate against the dollar went down by 3.9% in nominal terms (7.5% in real terms) over the course of 2002. This change reflected the extraordinary influx of remittances and short-term capital, as well as the improved expectations associated with the stabilization programme, in a context of limited intervention by the central bank in the foreign-exchange market. In the first half of 2003 the exchange rate increased by 1.5% in nominal terms; this percentage was lower than domestic inflation over the same period.

d) Structural reforms

There were two policy objectives in this area. The first was to support the process of establishing a regional customs union. By the end of 2002 about 59% of the Central American common external tariff had already been harmonized, and some administrative procedures for intraregional trade had been simplified. The second objective concerned the country's current trade agreements (with Cuba, Colombia, the Dominican Republic, Mexico and Venezuela) and the negotiation of new ones. On the basis of preparatory work carried out in 2002, a round of negotiations began in January 2003 for a free trade agreement between Central America and the United States. The first three rounds of negotiations proceeded smoothly; in the fourth, however, which was held in mid-March, Guatemala offered to liberalize its trade more extensively than the rest of the Central American countries. As of mid-2003 negotiations among the Central American parties were still geared to resolving those disparities.

3. The main variables

a) Economic activity

Guatemala's macroeconomic situation in 2002 was affected by the weak recovery of the United States economy and the deterioration of the terms of trade, in addition to the application of tight fiscal and monetary policies. Consequently, the expansion of productive activity lost momentum for the fourth straight year, owing in particular to the fall in exports and construction (-15.3%). In May the authorities announced an economic recovery programme based on the private concession of airports, ports and power generating plants and on infrastructure works, including the expansion of various highways and the construction of a new international airport. Owing in part to a shortage of resources, both components of the programme came up against difficulties that delayed their implementation.

The only component of demand that grew faster than in 2001 was fixed capital formation in the private sector, which achieved a notable 10.9% increase (in contrast to the 5.6% drop observed in 2001). Its capacity to generate momentum in the rest of the economy was limited, however, in part because it was based more or less on imports of capital goods for power generation. Its effect was also partially undermined by a 9.2% cutback in public investment, which limited the growth rate of total fixed capital formation to 5.1% (compared to 1.8% in 2001).

Exports contracted again in real terms (-6.1%) and imports continued to expand significantly (8%), but at a slower rate than in 2001. This performance was due in part to the sluggishness of external markets, but it also reflects, to some extent, the impact of the real appreciation of the currency. Expenditure for private consumption rose by 4.7% (5.6% in 2001), while government consumption was down (-2.1%, compared to a 5.4% rise in 2001) as a result of fiscal belt-tightening.

The official economic growth target for 2003 is 2.4%. This rate may be a bit too optimistic if the recovery of the United States economy is delayed and if domestic investment slows down because of uncertainty surrounding the presidential election.

Goods production in 2002 was virtually stagnant (0.6%). Notable in this regard were the drop in construction value added (-15.3%) and the slowdown in manufacturing, which has continued for several years (0.8%, compared to 1.1% in 2001). The downturn in construction was due to public spending cuts. Agriculture expanded by 1.8% even though coffee production was still mired in the structural crisis created by the collapse of international prices. The agricultural recovery was based on the higher output of sugar cane (with the use of additional land) and cardamom, partly owing to new production by former coffee growers. Banana production grew at the same rate as in 2001 (8.1%), driven by the boom in external demand.

Throughout 2002 manufacturing production continued to lose momentum (with growth of only 0.8%) under the pressure of import penetration, financing difficulties, the real appreciation of the local currency and, to some extent, the credit squeeze. Only two sectors had growth rates higher than population growth: clothing (2.7%) and miscellaneous manufactured articles (2.6%). The slowdown was more pronounced in the other sectors, and some of them experienced a drop in output: the tobacco industry (-15.7%), wood (-1.2%), furniture and accessories (-1.2%), beverages (-0.6%) and non-metallic minerals (-2%). Meanwhile, mining production increased by 6.6%, while the GDP for that activity was up by 9.8%.

Basic services expanded by 6.6%, compared to 3.8% in 2001. Particularly dynamic were electricity, gas and water (9.1%), as new generators in the cities of Guatemala and Baja Verapaz came on stream. Transport, storage and communications rose by 5.7% (compared to 6.8% in 2001), despite lower growth in telephone line activation.

Production in other services rose by 2.3% (less than the 2001 rate of 2.4%), attesting to the slower growth of almost all its components. Commerce was up by 2.8%, compared to 2.7% in 2001, as weaker domestic economic activity limited its growth. Banking and insurance grew by a mere 1.8% as a result of the problems affecting bank intermediation. The real estate sector expanded by 2.7%. Lastly, community, social and personal services increased by only 1.2% because of the cutback in government services (-0.6%) resulting from the rationalization of public spending.

b) Prices, wages and employment

Tight fiscal and monetary policies, the tapering-off of the effect of the VAT rate increase on domestic prices and the decline in the exchange rate helped to reduce inflation to 6.3% (compared to 8.9% in 2001), which was very close to the monetary programme target (4%-6%).

This target seems to be a feasible one, given that accumulated inflation up to June 2003 was 3.3% and the year-on-year rate is projected to be 6%.

The lack of updated employment statistics makes it hard to get an accurate idea of the current employment situation. In May and June 2002, for the first time, the National Statistical Institute conducted a survey on employment and income. According to the results, the open unemployment rate in 2002 was 3.1%, and 69% of the economically active population (EAP) worked in companies with fewer than six employees.

Given the listlessness of manufacturing and the slackening of economic growth in 2002, it seems certain that the generation of formal employment must have fallen once again. The construction crisis supports this impression, as does the difficult situation in the production of coffee and non-traditional products. The employment outlook for 2003 depends basically on the growth rate of the national economy. In this connection, the steady decline in the monthly economic activity index from November 2002 to March 2003 is not encouraging. In that last month, the index was only 2.6% higher than it had been 12 months earlier, which was less than the 3.4% recorded in the final months of 2002. Unless productive activity steps up its growth in the remainder of the year, the generation of formal employment is likely to fall off even more and, in general, most of the population is unlikely to see a significant improvement in social conditions. Minimum wages showed a nominal annual increase of 9% in non-agricultural activities and 8% in agricultural activities. In real terms the increase was 3%, meaning that real wages are still on the rise.

c) The external sector

Despite the persistent slowdown in economic activity in 2002, the trade deficit as a percentage of GDP widened for the sixth successive year, exceeding by 32% the level recorded in 2001 and more than quadrupling the figure for 1996. This extraordinary increase was due to both the contraction in merchandise exports (-8.2%) and the constant expansion of imports (8.5%).

In the course of 2002 the value of exports to Central America fell substantially (-17.5%). This contrasts markedly with their performance the previous year, when the subregion was the fastest-growing market for Guatemalan exports. The 1.7% contraction in Guatemala's exports to the rest of the world was much less acute than the 2001 downturn (-20.8%); the decline in sales of traditional products (-5.4%) could not be offset by the slight increase in maquila exports (2.5%) and in exports of non-traditional products (1.2%).

The drop in the value of traditional exports was due primarily to the contraction in exports of sugar (-19.8%) and coffee (-10.6%). The 55% decline in exports of these two products over the past three years is a symptom of the structural crisis in the sector that has not yet been resolved. Among non-traditional products, the only increases were in petroleum (54.6%), sesame seed (11.4%), natural rubber (18%) and food products (17.6%). Exports of the other items diminished, with particularly sharp declines in the case of shrimp, fish and lobster (-67.9%), clothing (-43%) and leaf tobacco (-26.7%).

Merchandise imports from the rest of the world increased substantially in 2002 (by 12.3%, compared to 6% in 2001), while those from Central America diminished (-15.6%). With the recovery of private investment after a two-year slump, imports of capital goods for updating equipment, and especially for power generation, rebounded strongly (16.7%). Imports of consumer goods rose by 10.7% and those of intermediate goods, by 3.1%, influenced by the 8.6% rise in the oil bill. The appreciation of the local currency also helped to boost imports.

In the first three months of 2003 the trade deficit widened by 18.8% compared to its level in the same period of 2002, owing to the fall in exports (-3.3%) and the rise in imports (9.6%). Sales to Central America grew by 5.9%, while the vast majority of traditional exports were down. The exception was coffee, which experienced an upturn of 23.6%, while petroleum exports surged by 61%. In contrast, sharp reductions were observed in exports of sugar (-26.2%), bananas (-29%) and cardamom (-4.6%). The pronounced year-on-year variation in imports in the first quarter of 2003 reflects increased purchases of consumer durables (20.9%) and fuels and lubricants (101.2%), as purchases of consumer non-durables contracted (-4.3%) with regard to the same period of 2002.

In 2002 the income balance deteriorated owing to reduced receipts of interest payments associated with the outstanding debt for the privatization of the telephone company. The increase in the trade and factor income deficits was more than offset by the extraordinary flow of external transfers (US$ 1.942 billion) from the one million Guatemalans residing in the United States. The current-account deficit accordingly shrank from 5.9% of GDP in 2001 to 5.2% in 2002. The deficit was financed to some extent with short-term private capital, attracted mainly by the favourable differential in yields. Foreign direct investment fell dramatically, amounting to US$ 110 million, as against the US$ 456 million received in 2001, largely as a result of the privatization of the telephone company.

The balance of external public debt as of 31 December 2002 was US$ 3.037 billion, compared to US$ 2.847 billion a year earlier. This rise was due to the government policy of changing the composition of public-sector borrowing, giving priority to external sources in order to reduce financing costs. Over the first four months of 2003 external debt rose slightly (0.4%) in relation to its level at the close of 2002, while domestic debt increased by 13.8%.

The balance of net international reserves grew by US$ 21.7 million, and at the end of 2002 amounted to US$ 2,369,600,000 which met the commitment made in the agreement with IMF. Under the extension of the agreement granted in June 2003, remittances are projected to show a net increase of US$ 250 million in the coming year. As of early April, the balance had already reached US$ 60.4 million.

Haiti

1. General trends

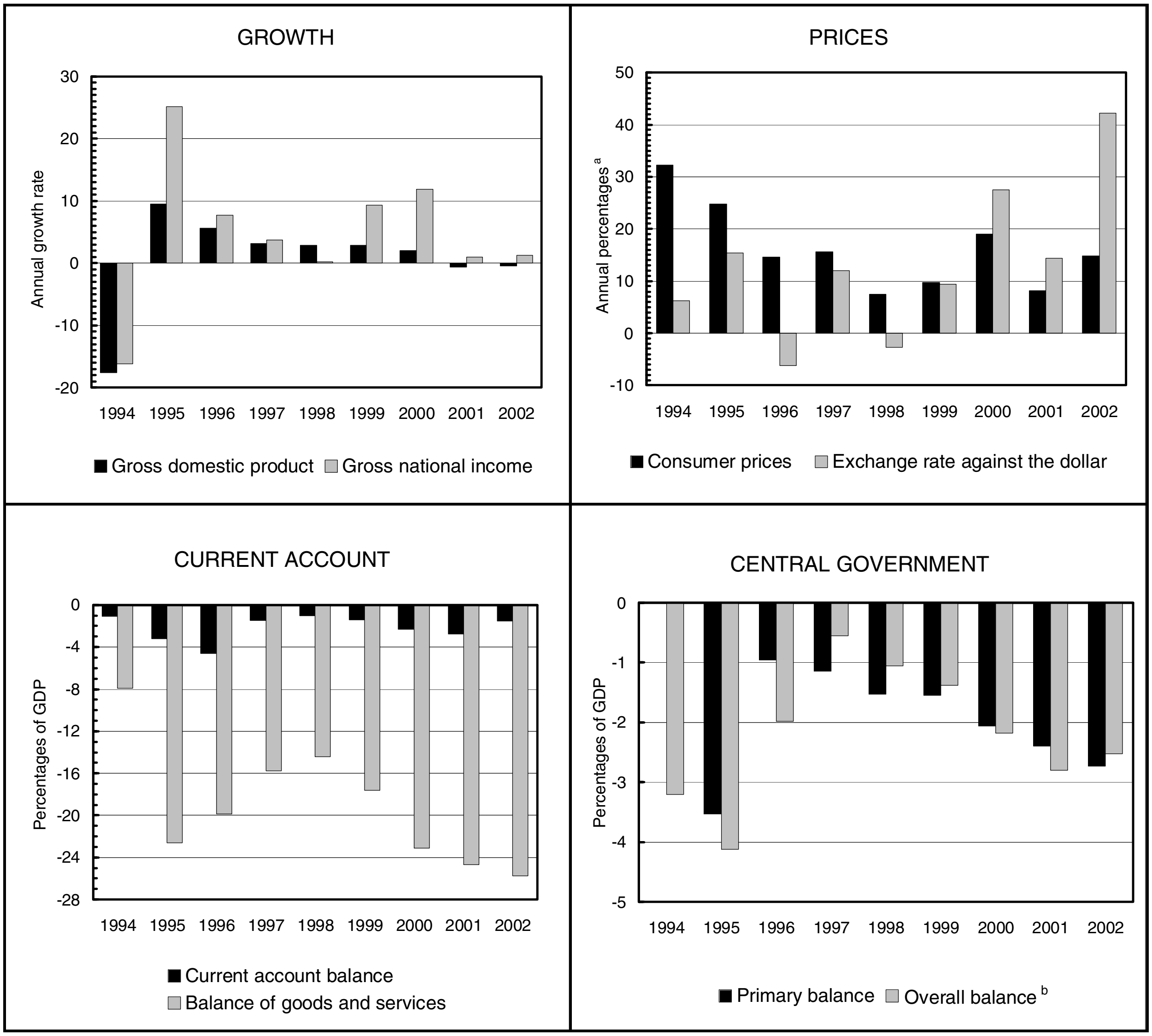
In 2002 Haiti experienced negative economic growth for the second year running, with a downturn of 0.5% in GDP, in an environment of continuing political and institutional instability and consequent drastic reductions in external financing. The public accounts were increasingly fragile and the fiscal deficit was equivalent to 2.5% of GDP. The value of both exports and imports of goods was sharply down, by 10% and 7%, respectively. This poor performance could only worsen an already delicate economic situation, in a country in which per capita GDP is a meagre US$ 417 at 1995 prices. The economic situation has a massive negative social impact and a number of international institutions have even cited the possibility of an imminent humanitarian crisis, as larger and larger segments of the population have reached critical levels of vulnerability. Accordingly, Haiti is the only country in the region to have been classified as a least developed country (LDC), and as such it is eligible for significant amounts of international assistance on very favourable terms.

Substantial flows of remittances, which reached US$ 676 million in fiscal year 2002,[1] averted an even steeper downturn in the current account (-1.4% of GDP). The deficit on the overall balance (US$ 80 million) was covered by reserves, which accordingly shrank by US$ 49 million, and by US$ 28 million in exceptional financing, interest arrears and refinancing. The government was forced to take these measures by an almost complete absence of external financing, despite its efforts in 2001 and 2002 to secure the signature of a new IMF staff-monitored programme, which was not finalized until May 2003. Under this programme, the authorities made a commitment to reduce inflation and narrow the public deficit, stabilize the exchange rate and create a political environment that will help to restore the confidence of both local economic agents and the international financial community.

Only three months before the close of fiscal year 2003, there is little sign of a solution to the country's political conflict and little prospect of economic recovery. On the political front, despite the latest OAS mission in March 2003 and the resolution on Haiti adopted at the OAS General Assembly's thirty-third session, held in June, both local political circles and the international community are very sceptical about the possibility of ironing out the main points of conflict between the government and the opposition, which were triggered by the disputed outcome of the legislative

1 The fiscal year corresponds to the 12-month period from October of the previous year to September of the current year.

Figure 1
HAITI: MAIN ECONOMIC INDICATORS



Source: ECLAC, on the basis of official figures.
[a] December-to-December variation.
[b] Includes interest.

elections in May 2000 and worsened by a number of additional factors since then. What has been observed, instead, is a growing polarization that has led to the emergence of other sectors of civil society, in particular what is known as the Group of 184, on the political scene, in addition to the longer-established Lavalas Family party (currently in power) and Democratic Convergence (a coalition of different opposition organizations).

On the economic front, since the beginning of fiscal year 2003 –i.e., October 2002– there has been worrying evidence of instability, with persistent rumours that dollar deposits may be converted into local currency. This speeded the devaluation of the gourde and triggered a flight of foreign currency estimated at US$ 90 million in the first quarter.

Domestic prices for hydrocarbon derivatives began to rise in January 2003 (by 52%) and accumulated hikes of over 100% by the end of June. This generated an inflationary surge (an annualized rate of 41.7% in June 2003), which was exacerbated by a rise in the nominal exchange rate (an annualized 41% in June 2003) and by monetary financing of the public sector, which at the end of January represented 75% of the sum accumulated over the entire previous fiscal year.

2. Economic policy

In an unstable political and institutional context and with very little manoeuvring room, the few measures the authorities were able to take in 2002 were not enough to prevent a worsening of the macroeconomic situation. Economic policy, in particular, consisted mainly of conservative measures intended to mitigate the expected consequences of both the persistent economic stagnation and a harsh external environment.

a) Fiscal policy

Faced with a lack of external financing, the central bank (Banque de la République d'Haïti) had to fund the fiscal deficit, which amounted to 2.5% of GDP, while external debt servicing fell heavily into arrears.

In fiscal year 2002 the central government's total income went up by 12.2% in real terms thanks to a significant upturn in external trade taxes (7%), VAT receipts (17%) and direct taxes (17%); the first two accounted for almost 60% of total tax receipts. Despite this improvement, the central government's income level was still 10% lower than it had been in 1999, given the prolonged stagnation of the economy. The increase in income was insufficient to offset a rise in total real spending, which was up by 11%, owing chiefly to sharp increases in real operating expenditure and investment, since social spending –which was limited to begin with, at just 3% of GDP– went down by 3.5% in real terms.

The budget for fiscal year 2003 was adopted in early June. It envisages a reduction in financing by the central bank, on the assumption that new external contributions of around US$ 60 million will be received and that total income will increase by 25% in nominal terms.

Most external financing remains frozen and, although a solution to the political and institutional conflict would help to secure new disbursements, most of their effects would not be felt until the next fiscal year. By February 2003 outstanding payments amounted to US$ 65 million, owed mainly to the World Bank (US$ 23 million) and IDB (US$ 28 million). The country's payment arrears with IDB could lead to the cancellation of loans that have been approved (US$ 300 million), but whose disbursement is subject to the payment of outstanding loan instalments. If this situation in particular could be resolved, the Haitian authorities could secure nearly US$ 50 million in additional resources almost immediately through policy-based lending (PBL) procedures. This largely accounts for the authorities' discussions with the domestic private banking sector in June to secure bridging loans to pay off arrears owed to IDB.

b) Monetary policy

Monetary policy took a looser stance in order to counter recessionary pressures in the economy. Interest rates on the central bank's 91-day bonds –the reference rate– came down significantly (from 20.1% in October 2001 to 10.3% in September 2002) and the money supply expanded by 6.4% in real terms over that period. This generated a slight upturn in private credit (4.3%) –after a sharp contraction the preceding year (-18%)– which was, however, much smaller than the expansion of public credit (13.9%) and was not enough to jump-start the productive sectors of the economy, given the poor expectations arising from the general political instability and high real lending rates (16.3%). Nevertheless, in the fourth quarter of 2002 monetary policy had to change course in order to contain inflationary pressures and slow the devaluation of the currency. The central bank thus increased the yield on its 91-day bonds three times (to 15.6%, 24.4% and 27.5% in November 2002 and February and March 2003, respectively).

The closure in July 2002 of the last of the savings and loan cooperatives –which lost depositors an amount estimated at close to US$ 200 million– and the establishment of institutional mechanisms for the oversight of parafinancial enterprises seem to have staved off the worst risks of this particular period. However, the financial effects of this crisis (not to mention the social effects, which have been evidenced by the continued claims of depositors) were manifested by a downturn in local-currency time deposits, the only monetary liability to record a real decrease (-5.3%). Without a doubt, the whole banking system was affected –in its indicators of profitability and, especially, of asset quality– by the deterioration in the economic environment in general and the financial sphere in particular. Net bank earnings fell by 24% in real terms, while loan loss provisions as a percentage of loans outstanding rose to 84.4% (compared to 66.3% in 2001).

c) Exchange-rate policy

Net interventions by the central bank in the exchange market in fiscal year 2002 –which consisted

Table 1
HAITI: MAIN ECONOMIC INDICATORS

	1994	1995	1996	1997	1998	1999	2000	2001	2002[a]
	Annual growth rates [b]								
Gross domestic product	-17.6	9.5	5.6	3.2	2.9	2.9	2.0	-0.6	-0.5
Per capita gross domestic product	-19.0	7.5	3.7	1.3	1.0	1.1	0.2	-2.4	-2.3
Gross national income	-16.2	25.1	7.7	3.8	0.3	9.3	11.9	0.9	1.3
Gross domestic product by sector									
Agriculture	-3.7	0.1	1.0	-1.5	-0.2	-2.8	-3.6	0.6	-3.7
Mining	-7.4	79.4	-26.0	10.2	9.5	7.1	5.9	-4.9	1.5
Manufacturing	-35.9	4.3	5.6	0.3	0.3	-3.0	-0.5	0.1	0.3
Electricity, gas and water	-27.7	5.3	0.6	5.3	-2.8	-3.5	-9.3	-27.1	2.0
Construction	-16.1	67.0	-7.9	9.1	11.2	10.4	8.3	0.7	0.9
Wholesale and retail commerce, restaurants and hotels	-11.2	11.2	8.6	5.8	3.1	4.0	4.5	0.4	0.0
Transport, storage and communciations	-17.3	10.1	7.2	7.2	7.1	17.0	12.5	2.2	-0.2
Financial establishments, insurance, real estate and business services	-21.4	-6.7	31.9	6.8	5.9	3.2	4.4	-0.7	-0.1
Community, social and personal services	1.7	-0.1	1.8	1.2	1.3	-0.1	-1.6	-2.6	0.3
Gross domestic product by type of expenditure									
Consumption	-13.3	2.6	9.3	2.1	3.8	2.1	7.4	-1.2	-1.0
General government	2.4	-0.7	1.2	-0.1	1.1	0.2	1.3	-6.0	3.9
Private	-14.6	3.0	10.1	2.3	4.0	2.3	7.9	-0.8	-1.3
Gross domestic investment	-34.8	123.4	11.8	7.6	-3.2	24.0	18.3	-1.9	1.3
Exports of goods and services	-33.7	35.2	27.3	14.2	23.3	16.5	6.3	-3.2	-2.9
Imports of goods and services	-18.2	69.2	32.6	7.2	6.6	22.7	29.3	-3.5	-0.8
	Percentages of GDP								
Investment and saving									
Gross domestic investment [b]	12.8	26.1	27.6	28.8	27.1	32.6	37.8	37.4	38.0
Gross domestic investment [c]	10.2	26.1	28.1	24.5	26.0	27.7	27.3	25.7	26.8
National saving [c]	9.1	22.9	23.5	23.1	25.0	26.3	25.0	22.9	25.2
External saving [c]	1.1	3.2	4.6	1.5	1.0	1.4	2.3	2.8	1.6
	Millions of dollars								
Balance of payments									
Current account	-23	-87	-138	-48	-38	-59	-86	-97	-49
Goods balance	-111	-429	-416	-354	-341	-677	-758	-750	-706
Exports fob	60	88	83	205	299	341	328	305	274
Imports fob	-171	-517	-499	-560	-641	-1,018	-1,087	-1,055	-980
Services balance	-57	-180	-174	-158	-201	-43	-90	-106	-105
Factor income balance	-11	-31	-10	-14	-12	-13	-9	-9	-14
Current transfers balance	156	553	463	478	516	674	772	769	776
Capital and financial balance [d]	-26	224	87	78	73	80	40	94	-32
Net foreign direct investment	0	7	4	4	11	30	13	4	6
Financial capital [e]	-26	217	83	74	62	50	27	90	-37
Overall balance	-50	137	-50	30	34	21	-46	-2	-80
Variation in reserve assets [f]	13	-176	49	-51	-29	-34	57	-5	49
Other financing [g]	37	38	2	21	-5	12	-11	7	32
Other external sector indicators									
Terms of trade for goods (index 1997=100)	102.1	105.5	95.6	100.0	102.0	100.5	93.0	94.0	93.1
Net resource transfer (% of GDP)	0.0	8.6	2.7	2.6	1.5	2.0	0.5	2.6	-0.4
Gross external public debt (millions of dollars)	875	901	914	1,025	1,104	1,162	1,170	1,189	1,212
Gross external public debt (% of GDP)	41.2	33.4	30.8	31.6	29.4	28.4	31.9	34.3	38.5
Net interest and earnings (% of exports) [h]	-16.7	-15.9	-5.2	-3.6	-2.4	-2.4	-1.8	-2.1	-3.2

Table 1 (concluded)

	1994	1995	1996	1997	1998	1999	2000	2001	2002[a]
	Annual percentages								
Prices									
Variation in consumer prices	32.2	24.8	14.5	15.7	7.4	9.7	19.0	8.1	14.8
Variation in nominal exchange rate	6.2	15.4	-6.3	12.0	-2.6	9.4	27.5	14.4	42.2
Variation in real minimum real wage	-28.1	88.0	-17.1	-13.9	-11.3	-7.9	-11.8	-11.7	-8.8
Real deposit rate [i]	...	...	...	-4.3	5.3	-2.4	-5.7	5.2	-16.0
Real lending rate [j]	...	...	...	4.6	15.1	11.7	5.5	19.1	-2.5
Equivalent deposit rate in foreign currency [k]	...	...	...	-1.1	16.1	-1.8	-12.3	-0.6	-23.9
	Percentages of GDP								
Central government									
Current income	2.5	5.5	6.9	8.7	8.3	8.8	7.9	7.5	8.4
Current expenditure	5.5	9.5	8.5	9.4	8.8	9.3	8.1	8.3	9.0
Saving	-3.0	-3.9	-1.7	-0.7	-0.5	-0.5	-0.2	-0.8	-0.6
Capital balance	-0.2	-0.7	-0.3	-1.0	-2.0	-2.1	-2.4	-1.9	-2.3
Primary balance	...	-3.5	-1.5	0.2	-0.3	-0.6	-1.7	-2.4	-2.7
Overall balance	-3.2	-4.1	-2.0	-0.6	-1.1	-1.4	-2.2	-2.8	-2.5
Public debt	...	...	39.4	38.5	37.2	36.4	41.2	43.4	47.8
External	...	...	26.3	27.0	25.9	25.0	28.4	29.5	33.9
Domestic	...	...	13.1	11.5	11.3	11.4	12.8	13.9	13.9
Interest payments (% of current income)	...	10.7	7.5	8.4	8.4	9.3	6.1	3.6	1.6
Money and credit [l]									
Domestic credit [m]	...	9.0	11.4	13.1	13.0	13.3	14.5	14.2	15.0
To public sector	...	-0.1	-0.1	-0.2	-1.0	-0.5	-0.3	-0.1	0.0
To private sector	...	9.1	11.5	13.3	14.0	13.9	14.8	14.3	15.0

Source: ECLAC, on the basis of official figures.
[a] Preliminary figures. [b] Based on constant 1995 dollars. [c] Based on figures in local currency at current prices. [d] Includes errors and omissions. [e] Refers to the balance on the capital and financial accounts, minus net foreign direct investment plus errors and omissions. [f] A negative sign denotes an increase in reserves. [g] Includes the use of credit and loans from IMF and exceptional financing. [h] Refers to net investment income divided by exports of goods and services from the balance of payments. [i] Average of maximum and minimum rates on time deposits in commerical banks. [j] Average of maximum and minimum lending rates in commerical banks. [k] Average rate for deposits, deflated by the variation in the dollar exchange rate. [l] Average annual values were used for monetary figures. [m] Refers to net credit to the public and private sectors extended by commercial banks and other financial and banking institutions.

solely of hard-currency purchases– amounted to almost US$ 16 million, compared to only US$ 3 million the year before.

The monetary authorities remained flexible on exchange-rate policy but intervened to avoid large fluctuations. The monthly average exchange rate increased from 27.1 gourdes to the dollar in June 2002 to 37.21 in December and to 45.25 in February 2003. It later dropped to 38.4 gourdes to the dollar in June 2003.

In 2002 the economy became further dollarized. At the end of September foreign currency deposits represented 37% of broad money (M3) and 45% of all deposits in the system. The prevailing economic, political and social uncertainty, however, altered the portfolio composition of these deposits in favour of more liquid instruments. This was apparent in the fact that time deposits in dollars decreased from 43% of total foreign currency deposits in 2001 to 37% in 2002. Another factor contributing to this phenomenon was the downturn in levels of activity and income, which made it harder for depositors to tie up their monetary assets for longer periods.

The central bank was not able to make good the loss of reserves incurred in 2002 or to intervene directly when speculative attacks against the gourde took place in October and November 2002 and February 2003.

d) Trade policy

In general, Haiti's involvement in regional trade integration schemes is fairly limited, so its formal ratification, in July 2002, of its incorporation into

Table 2
HAITI: MAIN QUARTERLY INDICATORS

	2001				2002[a]				2003[a]	
	I	II	III	IV	I	II	III	IV	I	II
Consumer prices (12-month variation, %)	16.3	16.7	12.4	8.1	8.5	8.4	10.1	14.8	37.0	44.5
Average nominal exchange rate (gourdes per dollar)	23.5	23.5	24.6	26.1	26.8	26.9	28.6	34.8	42.1	39.3
Nominal interest rates (annualized percentages)										
Deposit rate [b]	14.3	14.8	13.3	12.1	9.2	7.6	7.9	8.3	12.1	14.5
Lending rate [c]	29.1	28.8	27.8	28.8	26.3	25.2	26.0	25.2	27.0	30.0
Interbank rate [d]	14.0	14.0	14.0	12.1	8.4	5.9	6.0	5.7	11.0	22.1
Domestic credit [e] (change from same quarter of preceding year)	10.4	7.5	-7.7	7.3	7.4	10.4	15.2	30.4	40.7	...

Source: ECLAC, on the basis of official figures.
[a] Preliminary figures. [b] Average of maximum and minimum rates on time deposits in commerical banks. [c] Average of maximum and minimum lending rates on time deposits in commerical banks. [d] Seven-day mnoney market rate. [e] Refers to net credit to the public and private sectors extended by commercial banks and other financial and banking institutions.

CARICOM was an exceptional move. It had participated in CARICOM since 1997 with provisional membership status, subject to ratification by the Haitian Parliament.

Although it may be premature to attempt an analysis of the possible effects of this step on the country's economy, it should be mentioned that, unlike its CARICOM partners, Haiti began to open its economy to the world market almost unilaterally from 1995 onward, so that its tariffs are already among the lowest in the region. In fact, the highest tariff level is 15%, barring a few exceptions for products such as gasoline (57.8%). In its negotiations with CARICOM, Haiti was able to benefit from a number of safeguards, particularly its status as the region's only LDC and renewable tariff truces on almost 500 products, in view of the common external tariffs applicable under the CARICOM regime.

3. The main variables

a) Economic activity

Disposable national income grew by a meagre 1.3% and per capita GDP was negative for the third year running, at -2.5%, owing to a further downturn in output (-0.5%), which was accompanied by a 6.4% decline in imports of goods and services. In 2002 the level of overall supply in the Haitian economy was 23% higher than the figure for 1997. Even so, as a result of the meagre development of GDP over that five-year period (1.3% a year), the volume of imports had risen by 62%. Owing to the structural conditions underlying these phenomena, the country is able to meet only half its domestic demand. Meanwhile, on the demand side, the negative trend in private consumption (-1% in 2002) and in exports of goods and services (-2.9%), as well as the negligible rise in investment (1.3%), confirmed that the country was experiencing another economic recession.

The domestic supply of goods and services declined largely because of a downward trend in the agricultural sector (-3.7%) that resulted from poor weather conditions (droughts and floods), and especially because of a combination of adverse effects associated with structural failings in the sector. Though it lacks both productive and financial resources, the domestic agricultural sector has to compete with external agricultural supply in very unfavourable conditions. This was compounded by the negative effects of another downturn (-11%) in the international price of coffee, which is one of Haiti's main cash crops.

Manufacturing stood still at 0.3%, undoubtedly as a result of a weakening of the maquila industry, which is its largest component. In turn, almost all the other sectors of local activity stalled or declined outright, in part because of a sharp drop in private consumption. In addition, local demand has shifted strongly towards imported goods. For example, imports of “worn clothing” (Harmonized System code 6309) and “edible offal” (code 0206) from the United States amounted to over US$ 10 million.

Within the category of “other services” (49.4% of GDP), the largest segment –commerce, restaurants and hotels (26.5% of GDP)– showed no variation, which seems to reflect a considerable downturn even in the informal activities that dominate this subsector.

The stagnation of construction (0.9%) also illustrated the economy’s overall trend towards recession, in view of the procyclical nature of this activity. The downswing was offset by public works, which accounted for over a third of public investment. The main construction inputs rose in price (cement, 21%; rods, 9%; and bricks, 5%), however, which largely explains the recessionary tendency of private construction.

Electricity generation has long been a bottleneck in Haiti’s economic activity. Its modest climb of 1.4% was not enough to cover unmet demand either in the commercial and industrial sector or in households, even though these two sectors’ consumption still represents only 80% and 75%, respectively, of the figure recorded in 1998. The closure for several months of the country’s largest hydroelectric plant forced the authorities to resort to private suppliers and to extend a special subsidy to the State company to enable it to import additional hydrocarbons.

b) Prices, wages and employment

The rate of inflation rose to 14.8% in 2002, which was more than six percentage points above the 2001 figure. This upsurge began in the second half of the year and worsened in 2003, with the 12-month rate reaching 42% in June. This state of affairs was mainly a result of currency devaluation and fuel price adjustments. What is more, a breakdown of more specific segments that have a major impact on Haiti’s consumption patterns, particularly agricultural goods, reveals much sharper increases. The prices of domestic agricultural goods rose considerably faster than the overall price index.

The nominal minimum wage (36 gourdes a day) remained unchanged until February 2003, when it was increased to 70 gourdes (which is less than US$ 2). The purchasing power of the minimum wage had already dropped by over 50% with respect to its level of 1996, when the last adjustment took place. The recent increase therefore falls far short of making up the decline in the general population’s standards of living, which deteriorated even more quickly following the widespread price increases that began to be observed in January 2003. In a country whose population consists for the most part of “non-wage earners”, this indicator, though it does not reflect actual average income, illustrates the sort of shortfall in resource availability that large segments of the population may face. Although they refer to 2001, the preliminary findings of a survey on living conditions conducted by the Haitian Institute of Statistics bear out this hypothesis. The data show that 57% of urban households and 82.5% of rural households are poor (meaning that their income does not exceed US$ 2 a day in terms of purchasing power parity). Households defined as living in extreme poverty (US$ 1 a day) accounted for 38% of urban households and 64% of rural ones.

According to the Haitian Association of Industry (ADIH), employment in the maquila industry saw an upturn, with almost 5,000 workers hired in 2002. At the same time, the magnitude of unemployment, which borders on 40% in urban areas, together with the absence of any specific policies to deal with it and the persistent economic crisis, have set the country back yet again in this area, which undoubtedly constitutes one of the Haitian economy’s most dramatic structural lags.

c) The external sector

Haiti’s economy has traditionally been weak in respect of external merchandise trade and –unlike other Caribbean economies in which tourism activity helps to redress the imbalance– has not been able to offset this with strong trade in services. The worsening of domestic production conditions and the slowdown in the United States economy in 2002 have also contributed to the external sector’s recessionary performance.

Exports, whose performance declined perilously for the third year running (down by 10% in both value and volume), were not enough to offset the trade deficit, since they financed barely a third of imports. Although imports trended downward, they still accounted for a substantial share of overall supply (53%). Of course, certain categories of imports are highly inelastic, in particular hydrocarbons and food. The trade deficit therefore remained unwieldy at 26% of GDP.

Haiti’s external trade with the United States, its main export market (91%) and the main origin of its imports (55%), trended downward in keeping with the decline in merchandise exports and imports overall. The depressed state of United States demand hurt maquila activity in the area of textiles and clothing, which recorded a significant drop in value and volume (7.8% and 8.7%, respectively). Mango exports, by contrast, displayed a large upturn (63% in value and 48% in volume). Cocoa exports were also up (by 164% in value and 48% in volume) as a result of a 57% jump in international prices.

Large inflows of remittances from abroad kept the current account from showing an even bigger deficit. Remittances –mainly from the United States– are an essential feature of Haiti's socio-economic situation, since their contribution to GDP (25%) is much larger than in any other country in the region (compared to 13% in El Salvador and 8% in the Dominican Republic, for example). They represent by far the country's most important source of foreign exchange, providing almost twice the amount brought in by goods and services exports.

Arrears in external debt servicing –which are recorded below the line in the balance of payments as exceptional financing– have become a bone of contention between the Haitian authorities and the international community because of the conditionality –a settlement of the political conflict– attached to new disbursements, except in the case of IDB loans, which require only the regularization of outstanding payments.

In fiscal year 2002 Haiti's accumulated arrears totalled US$ 49 million, but the country received disbursements of only US$ 13 million, which fell far short of meeting its need for fresh resources. The overall debt balance therefore remained almost unchanged at US$ 1.212 billion, but rose to 38% as a proportion of GDP.

In the framework of the bicentenary of Haiti's independence, which will be celebrated next year, a number of plans have been made for foreign direct investment in the tourism segment in fiscal year 2003. These investments, which involve United States and French partners, would total close to US$ 75 million. Almost all of these plans are still at a preliminary stage, but if investments in the course of the year bring in some US$ 25 million, Haiti will record a level of FDI not seen for the last 20 years.

Between October 2002 and April 2003 external trade with the United States displayed an upswing in both exports (22%) and imports (31%). The increase in exports was attributable chiefly to higher sales of maquila-produced textiles (which were up by 14% in volume and 12% in value at annualized rates to April) and cocoa (whose volume and value soared by 81% and 197%, respectively). Higher agricultural imports were largely a reflection of the performance of a small group of consumer commodities (rice, wheat, chicken and legumes), which account for over 50% of the rise. Rice imports, which alone represent 12% of agricultural supply, showed a volume increase of 50%.

Honduras

1. Main trends

In 2002 the performance of the Honduran economy was hampered for the second year in a row by the slow growth of the world economy, whose effects were compounded by a number of domestic factors that conspired against an economic recovery. The result was a meagre growth rate of 2.4%, which was similar to the previous year's rate. Inflation continued to trend downward to reach 8.1%, while the rate of unemployment and the real exchange rate varied little. The central government and balance-of-payments current-account deficits were lower than in 2001, at 5.5% and 3.7% of GDP, respectively.

The prices of traditional export products remained low and there was a sharp decline in external cooperation resources to rebuild the infrastructure devastated by hurricane Mitch in late 1998. A number of adverse domestic factors came into play during the year. First, the after-effects of the hurricane were still making themselves felt, especially in the agricultural sector and in small and medium-sized firms. Second, the economy suffered as a result of the uncertainty associated with the country's difficulties in implementing its agreement with IMF. Lastly, the new government which took office in January delayed the implementation of public investment projects, opting instead to give top priority to the improvement of fiscal affairs.

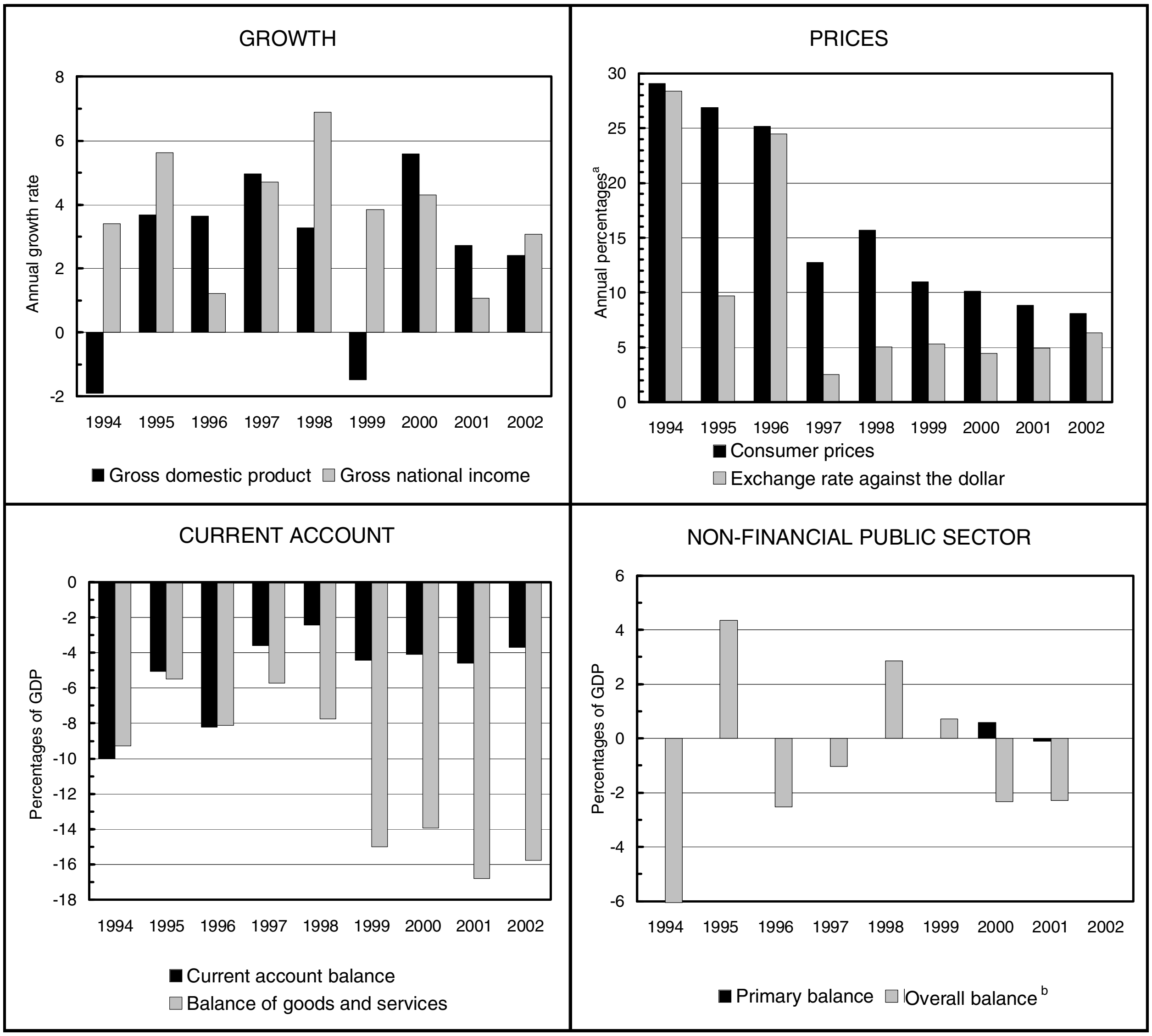
This decision on the government's part stemmed from the objective of complying with the conditions required to benefit from the Heavily Indebted Poor Countries (HIPC) Initiative. One of these conditions was to arrive at a new agreement with IMF, since the previous one was not completed satisfactorily, especially with regard to fiscal affairs. Under the HIPC Initiative the country would obtain external debt relief worth more than US$ 900 million over the next 15 years, which would be used to carry forward the poverty reduction strategy begun in 2002.

This combination of factors, which carried over into the first half of 2003, was compounded by the failure to reach a new agreement with IMF as planned. Uncertainty, which is one of the factors that weigh most heavily in investment decisions, will therefore continue to dog the Honduran economy.

The country's sluggish economic growth was a reflection of several worrying trends, the first of which was a slide in gross fixed investment for the third year running. This was accompanied by feeble growth in the maquila industry and a decline in exports, both of which resulted from slack external demand and the appreciation of the lempira, which has continued uninterrupted for the last six years. In addition, the downturn in both external aid and foreign direct investment suggests that net transfers of external resources will continue to shrink. Lastly, indirect tax receipts, which account for three quarters of tax revenue, weakened for the third year in a row.

The central bank's monetary programme estimates growth at between 3% and 3.5% in 2003, based on the supposition of an economic upturn in the United States, which is Honduras's main trading partner. Other goals are to bring the annual rate of inflation to between 7.5%

Figure 1
HONDURAS: MAIN ECONOMIC INDICATORS



Source: ECLAC, on the basis of official figures.
[a] December-to-December variation.
[b] Includes interest.

and 8% and to reduce the central government's fiscal deficit to the equivalent of 3.5% of GDP. If the economy were to see an upswing, the balance-of-payments current-account deficit would widen to 6.6% of GDP.

The tax reform adopted in April 2003, which could bring in additional revenues in excess of 1% of GDP during the year, together with the restructuring of the public sector planned for the second half, should make it possible to reduce the fiscal deficit faster than in 2002. Within this framework, the administration's policy mix continues to be based on fiscal adjustment as a route towards a looser monetary policy. The government also hopes to conclude the negotiations on a free trade agreement between the Central American countries and the United States, and to move forward with the formation of the Central American Customs Union.

A number of the indicators now available for the first quarter of 2003 suggest that growth for the year will be slightly higher than in 2002. The economic reactivation is proceeding very slowly, since external demand has yet to pick up significantly from its level of the past two years. A little propulsion has been provided by domestic demand, which is displaying an incipient upswing in investment and a modest rate of consumption.

2. Economic policy

The main objective of economic policy was to maintain macroeconomic stability, in particular by putting public finances on a sound footing, and to carry out structural reforms in an effort to fulfil the conditions for reaching the completion point under the HIPC Initiative. The goals of the economic programme were to achieve a central government deficit of 5% of GDP, an inflation rate of 8% and exchange-rate stability. The early months of 2003 saw no change in economic policy objectives and instruments, with the exception of the fiscal deficit target, which was reduced to 3.5% of GDP.

a) Fiscal policy

The authorities sought to improve the country's fiscal health because the size of the deficit, at 6% of GDP in 2001, was blocking progress in the negotiations with IMF. The steps they took in this direction included the adoption of austerity measures and the reining-in of current expenditure, the negotiation of statutory wage increases and tax reform under the Financial Balance and Social Protection Act.

This legislation includes measures to increase tax revenues, such as the widening of the base of contributors liable to pay taxes, stricter controls on exemptions and penalties for tax evasion. At the same time, import taxes were lowered to harmonize tariffs with those of the other Central American countries. In April 2003 the authorities adopted a new reform aimed at enhancing tax equity, broadening the tax base and stabilizing State revenues.

Current income expanded by 2.2% in real terms, thanks to a 23% increase in non-tax revenues. By contrast, tax revenues were down (0.3%) because of the weakness of the economy. These revenues rose by just over 2% in real terms in the first quarter of 2003, however, as a result of the reform and of tighter controls. Receipts from direct taxes fell by 0.9%, after having risen by almost 8% in 2001.

Indirect taxes performed marginally better than direct taxes. Sales taxes were up by 1.6% in real terms, in keeping with the performance of the economy in general, while taxes on services rose by 10.5%. Lastly, receipts from external trade taxes plunged by 18%, partly as a result of tariff reductions.

The expansion of non-tax income, which represented one eighth of current income in 2002, was a result of a non-recurring 32% increase in current transfers to the central government. A little over half of this came from the State telecommunications firm Empresa Hondureña de Telecomunicaciones (Hondutel). Donations, by contrast, fell by almost 40%, since foreign assistance in the wake of hurricane Mitch is coming to an end.

Total expenditure shrank in real terms (-3.1%) for the first time since 1997. The fiscal adjustment primarily affected capital expenditure, which fell by 23%, while current expenditure was up by 4.9%. Current saving was negative for the second year running and came to represent only 0.9% of GDP.

Spending on wages and salaries rose by 8.3% in real terms, despite such measures as the elimination of duplicated posts and of two thirds of all vacant posts. Another item to see a rise was transfers (17%), owing to the expansion of contributions to decentralized institutions. By contrast, interest payments contracted by almost 11% as a result of debt rescheduling, debt forgiveness and lower interest rates.

The central government deficit therefore narrowed from the equivalent of 6% of GDP in 2001 to 5.5% in 2002. Two fifths of the financing for the deficit came from external sources and the rest from domestic sources. The non-financial public-sector deficit also shrank, from 2.3% of GDP to 2.1%.

Apart from tax reforms, activities to carry forward structural reforms included the adoption of measures to strengthen the legal system and combat corruption, and the adoption of the Administrative Simplification Act. In addition, a National Competitiveness Council was established and negotiations continued on the Central American Customs Union.

b) Monetary and exchange-rate policy

By setting the inflation target at 8% (after the country had posted inflation of 8.8% in 2001), the central bank allowed itself room for a looser monetary policy. The main policy instrument consisted of open-market operations, in both the longer-established local-currency form and the new modality of dollar-denominated monetary absorption certificates, which were introduced in 2001. Monetary absorption by means of these two modalities reached 3 billion lempiras, which was 600 million less than in 2001.

The intermediate results diverged considerably from target. The monetary base was supposed to expand by 2%, but in fact its growth was as high as 12.3% because

Table 1
HONDURAS: MAIN ECONOMIC INDICATORS

	1994	1995	1996	1997	1998	1999	2000	2001	2002[a]
	Annual growth rates [b]								
Gross domestic product	-1.9	3.7	3.7	4.9	3.3	-1.5	5.6	2.7	2.4
Per capita gross domestic product	-4.7	0.7	0.8	2.1	0.5	-4.1	2.8	0.1	-0.2
Gross national income	3.4	5.6	1.2	4.7	6.9	3.8	4.3	1.1	3.1
Gross domestic product by sector									
Agriculture	1.3	7.6	3.3	5.5	-1.9	-8.5	11.7	-0.5	4.8
Mining	-2.7	14.3	8.4	4.8	3.7	5.4	1.7	-0.8	5.0
Manufacturing	-1.0	4.4	5.8	6.0	3.4	2.6	5.5	5.2	2.8
Electricity, gas and water	-6.3	13.6	16.0	7.4	4.9	2.1	10.6	-1.8	5.6
Construction	-17.9	-7.1	-10.5	2.4	5.3	10.5	1.5	-5.2	-14.6
Wholesale and retail commerce, restaurants and hotels	0.6	4.8	5.3	3.6	3.1	0.7	3.7	3.0	2.8
Transport, storage and communciations	-2.1	6.7	5.1	4.4	2.7	1.7	5.0	5.3	3.2
Financial establishments, insurance, real estate and business services	6.0	5.4	5.6	6.9	7.2	0.8	2.6	3.4	2.9
Community, social and personal services	-6.3	-2.3	1.3	3.9	3.2	-1.0	10.7	11.0	7.2
Gross domestic product by type of expenditure									
Consumption	1.2	-1.0	4.5	1.7	7.5	4.0	7.1	5.4	2.1
General government	-5.1	-2.8	5.3	-1.0	15.4	9.8	15.7	12.1	0.5
Private	2.2	-0.8	4.4	2.1	6.4	3.1	5.7	4.2	2.4
Gross domestic investment	7.3	3.0	-6.3	8.5	1.9	8.1	-3.0	-5.7	3.3
Exports of goods and services	-10.1	13.6	8.1	1.3	1.6	-11.2	7.3	5.1	2.1
Imports of goods and services	1.1	4.0	2.4	-1.4	7.5	4.3	3.8	4.0	2.1
	Percentages of GDP								
Investment and saving									
Gross domestic investment [b]	31.8	31.6	28.5	29.5	29.1	31.9	29.3	26.9	27.2
Gross domestic investment [c]	37.6	31.6	31.1	32.2	30.9	34.7	30.6	29.8	27.8
National saving [c]	27.4	27.1	26.5	28.3	28.4	30.2	26.3	24.7	23.3
External saving [c]	10.3	4.5	4.6	3.9	2.5	4.5	4.3	5.2	4.6
	Millions of dollars								
Balance of payments									
Current account	-343	-201	-335	-170	-128	-241	-246	-293	-243
Goods balance	-250	-141	-287	-192	-304	-753	-658	-865	-874
Exports fob	1,102	1,377	1,638	1,847	2,067	1,756	2,012	1,943	1,930
Imports fob	-1,351	-1,519	-1,926	-2,039	-2,371	-2,510	-2,670	-2,807	-2,804
Services balance	-69	-76	-45	-78	-104	-61	-182	-210	-160
Factor income balance	-214	-226	-231	-213	-208	-164	-153	-148	-166
Current transfers balance	189	243	227	312	488	737	747	929	957
Capital and financial balance [d]	273	160	257	358	270	457	192	293	307
Net foreign direct investment	35	50	91	128	99	237	282	195	143
Financial capital [e]	238	110	166	231	171	220	-90	98	164
Overall balance	-70	-41	-79	188	141	216	-54	0	64
Variation in reserve assets [f]	-74	-90	13	-296	-230	-474	-119	-147	-214
Other financing [g]	144	132	66	108	89	258	173	148	151
Other external sector indicators									
Real effective exchange rate (index 2000=100) [h]	135.8	124.5	127.3	119.8	109.8	104.7	100.0	97.1	97.6
Terms of trade for goods (index 1997=100)	79.8	86.7	80.4	100.0	102.3	95.5	90.0	88.1	85.4
Net resource transfer (% of GDP)	5.9	1.6	2.3	7.8	8.0	16.8	3.7	5.1	6.7
Gross external public debt (millions of dollars)	4,040	4,243	4,121	4,073	4,404	4,729	4,721	4,802	4,715
Gross external public debt (% of GDP)	117.7	107.1	101.0	86.4	83.7	87.2	78.4	75.0	71.8
Net interest and earnings (% of exports) [i]	-16.2	-14.1	-13.1	-9.7	-8.5	-7.3	-6.1	-6.1	-6.8

Table 1 (concluded)

	1994	1995	1996	1997	1998	1999	2000	2001	2002[a]
					Percentages				
Employment									
Labour force participation rate [j]	49.2	49.5	52.2	53.1	52.9	55.7	...	52.5	51.7
Open unemployment rate [k]	4.0	5.6	6.5	5.8	5.2	5.3	...	5.9	6.1
Visible underemployment rate [k]	1.7	1.5	2.4	3.0	2.1	2.7	...	4.4	3.9
					Annual percentages				
Prices									
Variation in consumer prices	29.1	26.9	25.2	12.7	15.7	11.0	10.1	8.8	8.1
Variation in+A112 nominal exchange rate	28.4	9.7	24.5	2.5	5.1	5.3	4.4	5.0	6.3
Variation in real minimum wage	-14.0	-5.5	-4.0	6.3	3.3	0.4	8.4	6.7	-1.6
Real deposit rate [l]	-14.6	-9.7	-8.4	8.9	1.6	9.5	4.9	5.8	4.7
Real lending rate [m]	-4.6	2.4	1.8	18.6	12.0	18.8	14.7	14.4	12.9
Equivalent deposit rate in foreign currency [n]	-13.1	2.1	-6.2	18.2	12.9	13.9	11.0	9.1	7.0
					Percentages of GDP				
Non-financial public sector									
Current income	26.7	30.2	29.5	29.4	31.8	32.1	30.1	31.9	...
Current expenditure	22.6	23.3	22.8	22.8	22.9	22.6	24.7	27.1	...
Saving	4.1	7.0	6.7	6.5	8.9	9.5	5.4	4.8	...
Capital balance	-10.2	-11.4	-9.2	-7.6	-6.3	-8.9	-6.7	-6.1	...
Primary balance	...	...	...	...	...	...	0.6	-0.1	...
Overall balance	-6.0	4.3	-2.5	-1.0	2.9	0.7	-2.3	-2.3	...
Money and credit [o]									
Domestic credit [p]	26.1	24.5	23.3	24.1	31.0	33.1	33.4	35.3	35.7
To public sector	2.6	1.7	0.9	-0.1	-2.3	-4.8	-4.6	-3.5	-3.0
To private sector	23.5	22.7	22.3	24.1	33.4	37.9	38.0	38.9	38.8
Liquidity (M3)	30.1	29.2	29.0	35.0	40.8	43.3	45.3	46.7	48.7
Currency in circulation and domestic currency deposits (M2)	26.6	25.1	22.7	27.2	32.2	33.2	34.7	34.7	34.7
Foreign currency deposits	3.5	4.1	6.3	7.8	8.6	10.1	10.6	11.9	14.0

Source: ECLAC, on the basis of official figures.
[a] Preliminary figures. [b] Based on constant 1995 dollars. [c] Based on figures in local currency at current prices. [d] Includes errors and omissions. [e] Refers to the balance on the capital and financial accounts, minus net foreign direct investment plus errors and omissions. [f] A negative sign denotes an increase in reserves. [g] Includes the use of credit and loans from IMF and exceptional financing. [h] Annual average, weighted by the value of exports and imports of goods. [i] Refers to net investment income divided by exports of goods and services from the balance of payments. [j] Economically active population as a percentage of the working-age population, nationwide total. [k] Rates of unemployment and underemployment are percentages of the economically active population, nationwide total. [l] Weighted average of time deposits. [m] Weighted average of loans. [n] Average rate for deposits, deflated by the variation in the dollar exchange rate. [o] Average annual values used for monetary figures. [p] Refers to net credit to the public and private sectors extended by commercial banks and other financial and banking institutions.

the central bank's net international reserves increased by 11.8%, as against the rate of 0.9% envisaged in the monetary programme for 2002. Net international reserves expanded even faster in the financial system overall, at a rate of 20%, and current-account deposits also increased. As a result, monetary aggregates in general expanded at faster rates than in 2001. Narrow money (M1) was up by 14.6%, which was almost three times the rate recorded in 2001. The money supply (M2) grew by 11.3%, which was three percentage points higher than the 2001 rate, while broad money (M3) increased by 13.2%, which was slightly lower than the previous year's rate. Monetary aggregates expanded at a similar pace in the first quarter of 2003.

Although liquidity was more abundant than planned, credit to the private sector was lower for the fifth year running, since it grew by only 7.6% in 2002, which was below the rate of inflation. This state of affairs carried over into early 2003. The abundance of liquidity did, however, have a slight effect on interest rates, which have been descending steadily for several years. The weighted average rate on deposits came down from 12% a year in December 2001 to 10.6% in December 2002, while the average lending rate decreased from 23.7% to 22.7%.

Table 2
HONDURAS: MAIN QUARTERLY INDICATORS

	2001				2002[a]				2003[a]	
	I	II	III	IV	I	II	III	IV	I	II
Gross domestic product (change from same quarter of preceding year) [b]	0.1	0.1	0.0	0.0	0.0	0.0	...	...	...	...
Goods exports fob (millions of dollars)	337	368	307	328	310	379	327	305	279	...
Goods imports cif (millions of dollars)	764	769	746	705	676	738	733	745	726	...
International reserves (millions of dollars)	1,303	1,289	1,225	1,416	1,437	1,538	1,463	1,524	1,450	...
Real effective exchange rate (2000=100) [c]	98.2	97.1	96.6	96.7	96.8	97.5	97.7	98.2	98.6	99.7
Consumer prices (12-month variation, %)	10.2	9.4	10.1	8.8	7.7	7.6	7.2	8.1	8.7	7.2
Average nominal exchange rate (lempiras per dollar)	15.2	15.4	15.5	15.8	16.1	16.3	16.6	16.8	17.0	17.2
Nominal interest rates (annualized percentages)										
Deposit rate [d]	14.5	14.6	14.5	14.3	14.4	14.3	13.6	12.8	12.2	11.6
Lending rate [e]	24.4	23.9	23.5	23.3	23.1	23.0	22.6	22.1	21.5	21.1
Interbank rate	...	...	...	...	12.2	11.0	9.0	8.2	7.2	7.1
Domestic credit [f] (change from same quarter of preceding year)	18.2	18.0	18.0	16.5	13.4	7.0	7.1	7.7	9.2	...

Source: ECLAC, on the basis of official figures.
[a] Preliminary figures. [b] Based on figures in local currency at constant 1978 prices. [c] Quarterly average, weighted by the value of goods exports and imports. [d] Weighted average of time deposits. [e] Weighted average of loans. [f] Refers to net credit to the public and private sectors extended by commercial banks and other financial and banking institutions.

The interest-rate spread therefore broadened to 1,208 basis points, which made it one of the widest in the region.

The National Banking and Insurance Commission intervened in two banks: Banco Capital and Banco Sogerin. To prevent similar problems from occurring in the future, the central bank raised the minimum capital requirement for institutions in the financial system and limited total credit to related parties to no more than 30% of an institution's capital and reserves (whereas that proportion had previously been as high as 120%). In addition, financial institutions were barred from participating directly or indirectly in offshore operations by taking deposits or channelling resources from the public, and legislation was passed to combat asset laundering. In May 2003 an early warning system was launched with a view to reducing the time between the detection of a banking problem and the adoption of suitable measures to correct it.

Exchange-rate policy continued to be based on a crawling-band regime involving a system of public auctions of foreign exchange, known by the Spanish acronym SAPDI, and the government attempted to strike a balance between keeping the exchange rate competitive and minimizing the volatility of the real exchange rate.

The lempira exchange rate rose to 16.9, representing a nominal depreciation of 6.3%, which was slightly above the rate of 5.1% recorded in 2001. In real terms this represented a slight appreciation, however, in a continuation of the pattern that began six years ago and carried over into the first half of 2003, when nominal depreciation was less than 3%.

c) Trade policy

The new government continued to pursue a trade policy geared to opening up new markets and consolidating earlier gains. Progress was made with the other Central American countries in standardizing tariffs on imports from third countries. Moreover, tariff rates on imports of final and intermediate goods were changed to a flat 15% under the Financial Balance and Social Protection Act.

A plan of action was adopted for the elimination of barriers to intraregional trade and to the formation of the Central American Customs Union. In addition, the Treaty on Investment and Trade in Services was adopted, and progress was made in the negotiations on a Central American agreement on government procurement and in other discussions. The negotiations on a free trade agreement between the United States and the Central American countries moved ahead quickly, thanks to the United States government's political will to conclude them by the end of 2003. One positive development in early 2003 was Nicaragua's temporary suspension of the 35% tariff it had imposed on imports from Honduras.

3. The main variables

a) Economic activity

Overall demand expanded by 2.4% in 2002, which was slightly lower than the 2001 rate. Domestic demand, which increased at a similar pace, was undermined for the third year running by a drop in gross fixed investment (5.7%). Within this category, private investment showed a degree of vitality, with a rise of 3.8%, but this was more than offset by a 27% downturn in public investment.

Total consumption was up by 2.1%, which was less than half the expansion posted the year before. This was attributable to the sluggish growth of government consumption (0.5%), which had recorded double-digit increases in the preceding four years as a result of the reconstruction process. The growth rate of private consumption declined from 4.4% in 2001 to 2.4% in 2002, despite a copious inflow of family remittances. Exports and imports followed a similar pattern, with volume increases of 2.1%, compared to 5.1% and 4%, respectively, in 2001.

Performance was fairly even across all the main sectors of activity except construction, which contracted for the second year running, this time by 14.6%. By contrast, agriculture saw an upswing of 4.8% after having stagnated in 2001. This reflected the strong performance of products for domestic consumption such as maize, rice and plantains, whose production expanded by more than a fifth, and beans, which expanded by more than two fifths. Cotton production surged by an extraordinary 85%, while banana production shrank by 8% after two years of brisk growth. Coffee showed a small upturn in 2002, livestock production stagnated and poultry production performed well again after several years of rapid expansion. In the first quarter of 2003 the agricultural production index showed an increase of 5%.

Manufacturing grew by 2.8%, which was half the previous year's rate. Output of textiles and clothing was up by 7.7% in a continuation of its positive performance in recent years. By contrast, non-metallic minerals, base metal industries and metal products, machinery and equipment dropped from relatively high positive growth rates in 2001 to negative rates in 2002. This was not the case of the mining sector, however, which expanded by 5%. In 2003 the construction industry has shown signs of reversing its contractionary trend of 2001-2002, with growth of 27% in the first quarter.

Services performed slightly better than the rest of the economy. Output of electricity, gas and water made up the downturn observed in 2001, increasing by 5.6%. Tourism maintained the buoyancy it has shown in recent years, with an expansion of 12%. Lastly, community, social and personal services were up by 7.2%.

After having retreated slightly in 2001, maquila activity made a half-hearted recovery in 2002 (1.5%). The slow growth of the United States economy, which is the main destination for maquila exports, was to blame for this poor performance. The number of people employed in the maquila industry dipped to 107,000, which represented a decrease of 2.4%. These trends were reversed in the first quarter of 2003, however, when maquila exports and employment jumped by about 13%.

b) Prices, wages and employment

Inflation, measured by the variation in the consumer price index, came down from 8.8% in 2001 to 8.1% in 2002. This was attributable to an excellent trend in food prices, which rose by only 1.6%. Meanwhile, upward pressure was exerted by the costs of education (16.4%) and housing, water, electricity, gas and other fuels (14.8%). The other items in the basket saw more moderate price rises. Cumulative inflation amounted to 3.6% in the first six months of 2003 and 7.2% over the 12 months ending in June.

The average annual variation in the wholesale price index moved from 5.4% in 2001 to 2%, which was the lowest figure recorded in the last 15 years. This was, admittedly, the result of slack domestic demand, which limited the increase in wholesale prices for locally-produced goods to 1.4%, while agricultural products posted almost no variation (0.1%). The prices of imported goods rose by 3.2%, which was half the increase recorded in 2001.

The nominal minimum wage increased by an average of 9% beginning in May, compared to 15.9% the year before. Average real wages thus declined by 1.6% in 2002. The public-sector payroll expanded by 16.3%, which represented a real rise of 7.6%. This reflected the adjustment of statutory wages for teachers and medical and paramedical staff. The minimum wage was raised by 9.7% in early 2003.

Household survey data show that the economically active population grew by 4.5% and employment, by 2.3%. The difference between the two figures was explained by an increase in invisible underemployment, which rose from 24% in 2001 to 26.6% in 2002, indicating that the majority of new entrants to the labour market found employment in the informal sector. The rate of open unemployment decreased from 4.1% to 3.9% nationwide, but increased in the two largest cities, Tegucigalpa and San Pedro Sula.

c) The external sector

External demand remained weak in 2002, especially in the United States, which is the target market for half of Honduras's exports, and the terms of trade deteriorated for the fourth consecutive year. Current transfers continued to rise, and the balance-of-payments current account ended the year at US$ -240 million. The financial account posted a positive balance of US$ 190 million.

Goods exports declined for the second year in a row, this time by 0.6%, which reflected a slide in traditional exports (7.7%) and an increase in non-traditional and maquila exports (3.2% and 1.5%, respectively). With the exception of coffee, practically all traditional exports recorded declines in both unit value and the volume exported. This resulted in double-digit slumps in the export values of sugar, silver, zinc, bananas, lead and tobacco. In the case of coffee, the expansion of exports was attributable to an increase in volume, since its international price continued to be depressed. In the first quarter of 2003 coffee exports were up by 11%, which heralds a good year for this product.

Non-traditional exports turned in a mixed performance. Shrimp and soap and detergent recorded decreases, while the export value of all the other products went up. Maquila exports, which were strong performers throughout the 1990s, showed little growth in 2002.

Goods imports came to a virtual standstill (-0.1%) and imports of raw materials and intermediate goods were down by 3%, despite an increase in purchases of petroleum and fuels. The value of imports of construction materials tumbled by a third, as the period of reconstruction in the wake of hurricane Mitch drew to a close. By contrast, the value of imports of consumer and capital goods climbed slightly.

The services balance posted an upturn of US$ 50 million, mainly on the strength of the tourism sector's performance. The factor income balance worsened, with a downturn of US$ 20 million, while the balance of current transfers rose by US$ 30 million. This reflected the trend in family remittances, which continued to expand, reaching the equivalent of 11% of GDP. The balance-of-payments current-account deficit accordingly decreased from 4.6% of output in 2001 to 3.7% in 2002.

The capital and financial account posted a balance of US$ 190 million, which was US$ 40 million less than the 2001 figure. Long-term capital inflows were less abundant, but this downturn was partially offset by flows of short-term capital. Foreign direct investment declined from US$ 195 million in 2001 to US$ 143 million in 2002. Credit to the public sector moved from an inflow of US$ 124 million in 2001 to an outflow of US$ 10 million. Net international reserves expanded by US$ 214 million, bringing the total to US$ 1.85 billion, of which two thirds, or the equivalent of 4.3 months' worth of imports, are held by the central bank.

Mexico

1. General trends

In 2003 the Mexican economy looks set to complete a third consecutive year of virtual stagnation, having recorded average annual growth of 5.4% between 1996 and 2000. Gross domestic product (GDP) grew by 0.8% in 2002 –barely half the government's target– and an expansion of around 1.5% is forecast for 2003. This lacklustre performance is insufficient to avert fresh job losses or to halt the slide in per capita income. The 2002 result reflected a combination of sluggish consumption, a slide in investment for the second year running and a weak performance by non-oil exports, which had been the engine of Mexican economic growth in recent years. A robust upswing in oil exports and lower international interest rates gave contrast to an otherwise largely negative external panorama.

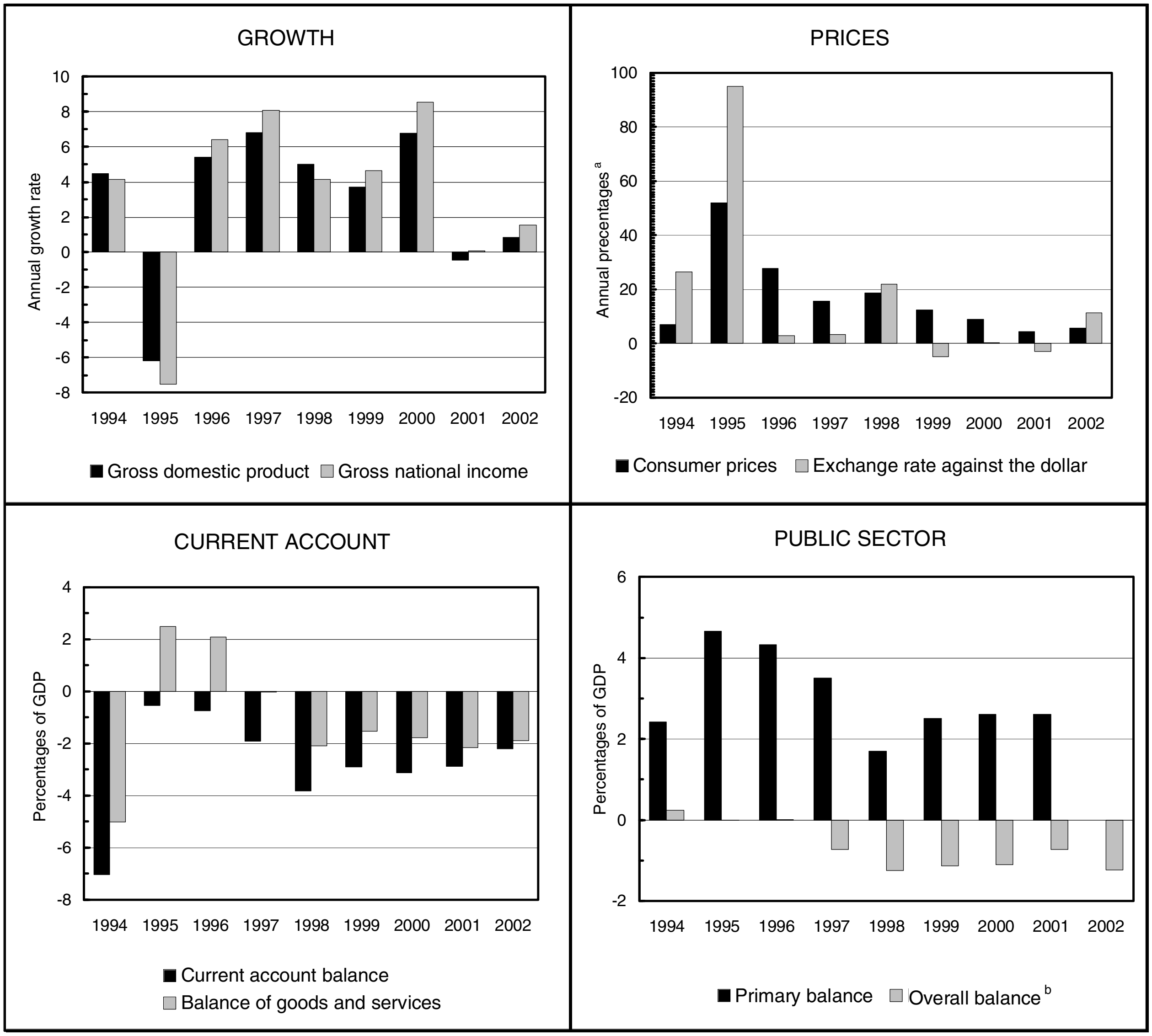
Although external trade was virtually flat in 2002, exports grew faster than imports, and this helped narrow the balance-of-payments current account deficit to 2.3% of GDP. Maquila exports (50% of the total) slumped, causing plant closures and numerous redundancies, as a knock-on effect of anaemic demand in the United States and the transfer of operations to other countries able to offer lower production costs. In contrast, oil exports benefited from the high price of crude on the international market. The transfers account revealed a steep rise in remittances from Mexicans living abroad (1.6% of output); and foreign direct investment (FDI) totalling US$ 13.6 billion was sufficient to finance almost the entire current account deficit on its own.

Economic policy was geared towards keeping economic fundamentals in balance by maintaining fiscal discipline and targeting public spending on social development and job creation. The sluggish performance of the productive sector stymied the government's efforts in this direction, however. The 2002 public-sector deficit, at 1.2% of GDP, exceeded the official target of 0.7%, largely because of the cost of reforming the rural credit system, which alone represented 0.6% of GDP.

Once again, the core objective of monetary policy was to keep inflation in check; nonetheless the rate rose to 5.7% in 2002, overshooting its target by 1.2 percentage points. During the first seven months of 2003 prices rose by only 1.4%, however, which suggests that the annual target of 3% announced for this year is within reach. The government's monetary policy stance shifted several times in 2002, in response to changing economic conditions. The downturn that occurred in the early months of 2002 led to a loosening of monetary policy in April, but as exchange- and interest-rate volatility began to threaten the authorities' grip on inflation, Banco de México increased liquidity requirements and maintained this tighter monetary policy into 2003.

Within the floating exchange-rate regime, the peso fluctuated in response to international economic and financial conditions during 2002, although its real parity

Figure 1
MEXICO: MAIN ECONOMIC INDICATORS



Source: ECLAC, on the basis of official figures.
[a] December-to-December variation.
[b] Includes interest.

for the year as a whole remained unchanged. This represented a break in the real appreciation of the peso which had been taking place since 1996. Nominal currency depreciation, compounded by the impact of bad weather on the prices of a number of foodstuffs, were responsible for pushing the overall price index more than one percentage point above the government's 4.5% target.

Overall demand rose by a modest 1.1% in 2002. This was driven mainly by private consumption, whose buoyancy reflected a 1.5% real increase in wages, further encouraged by consumer credit schemes implemented by banks and non-bank institutions. Investment, by contrast, retreated for the second year in a row. The production of tradable goods suffered from the effects of slacker external demand: agriculture, mining and manufacturing were down by 0.4%, 0.3% and 0.6%, respectively, while services grew robustly, especially financial services (4.4%), and electricity, gas and water (3.8%).

Formal employment (measured by the number of workers registered with the Mexican Social Security

Institute) shrank in 2002 for the second straight year, while the rate of open unemployment rose to 2.7%. The informal sector absorbed some of the labour not employed in formal activities, which translated into a high level of underemployment. Employment in the maquila industry contracted by 10% with the loss of 120,000 jobs.

In 2003 the Government has targeted economic policy on reviving production and employment, while ensuring prudence and economic discipline in order to maintain a stable and predictable environment. Fiscal policy has again been geared towards strengthening public finances and invigorating production, with a new focus on boosting the domestic market. Public spending has been aimed at redressing social deficits and restructuring security systems, together with the modernization and upkeep of the country's physical infrastructure.

Economic activity continued to crawl along in the early months of 2003, basically reflecting modest growth in external demand and a slow increase in investment. This has further perpetuated the torpid growth rates that have persisted for three years now. The uncertain path of recovery in the United States continues to conspire against the Mexican economy, even though the conclusion of the conflict in Iraq helped to calm financial volatility and removed a factor of uncertainty from the international panorama.

These developments, in conjunction with the approach of mid-year parliamentary elections in Mexico, have strengthened doubts over the future course of the domestic economy and are weighing on production and investment decisions. The official growth target of 3% announced at the beginning of the year now looks difficult to attain; growth of 1.5% would be more feasible, driven mainly by private consumer spending. Although this muted performance will make it hard for the Government to meet its fiscal deficit target of 0.6% of GDP, it should ease pressure on the balance of payments, and the current account deficit is now forecast at around 2% of output.

2. Economic policy

Against a backdrop of slack external demand and volatile economic expectations, monetary and foreign-exchange policies played a key role in preserving financial stability. The tonic was fiscal discipline and monetary austerity, but the structural reforms proposed by the Government –especially the fiscal component– failed to gain support. In 2003 economic policy continues to face a panorama of external vulnerability, dominated by uncertainty as to the course of the economic upswing in the United States, which largely determines the fate of any recovery in Mexico, at least in the short term.

a) Fiscal policy

Fiscal policy remained tight throughout 2002, with the level of economic activity acting as a drag on receipts, although non-recurrent revenues received by Petróleos Mexicanos (PEMEX) helped to narrow the deficit and facilitated an upturn in public investment, following its sharp contraction in 2001. In 2003 the Government has kept public spending on a tight rein and has pursued a cautious borrowing policy, while persisting in its efforts to increase receipts. A fiscal deficit of 0.6% of GDP is forecast for the year as a whole.

The public-sector deficit amounted to 1.2% of GDP in 2002, which was half a percentage point over target, partly because of the cost of winding up the rural credit institution Banrural and putting Financiera Rural in its place. Expenditure expanded by 6% in real terms, and income, by 4%; the higher spending was financed mainly by a 38% real increase in PEMEX revenues.

Public-sector budgetary income came in at around 22.6% of GDP, slightly below the level forecast early in the year. Tax revenues expanded by 6.1% in real terms and represented 11.8% of GDP; PEMEX revenues were up by 45%, accounting for 7.2% of GDP. The best revenue earners were income tax, thanks to administrative simplification measures; and levies on production and services, reflecting a higher rate of gasoline tax. This offset more modest expansions in VAT receipts (due to slacker growth in domestic sales) and in import duties (reflecting lower imports, and the implementation of tariff reductions as free trade agreements came into effect). Non-tax revenues contracted by 13% in real terms, reflecting a downturn in petroleum duties in the wake of smaller export volumes and weaker domestic sales by PEMEX.

Net budgetary expenditure in 2002 rose by 6% in real terms to absorb 23.7% of GDP –1% higher than budgeted at the start of the year. This was due to the liquidation of Banrural and the establishment of Financiera Rural, higher spending on social sectors, and

Table 1
MEXICO: MAIN ECONOMIC INDICATORS

	1994	1995	1996	1997	1998	1999	2000	2001	2002[a]
	Annual growth rates[b]								
Gross domestic product	4.5	-6.2	5.4	6.8	5.0	3.7	6.8	-0.5	0.8
Per capita gross domestic product	2.6	-7.8	3.7	5.1	3.3	2.1	5.2	-1.9	-0.6
Gross national income	4.2	-7.5	6.4	8.1	4.2	4.7	8.6	0.1	1.5
Gross domestic product by sector									
Agriculture	0.9	0.9	3.6	0.2	0.8	3.6	0.6	3.3	-0.4
Mining	2.5	-2.7	8.1	4.5	2.7	-2.1	3.8	0.8	-0.3
Manufacturing	4.1	-4.9	10.8	9.9	7.4	4.2	6.9	-3.7	-0.6
Electricity, gas and water	4.8	2.1	4.6	5.2	1.9	7.9	1.0	1.3	3.8
Construction	8.4	-23.5	9.8	9.3	4.2	5.0	5.1	-6.2	1.7
Wholesale and retail commerce, restaurants and hotels	6.8	-15.5	4.8	10.7	5.6	3.1	12.4	-2.0	-0.4
Transport, storage and communciations	8.7	-4.9	8.0	9.9	6.7	7.8	9.6	3.3	2.2
Financial establishments, insurance, real estate and business services	5.4	-0.3	0.6	3.7	4.6	3.6	5.2	5.0	4.4
Community, social and personal services	1.3	-2.3	1.0	3.3	2.9	2.1	2.9	-0.3	1.3
Gross domestic product by type of expenditure									
Consumption	3.9	-7.6	2.3	5.0	5.1	4.2	8.6	2.2	0.3
General government	2.9	-1.3	-0.7	2.9	2.3	4.7	2.0	-1.2	-1.3
Private	4.1	-8.4	2.8	5.3	5.5	4.1	9.5	2.6	0.5
Gross domestic investment	10.8	-36.0	27.0	26.3	9.7	3.5	10.9	-5.8	1.6
Exports of goods and services	16.4	25.5	17.5	13.0	11.4	12.9	15.7	-1.8	-0.6
Imports of goods and services	17.8	-17.1	23.8	22.8	15.0	13.0	21.8	0.0	-1.0
	Percentages of GDP								
Investment and saving									
Gross domestic investment [b]	25.1	17.1	20.6	24.4	25.5	25.4	26.4	25.0	25.2
Gross domestic investment [c d]	21.9	20.0	23.2	26.0	24.4	23.5	23.8	20.9	20.3
National saving [c]	15.0	19.4	22.6	24.1	20.5	20.6	20.8	18.0	18.1
External saving [c]	6.9	0.5	0.7	1.9	3.8	3.0	3.0	2.9	2.2
	Millions of dollars								
Balance of payments									
Current account	-29,662	-1,575	-2,508	-7,665	-16,072	-13,996	-18,160	-18,002	-14,058
Goods balance	-18,464	7,089	6,531	624	-7,914	-5,584	-8,003	-9,954	-7,997
Exports fob	60,882	79,542	96,000	110,431	117,460	136,391	166,455	158,443	160,682
Imports fob	-79,346	-72,453	-89,469	-109,808	-125,373	-141,975	-174,458	-168,396	-168,679
Services balance	-2,721	65	371	-747	-905	-1,799	-2,323	-3,558	-4,048
Factor income balance	-12,259	-12,689	-13,940	-12,790	-13,266	-12,926	-14,827	-13,829	-12,282
Current transfers balance	3,782	3,960	4,531	5,247	6,012	6,313	6,994	9,338	10,268
Capital and financial balance [e]	12,463	-14,735	7,805	21,663	19,282	18,272	25,269	25,327	21,148
Net foreign direct investment	10,973	9,526	9,185	12,830	11,602	12,476	15,318	25,221	13,627
Financial capital [f]	1,491	-24,261	-1,380	8,834	7,680	5,796	9,952	106	7,521
Overall balance	-17,199	-16,310	5,297	13,998	3,210	4,277	7,110	7,325	7,090
Variation in reserve assets [g]	18,398	-9,650	-1,774	-10,512	-2,138	-592	-2,824	-7,325	-7,090
Other financing [h]	-1,199	25,960	-3,524	-3,487	-1,072	-3,685	-4,286	0	0
Other external sector indicators									
Real effective exchange rate (index 2000=100)[i]	102.6	151.6	136.2	118.8	118.7	108.3	100.0	94.1	93.8
Terms of trade for goods (index 1997=100)	99.3	96.1	98.8	100.0	96.5	98.4	103.2	103.2	103.7
Net resource transfer (% of GDP)	-0.2	-0.5	-2.9	1.3	1.2	0.3	1.1	1.8	1.4
Gross external public debt (millions of dollars)	139,800	165,600	157,200	149,028	160,258	166,381	148,652	144,534	141,000

Table 1 (concluded)

	1994	1995	1996	1997	1998	1999	2000	2001	2002[a]
Gross external public debt (% of GDP)	33.1	57.8	47.3	37.1	38.0	34.6	25.6	23.2	22.1
Net interest and earnings (% of exports) [j]	-18.1	-15.0	-13.9	-11.2	-11.1	-9.3	-8.8	-8.7	-7.8
					Percentages				
Employment									
Labour force participation rate [k]	54.7	55.4	55.4	56.2	56.5	55.8	56.3	55.6	55.1
Open unemployment rate [l]	3.7	6.2	5.5	3.7	3.2	2.5	2.2	2.5	2.7
Visible underemployment rate [l]	14.4	16.4	16.0	14.8	12.2	11.3	11.7	11.2	9.8
					Annual percentages				
Prices									
Variation in consumer prices	7.1	52.0	27.7	15.7	18.6	12.3	9.0	4.4	5.7
Variation in producer prices	9.1	59.5	25.3	10.5	17.5	12.5	6.4	1.3	9.2
Variation in nominal exchange rate	26.5	95.0	2.8	3.3	21.8	-5.0	0.3	-2.9	11.2
Variation in average real wage	4.7	-13.0	-9.9	-1.2	2.8	0.9	6.1	6.6	1.5
Real deposit rate [m]	2.8	-9.1	-1.4	-0.5	-4.4	-1.3	-1.7	-0.1	-2.2
Real lending rate [n]	9.1	4.0	8.2	8.0	7.9	13.3	9.4	8.6	4.0
Equivalent deposit rate in foreign currency [o]	-10.4	-29.3	21.1	11.0	-6.6	15.4	5.9	7.9	-7.5
					Percentages of GDP				
Central government (federal government and social security)									
Current income	...	...	...	...	...	...	...	...	...
Current expenditure	...	...	...	...	...	...	...	...	...
Saving	...	...	...	...	...	...	...	...	...
Capital balance	...	...	...	...	...	...	...	...	...
Primary balance	2.4	4.7	4.3	3.5	1.7	2.5	2.6	2.6	0.0
Overall balance	0.2	0.0	0.0	-0.7	-1.2	-1.1	-1.1	-0.7	-1.2
Public debt	19.8	30.0	25.0	20.3	20.9	21.1	17.8	18.5	20.4
External	17.1	30.6	22.2	14.1	13.5	10.6	8.6	6.2	4.7
Domestic	2.7	-0.6	2.8	6.2	7.4	10.5	9.2	12.2	15.7
Interest payments (% of current income)									
Money and credit [p]									
Domestic credit [q]	37.9	40.1	27.3	32.5	34.4	31.0	29.0	27.3	25.2
To public sector	6.1	9.4	7.4	15.6	15.7	14.8	15.7	15.5	13.7
To private sector	31.8	30.8	19.9	17.0	18.7	16.2	13.3	11.8	11.5
Liquidity (M3)	40.5	37.4	35.1	36.3	38.5	40.3	40.2	44.0	47.5
Currency in circulation and domestic currency deposits (M2)	33.6	32.4	33.0	34.2	36.6	38.7	38.6	42.2	45.5
Foreign currency deposits	6.9	5.0	2.1	2.1	2.0	1.7	1.6	1.7	2.0

Source: ECLAC, on the basis of official figures.
[a] Preliminary figures. [b] Based on constant 1995 dollars, at the official adjusted exchange rate. [c] Based on figures in local currency at current prices. [d] In the base year 1995, the difference with respect to calculation at constant prices arises from the use, for this purpose only, of an adjusted official exchange rate. [e] Includes errors and omissions. [f] Refers to the balance on the capital and financial accounts, minus net foreign direct investment plus errors and omissions. [g] A negative sign denotes an increase in reserves. [h] Includes the use of credit and loans from IMF and exceptional financing. [i] Annual average, weighted by the value of exports and imports of goods. [j] Refers to net investment income divided by exports of goods and services from the balance of payments. [k] Economically active population as a percentage of the working-age population, urban areas. [l] Rates of unemployment and underemployment are percentages of the economically active population in urban areas. [m] Weighted average for 30-day deposits. [n] Average cost of 28-day loans for first tier firms in the securities market. [o] Rate on deposits deflated by the variation in the dollar exchange rate. [p] Average annual values used for monetary figures. [q] Net credit to the public and private sectors extended by commercial banks and other financial and banking institutions.

Table 2
MEXICO: MAIN QUARTERLY INDICATORS

	2001				2002[a]				2003[a]	
	I	II	III	IV	I	II	III	IV	I	II
Gross domestic product (change from same quarter of preceding year) [b]	1.8	0.0	-1.5	-1.5	-2.2	2.0	1.8	1.9	2.3	...
Goods exports fob (millions of dollars)	39,641	40,776	39,012	39,014	36,496	41,551	41,434	41,281	39,186	40,697
Goods imports cif (millions of dollars)	41,863	42,522	40,799	43,213	38,122	42,978	42,925	44,655	39,571	41,918
International reserves (millions of dollars)	38,036	38,730	39,415	40,091	42,229	42,723	44,981	46,099	51,096	52,899
Real effective exchange rate (2000=100) [c]	98.9	93.1	92.9	91.5	88.8	92.2	96.4	97.8	104.4	101.3
Urban unemployment rate	2.5	2.3	2.4	2.6	2.8	2.6	2.9	2.5	2.8	3.0
Consumer prices (12-month variation, %)	7.2	6.6	6.1	4.4	4.7	4.9	4.9	5.7	5.6	2.9
Average nominal exchange rate (new pesos per dollar)	9.7	9.2	9.2	9.3	9.1	9.5	9.9	10.2	10.8	10.5
Real average wage (change from same quarter of preceding year)	6.0	5.3	6.3	8.9	3.7	2.5	0.5	-0.3	0.8	1.3
Nominal interest rates (annualized percentages)										
Deposit rate [d]	6.7	5.2	3.8	3.2	3.0	2.8	2.8	2.9	3.0	2.7
Lending rate [e]	18.5	15.1	11.1	10.8	9.6	8.6	9.2	10.1	10.9	7.7
Interbank rate	18.0	14.0	10.4	9.1	8.5	7.7	8.1	8.4	9.7	6.7
Sovereign bond spread (basis points)	424	304	428	308	250	321	434	324	294	229
Stock price indexes (indexes, June 1997=100)	101.6	120.7	94.6	112.3	131.8	104.4	88.7	93.7	87.1	105.3
Domestic credit [f] (change from same quarter of preceding year)	5.7	-2.0	-2.6	-8.4	-8.2	0.8	-2.7	12.5	9.0	...
Mature credit as a porportion of total credit (%) g	5.6	5.2	5.3	5.1	5.0	5.0	4.8	4.6	4.6	...

Source: ECLAC, on the basis of official figures.
[a] Preliminary figures. [b] Based on figures in local currency at constant 1993 prices. [c] Quarterly average, weighted by the value of exports and imports of goods. [d] Weighted average for 30-day deposits. [e] Average cost of 28-day loans for first tier firms in the securities market. [f] Net credit to the public and private sectors extended by commercial banks and other financial and banking institutions. [g] Total credit extended by multiple banks.

growth in the number of pensioners. Excluding the Banrural- Financiera Rural operation, the real increase in spending would have been just 2.4%.

The public-sector borrowing requirement (PSBR) which uses the main public finance categories to measure the effect of government activity on financial markets, amounted to 2.6% of GDP at the end of 2002 (1.3 percentage points less than in 2001, and 0.4% below the government's forecast). In addition to the public-sector economic balance, PSBR takes account of financial intermediation and a number of contingent programmes.

In 2002 the bulk of public-sector financing came from the domestic market. Total public debt amounted to 25% of GDP, 1.6 percentage points more than in 2001, while external debt expanded by 0.7 percentage points to reach 12.5% of GDP, owing entirely to the nominal depreciation of the peso. Domestic debt rose by 0.9 points, also reaching 12.5% of GDP. International bond issues of US$ 4.066 billion provided the main source of external financing, which totalled US$ 9.4 billion. Amortization payments amounted to about US$ 16 billion, including prepayments.

b) Monetary and exchange-rate policy

The monetary policy pursued by Banco de México in 2002 was based on four main pillars: adoption of a long-term target for inflation; a 3% inflation target for 2003 and the years immediately following; a one percentage point band of tolerance around that target; and the continuation of monetary policy announcements through press releases on pre-established dates, with a view to increasing its transparency and effectiveness. Monetary prudence and liquidity constraints have been maintained in the first few months of 2003.

During the course of 2002, the monetary authority took successive steps to tighten liquidity. In February it announced a first increase of 60 million pesos per day in the "corto" mechanism, raising this to a level of 360 million pesos. This was intended to prevent inflationary expectations being stoked and prices in general being pushed up by the partial elimination of subsidies on residential electricity rates announced in January. In April, as the economic outlook brightened and no significant inflationary pressures had materialized, the Bank eased its monetary stance and restored the liquidity-constraint mechanism to its position at the start of the year, namely 300 million pesos.

In the second semester, international economic prospects took a turn for the worse, however, particularly in the United States. This had a negative impact on expectations throughout the Mexican economy, and was reflected in both the exchange rate and rates of interest on Mexican bonds on the international market. With exchange- and interest-rate volatility now threatening to jeopardize its control of inflation, Banco de México adjusted policy once more by tightening liquidity requirements, from 300 million to 400 million pesos from September onwards, and then again to 475 million pesos in December. The benchmark interest rate (Treasury Certificates) fell from an average of 11.3% in 2001 to 7.1% in 2002. Prices on the Mexican Stock Exchange (BMV) also fluctuated around a generally falling trend, taking their cue from the New York Stock Exchange.

Total lending to the private sector by banks and non-bank institutions rose by 3.4% in real terms, thereby breaking the downward trend that had persisted since 1995. This upturn was attributable to an increase in non-bank credit (7.7%), since commercial bank loans fell once more (-2%), in keeping with the pattern prevailing since the crisis of the mid-1990s. The real balance on bank credit to the private sector thus represented 42% of total lending in 2002 (having been 73% in 1994), and was equivalent to only 36% of its 1994 value.

In the framework of the floating exchange-rate regime adopted in 1995, there were a number of speculative attacks against the peso during the course of the year, all of them short-lived. In real terms, the exchange rate held steady at its 2001 level, thereby halting the real appreciation that had been proceeding inexorably since 1996, apart from a pause in 1998.

The local currency appreciated during the first few months of 2002, to reach nine pesos to the dollar in April, before starting a gradual depreciation which took it to 10.2 pesos per dollar by the end of the year. The exchange rate continued to rise during the first half of 2003, reaching the 11 peso mark by May.

c) Structural reform

The Government persevered with its trade diversification and liberalization strategy, and held negotiations aimed at signing free trade agreements with Japan, Singapore, Panama and the members of MERCOSUR.

Following its debate in Congress in late 2001, the government's integrated fiscal reform proposal ended up as measures that were too diluted to boost receipts and which, moreover, encountered an unfavourable economic environment on implementation. Public finances therefore remained fragile and heavily dependent on oil revenues. Other important measures, including reforms in the energy, telecommunications, labour and fiscal domains are awaiting approval or submission to Congress.

3. The main variables

a) Economic activity

Sluggish output growth in 2002 reflected very similar performances from the different components of aggregate supply and demand, forming a macroeconomic panorama that was generally weak. As in 2001, but in contrast to the 1995-2000 period, the economy patently lacked a dynamic component to drive growth forward. In 1995-2000 external demand and occasionally consumption and investment alternated in this role, but in the most recent biennium growth rates have dropped across the board.

Following a 2.8% downturn in aggregate demand in the first three months of 2002, the second quarter saw an upswing that held out the prospect of recovery. Nonetheless, demand sagged again at the end of the year –mainly because international pessimism restrained investment– and output was up by only 0.8% at the year's end. Exports and consumption posted meagre increases of 1.4% and 0.9%, respectively, while gross fixed capital formation declined for the second year in a row (-1.3%).

The modest consumption growth was driven by private consumer spending (up by 1.2%), which offset a decline in public consumption (-1.3%). Private consumption was impaired by job losses in the formal sector of the economy and the low purchasing power generated by informal employment; but it also benefited in 2002 and 2003 from a real increase in average wages in some sectors, and from medium- and long-term bank and non-bank financing schemes at low interest rates, mainly for durable goods purchases. Bank and non-bank consumer lending to the private sector thus increased in real terms for the third straight year at double-digit rates (14% and 23%, respectively). Non-bank credit played a major part in this, accounting for almost half of all consumer lending at the end of 2002, compared to just 4% in 1994.

Investment growth in construction (1.7%) was not enough to offset a decline in the machinery and equipment segment (-3.7%). Gross fixed capital formation continued to trend downwards into the early months of 2003, thereby highlighting the obstacles facing economic revival in the medium term. Private investment contracted by 2.8%, while its public-sector counterpart expanded by 7.3%. The decline in private investment –for the second year running– was attributable to uncertain economic expectations and negligible growth in corporate profits. Public investment, meanwhile, was directed at energy, roads, education and potable water supply.

Activities targeting the external market saw slower growth in some cases and even negative rates in others, especially in the second half of 2002, compared to activities that are more dependent on domestic demand. Following an upturn in the first three quarters, agriculture declined by 4.5% in the final period, resulting in an average downturn of 0.4% for the year overall, which carried over into the first quarter of 2003 (-0.2%). This result reflected a combination of climatic factors that came into play at the end of the year and affected a wide range of products including maize, wheat, oranges, sorghum, rice, soya and avocados.

The industrial sector as a whole stood still in 2002. Dragged down by the effects of the slowdown in the United States, mining and manufacturing declined by 0.3% and 0.6%, respectively, while non-tradable production sectors, such as construction, and electricity, gas and water, expanded by 1.7% and 3.8%, respectively. Growth in construction largely represented public works, mainly in the petroleum, petrochemicals, electricity and communications sectors, which persisted into the first quarter of 2003 generating a further expansion of 1.8%.

In 2002, manufacturing output contracted in 26 of its 49 segments, of which the hardest hit were textiles (-6.2%), metallic products and machinery (-1.7%) and miscellaneous manufactures (-2%), although there has been a slight rebound in 2003 (0.9% in the first quarter). In contrast to the previous year, the automotive industry slumped badly in the early months of 2003, with production down by 14% in the wake of 11.6% and 21% reductions in domestic and foreign sales, respectively.

The maquila industry also experienced a steep downturn. At the end of 2002 there was a total of 3,248 establishments in the industry –515 down from their June 2001 peak. Plant closures generally reflected lacklustre demand in the United States market, although several operations transferred production to locations that were more attractive in terms of labour cost, productivity and local linkages. The wave of closures appears to have died down in 2003, and the number of establishments recorded in April was practically unchanged from the December 2002 figure.

GDP growth in 2002 and the first quarter of 2003 was driven by services, which expanded by 2.3% overall in 2002, and by 2.8% between January and March 2003. In 2002 the commerce, restaurants and hotels segment declined by 0.4%, reflecting its reliance on the external sector; but transport and communications grew by 2.2% thanks to demand for telephone services and rail, maritime and road transport. Financial services, insurance and real estate expanded by 4.4%, on the back of an increase in financial intermediation and housing rental. Meanwhile, community, social and personal services grew by 1.3%.

b) Prices, wages and employment

In 2002 Banco de México reiterated its long-term objective of achieving convergence between domestic inflation and price increases in the United States and Canada. The rate of inflation posted in 2002 was 1.2 percentage points above the forecast issued by the Government at the end the previous year, following three straight years in which targets had been achieved. The factors that prevented the target from being met in 2002 included the large rises in residential electricity and domestic gas charges, and price rises in the fruit and vegetable category.

Electricity charges fell in the northern cities at the start of the 2003 warm season; and the prices of certain goods, especially agricultural products, declined. Inflation was negative in May and very slightly positive in the following months, thereby lowering the annualized rate from 5.7% in December 2002 to 4.1% in July 2003.

As firms had to adjust their production levels in response to slacker demand (especially externally) large numbers of workers were laid off, particularly in the export sector. Manufacturing sustained the heaviest job losses (-5.9%) in 2002, while 120,000 jobs were lost in the maquila sector. Jobs were created in sectors producing for domestic consumption, however.

The average number of workers registered with the Mexican Social Security Institute (IMSS) declined in 2002 for the second year running, from an average of 12.54 million in 2001 to 12.435 million in 2002. This meant an additional loss of 0.8%, or over 100,000 jobs, following a 0.5% decrease in 2001. This was due entirely to a reduction in the number of permanent workers registered, since the number of temporary workers actually increased slightly.

Labour demand contracted in the formal sector, although informal activities appear to have absorbed large numbers of workers. This would account for the relatively small increase in the rate of open unemployment, from 2.5% in 2001 to 2.7% in 2002. Workers employed for less than 35 hours per week, together with the openly unemployed, accounted for 18.6% of the economically active population (EAP), as was the case in 2001.

According to the National Institute of Statistics, Geography and Information (INEGI), 200,000 workers joined the informal economy in the first quarter of 2003, making a total of 10.6 million or 26.2% of the total employed population. The working population not receiving social-security benefit of any kind grew by 2.1% in the same period.

Employment in the maquila sector –which has been the leader in terms of job creation for the last two decades– slipped for the second year running. Hours worked and employment declined by 10%, and the average number of maquila workers dropped from just over 1.2 million to under 1.1 million.

For a several years now, the economy has been unable to generate quality jobs in sufficient numbers, and job creation is falling ever further behind the rate of over one million new jobs per year needed to absorb workers joining the labour market. Informal activities can act as a social cushion, but they create low-paid, low-productivity jobs with no access to social security.

Real average wages continued to trend upwards, which, in conjunction with the low rate of economic activity, resulted in higher unit labour costs. Real wages rose by 1.5% in manufacturing, and by 4.2% in the maquila sector. The latter partly reflected severance payments to workers laid-off, which are included in wage calculations. In the commerce segment real wages rose by 3.5%. Labour productivity expanded by 5.4% and 1.4% in manufacturing and maquila activities, respectively, but slipped back by 2.3% in the commerce sector. Taken in conjunction with wage trends, these figures meant lower unit labour costs in manufacturing (-3,6%) but higher costs in maquila and commerce (2.8% and 6%, respectively).

c) The external sector

In 2002 the balance-of-payments current account deficit came in at US$ 14.1 billion, which was almost US$ 4 billion less than the figure for 2001 and equivalent to 2.3% of GDP. Three factors were responsible for this result: a reduction of almost US$ 1.5 billion in the trade deficit, due to growth in the value of goods and service exports (1.3%), while the value of imports virtually stagnated (0.4%); a decrease of US$ 1.5 billion in interest payments and profit remittances; and an increase of over US$ 900 million in the surplus on the transfers account, thanks to remittances from Mexicans living abroad, mainly in the United States.

The merchandise balance recorded a deficit of US$ 8 billion in 2002 –20% less than in the previous year, thanks to an increase in the value of oil exports (13%). The latter benefited from a US$ 3 rise in the average price per barrel, to US$ 21.58, which surpassed the government's estimates for 2002 by US$ 4.28. The total value of merchandise exports amounted to almost US$ 161 billion.

Non-oil exports expanded by 0.4% overall. Agricultural exports fell by 1.9%, due to reduced sales of fresh vegetables and produce, coffee and garbanzo beans, while tomatoes, maize, melons and watermelons, and some fresh fruits posted larger sales. Low growth in the value of manufacturing exports (1.1%) can be blamed on weak demand in the United States, which absorbs 89% of all shipments.

A small rise in the value of imports (0.2%) was attributable to modest growth in production, domestic demand and manufacturing exports. The latter's large imported input component, together with a high level of intra-firm exchange, are characteristic of Mexico's external manufacturing trade. Imports totalled almost US$ 169 billion, of which three quarters corresponded to intermediate inputs, and the rest to capital and consumer goods in equal proportions.

Intermediate and consumer goods imports expanded by 0.3% and 7.2%, respectively, while capital goods purchases fell by 6.7%, in the wake of faltering investment. Imports of intermediate goods by the maquila sector expanded by 2.9%, but those destined for the manufacturing sector retreated by 2%. Manufactured goods accounted for 95% of all Mexico's imports.

The early months of 2003 witnessed an upturn in external trade. In the first four months the trade deficit narrowed by 51%, thanks chiefly to the persistently high prices obtained for crude oil (US$ 24.60 per barrel on average during the first five months of the year) and the slow pace of capital goods imports. Total exports grew by 3.7% and imports, by 1.5% between January and April. Maquila exports dropped 2.3% and non-maquila exports rose by 9.5%. The price of crude oil trended downwards (from US$ 27.86 per barrel in January to US$ 22.40 in May), as a result of higher stocks in the United States and the possibility production in Nigeria, Iraq and Venezuela being put on a more regular footing.

Net remittances from Mexicans living abroad totalled about US$ 10.3 billion in 2002, equivalent to 1.7% of GDP and over three quarters of the value of crude oil exports. From 1995 to 2002 remittances expanded at an average annual rate of 14.6%. This trend has carried over into 2003, with family remittances reaching a level of US$ 2.7 billion in the first quarter – 26% more than in the same period a year earlier.

The capital account turned in a surplus of just over US$ 20 billion in 2002, which was a similar figure to the average for the last five-year period, although US$ 4 billion less than in 2001. The year-on-year decrease was mainly due to lower public-sector borrowing.

In 2002 foreign direct investment (FDI) amounted to US$ 13.6 billion. This was barely more than half the figure recorded in 2001, which had been inflated by the exceptional revenue received that year from the sale of the Banamex group to CitiCorp. Average annual FDI over the last five years (not counting the Banamex sale) was almost US$ 13.5 billion. New investment accounted for 49% of all investment received, reinvestment of earnings 16%, imports of fixed assets by maquila firms 15%, and borrowing by firms from their parent companies abroad, the remaining 20%. A sectoral breakdown shows that 42% was channelled to manufacturing, 30% to financial services, 12% to commerce and 8% to transport and communications. As much as 73% of all FDI came from the United States.

During the first quarter of 2003, FDI decreased by 2.7% with respect to the same period in 2002, dropping to US$ 2.6 billion. More than half of this went to manufacturing industry; a total of US$ 13 billion is expected for the year overall.

Exceptional revenues from oil exports drove up international reserves by US$ 7 billion in 2002, making a total of US$ 48 billion. By May 2003 the figure had reached a record of almost US$ 55 billion. In view of the rising cost of carrying these reserves, Banco de México introduced a mechanism to slow the rate of accumulation. This came into effect on 2 May 2003 and consists of the daily auction of a fixed amount of dollars to domestic lending institutions. The daily amount to be sold is preestablished every three months; for the first period of operation the figure was set at US$ 32 million.

Nicaragua

1. General trends

For the third consecutive year, the Nicaraguan economy experienced a slowdown. In 2002, GDP increased by a mere 0.7%, which represented a decrease of more than two percentage points with respect to the previous year. This translated into a further reduction of the country's already very low per capita GDP (-1.9%) and an increase in open urban unemployment from 11% to 12%.

The smaller increase in GDP was linked to the deterioration in the terms of trade, the slow growth of the global economy and world trade, and the fiscal adjustment process, which mainly affected public-sector investment. Another factor that contributed to this poor economic performance was the political uncertainty resulting from the lack of parliamentary support for initiatives developed by the executive branch, which in turn marred the investment climate and delayed the conclusion of a new agreement with the International Monetary Fund (IMF).

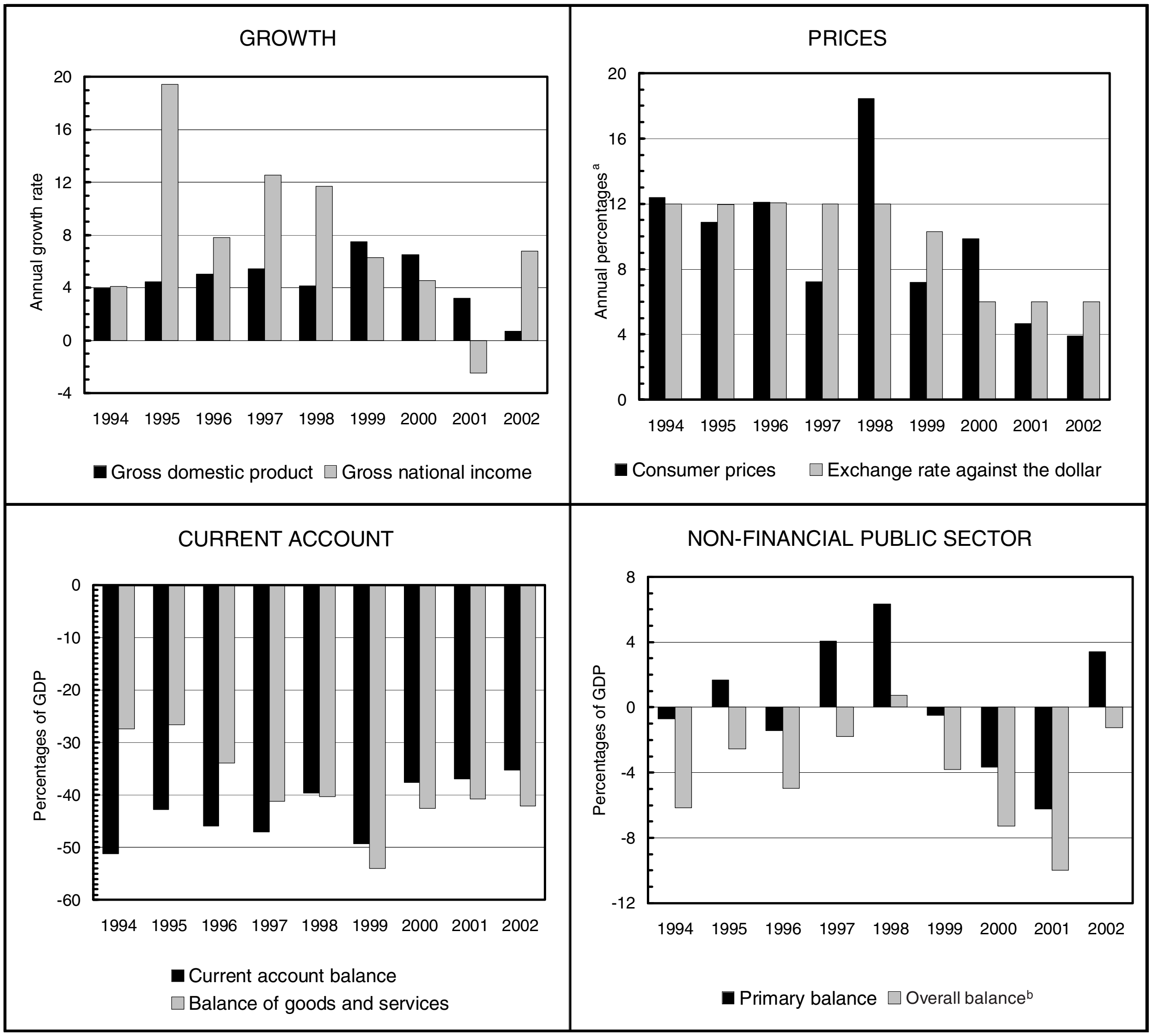
In December 2002, the government signed a three-year agreement with IMF that will permit Nicaragua to regain access to international financial cooperation and reach what is known as the "completion point" in the Heavily Indebted Poor Countries (HIPC) Debt Initiative, which will allow it to reduce its external debt considerably. The programme is designed to promote economic growth and poverty relief in a climate of low inflation and fiscal sustainability. The proposed strategy involves combining a smaller fiscal deficit with increased and more effective social expenditure aimed at combating poverty. Monetary policy is directed towards stabilizing prices, improving the financial position of the central bank and boosting international reserves.

This poor performance marked the end of eight years of economic growth, during which an average annual growth rate of 4.8% had raised per capita GDP from US$ 420 to US$ 479 (at 1995 prices). This constituted a partial recovery from the sharp declines caused by the serious political and economic crisis that had disrupted all production activity during the 1980s. Much of this recovery was attributable to voluminous inflows of external resources in the form of grants and donations, family remittances and soft loans.

A further fall in inflation brought the level down to 4% in 2002. The slope of the currency band remained at 6% for the year, which resulted in an increase in the real exchange rate. Unlike the previous year, fiscal policy was tight, and this helped the country to achieve its monetary policy objectives in terms of stabilizing prices and the exchange rate. The total public-sector deficit decreased from 16.4% to 9.2% of GDP and the balance-of-payments current account deficit shrank. Official and private capital and disbursements earmarked for balance-of-payments support under the IMF agreement covered the current account deficit and contributed to a build-up in net international reserves, thus providing stronger foreign-exchange backing for the monetary base.

Under the government's economic programme for 2003, GDP is projected to increase by 3% in real terms, inflation is expected to be 6% and the slope of the currency band is to remain the same. During the first

Figure 1
NICARAGUA: MAIN ECONOMIC INDICATORS



Source: ECLAC, on the basis of official figures.
[a] December-to-December variation.

semester of 2003, prices rose by 4.3%. However, the virtual stagnation of economic activity in the first quarter suggests that the annual growth rate will be 1.5% lower than government projections. The fiscal adjustment process should reduce the consolidated public-sector deficit to 6.3% of GDP, and the balance-of-payments current account deficit, measured as a percentage of GDP, is expected to narrow slightly.

2. Economic policy

In 2003, the country embarked upon an intensive macroeconomic adjustment process in an effort to reduce the extreme financial and external vulnerability caused by a growing fiscal deficit, mounting liabilities, an increase in the central bank's quasi-fiscal deficit, a strong upswing in domestic public debt and declining net international reserves. Macroeconomic policy was quite austere, and policy measures were focused on scaling back the fiscal deficit and building up international reserves to pave the way for a gradual decrease in the domestic public debt.

In 2002, a tax reform bill was passed that is designed to expand the tax base by cutting down on tax exemptions and special tax regimes, make the tax structure less regressive and combat tax evasion. Steps were also taken to align budgetary expenditure with the level of available resources and the country's poverty reduction strategy. Monetary policy remained tight, and fiscal policy became slightly more contractionary. It should also be pointed out that government savings and the easing of fiscal pressure facilitated the management of monetary policy and, to a certain degree, helped to improve the financial position of the central bank.

a) Fiscal policy

The new Administration that took office at the beginning of the year adopted measures to narrow the fiscal deficit. In particular, the authorities curbed public expenditure and, in July 2002, the National Assembly cut that year's budget by 1.5% of GDP. In August, the National Assembly also approved a tax package aimed at significantly reducing tariff and income tax exemptions and at raising corporate and withholding tax rates. Although the National Assembly added new items that are exempt from the general sales tax to the basket of staple goods, the tax reform bill still had a positive effect on revenues.

The central government's current revenues were up by 19.2%, the tax burden represented 22.7% of GDP, and grants and donations rose to 7.2% of GDP. As a result, total revenues went from 27.4% in 2001 to 31.1% in 2002. The sources of revenue that showed the sharpest increases were income tax collections (25.1%) and tariffs (18.8%), whereas revenues from the general sales tax dropped by 1.8%.

In addition, total central government expenditure was down from 38.8% to 33.1% of GDP. The main cause of this was the substantial cutback in investment expenditure (-23%), since current expenditure decreased by only 2.6% owing to the sizeable increase in interest payments (32.1%) occasioned by the external debt service and the cost of bailing out the banking system following the crisis in 2000-2001. As a result, the fiscal deficit fell from 11.4% of GDP in 2001 to 2.1% in 2002. Even excluding donations, the deficit still dropped from 16.4% to 9.2% of GDP. Unlike what occurred in 2001, the current account surplus and proceeds from privatizations reduced the need for external financing. In addition, the government transferred the equivalent of 3.9% of GDP to the central bank, i.e. half the amount of financing that the latter had extended to the government the year before.

After several bilateral creditors agreed to forgive portions of the country's financial obligations, the balance of the external public debt dipped slightly to US$ 6.363 billion (252% of GDP). Debt servicing amounted to US$ 158 million, or 6% of GDP.

In order to permit fiscal targets to be reached and to reinforce the poverty reduction strategy, in February 2003 the National Assembly approved an amendment to the law providing for the expansion of the tax base. At the end of April, reforms of the tax system and general budget for 2003 were approved, in accordance with the commitments made with IMF. The object of this tax reform –the sixth in seven years– was to boost tax collections by 1.7% of GDP, promote exports and secure the forgiveness of 80% of the country's external debt. Higher budget allocations for various social sectors and an upturn in investment in infrastructure are also expected.

b) Monetary policy

The fiscal adjustment policy was designed in conjunction with a looser monetary policy. The main aims were to ensure that international reserves remained at a level conducive to the maintenance of exchange-rate stability as an anchor against inflation, and to reduce domestic debt with a view to increasing liquidity in the banking sector and thus narrowing interest-rate spreads. This coincided with the beginning of the process of recovering the assets of commercial banks that had been liquidated in previous years.

The central bank maintained the reserve requirement rate of 19.25% that had been established in September

Table 1
NICARAGUA: MAIN ECONOMIC INDICATORS

	1994	1995	1996	1997	1998	1999	2000	2001	2002[a]
	Annual growth rates [b]								
Gross domestic product	4.0	4.4	5.1	5.4	4.1	7.5	6.5	3.2	0.7
Per capita gross domestic product	0.9	1.5	2.2	2.6	1.4	4.7	3.7	0.5	-1.9
Gross national income	4.1	19.4	7.8	12.5	11.7	6.3	4.6	-2.5	6.8
Gross domestic product by sector									
Agriculture	10.9	5.0	7.1	8.3	3.5	8.1	12.5	3.1	-2.9
Mining	-10.1	30.3	30.9	24.7	44.6	12.9	-16.0	4.8	16.8
Manufacturing	0.8	2.8	2.4	3.8	2.1	3.9	2.6	2.7	2.3
Electricity, gas and water	3.4	5.8	5.9	6.0	3.1	1.0	2.0	2.5	2.8
Construction	17.8	17.5	18.1	10.0	10.4	47.3	10.4	5.2	0.4
Wholesale and retail commerce, restaurants and hotels	1.6	5.1	5.1	5.3	4.9	5.7	3.9	3.4	3.1
Transport, storage and communciations	-0.6	5.1	4.7	5.3	4.7	5.7	3.9	3.4	3.1
Financial establishments, insurance, real estate and business services	0.9	3.3	3.5	4.1	3.4	4.8	3.8	3.8	3.8
Community, social and personal services	-3.2	0.0	-1.4	-2.8	1.7	1.3	1.5	1.9	2.0
Gross domestic product by type of expenditure									
Consumption	1.7	2.5	8.3	7.6	5.2	3.8	0.0	2.1	-2.6
General government	-2.7	-0.4	6.4	-0.4	0.1	11.3	2.0	9.5	-16.6
Private	2.5	3.1	8.6	9.0	6.0	2.7	-0.4	0.8	-0.1
Gross domestic investment	26.1	19.1	9.8	19.3	11.0	37.8	-11.8	-3.1	11.9
Exports of goods and services	14.7	14.2	6.9	20.4	7.0	8.5	12.8	8.7	-6.4
Imports of goods and services	12.3	11.6	13.7	22.2	9.8	14.9	-7.8	1.8	-3.3
	Percentages of GDP								
Investment and saving									
Gross domestic investment [b]	21.4	24.3	25.4	28.8	30.7	39.3	32.6	30.6	34.0
Gross domestic investment [c d]	22.8	24.9	27.0	31.7	33.8	43.3	35.0	32.8	36.5
National saving [c]	-28.3	-17.9	-18.9	-15.4	-5.9	-6.0	-2.6	-5.5	1.3
External saving [c]	51.2	42.8	45.9	47.1	39.6	49.3	37.7	38.3	35.2
	Millions of dollars								
Balance of payments									
Current account	-912	-785	-881	-927	-820	-1,092	-917	-946	-888
Goods balance	-433	-388	-531	-733	-755	-1,079	-920	-921	-935
Exports fob	348	493	512	637	642	620	728	699	702
Imports fob	-781	-881	-1,043	-1,371	-1,397	-1,699	-1,648	-1,620	-1,636
Services balance	-57	-100	-121	-79	-80	-116	-115	-120	-126
Factor income balance	-472	-372	-324	-265	-185	-197	-202	-240	-203
Current transfers balance	50	75	95	150	200	300	320	336	377
Capital and financial balance [e]	-250	108	421	1,000	590	1,001	717	679	678
Net foreign direct investment	40	75	97	173	184	300	265	150	174
Financial capital [f]	-290	33	324	827	406	701	452	529	504
Overall balance	-1,162	-677	-460	73	-229	-90	-199	-266	-210
Variation in reserve assets [g]	-85	12	-53	-173	31	-156	16	114	-71
Other financing [h]	1,246	665	513	100	199	247	183	153	281
Other external sector indicators									
Real effective exchange rate (index 2000=100) [i]	88.8	95.8	98.0	102.0	102.6	102.9	100.0	101.5	105.5
Terms of trade for goods (index 1997=100)	113.8	119.3	105.0	100.0	104.2	96.7	92.2	84.5	83.2
Net resource transfer (% of GDP)	29.4	21.9	31.8	42.5	29.2	47.5	28.7	23.1	30.0
Gross external public debt (millions of dollars)	11,695	10,248	6,094	6,001	6,287	6,549	6,660	6,374	6,363
Gross external public debt (% of GDP)	656.4	558.5	317.4	304.9	304.0	295.8	273.5	249.2	252.3
Net interest and earnings (% of exports) [j]	-101.8	-60.8	-50.3	-33.2	-22.3	-23.5	-21.1	-25.8	-22.4

Table 1 (concluded)

	1994	1995	1996	1997	1998	1999	2000	2001	2002[a]
				Percentages					
Employment									
Labour force participation rate [k]	46.4	46.8	48.9	...	...	...	...	...	57.5
Open unemployment rate [l]	17.1	16.9	16.0	14.3	13.2	10.7	9.8	11.3	11.6
				Annual percentages					
Prices									
Variation in consumer prices	12.4	10.9	12.1	7.3	18.5	7.2	9.9	4.7	3.9
Variation in nominal exchange rate	12.0	12.0	12.1	12.0	12.0	10.3	6.0	6.0	6.0
Variation in average real wage	5.3	1.8	-2.1	-0.2	7.4	4.4	1.6	4.3	4.3
Real deposit rate [m]	0.1	0.0	0.9	3.9	-5.6	1.6	-0.3	4.8	2.5
Real lending rate [n]	7.7	7.8	8.4	11.9	3.6	12.6	10.6	18.1	17.6
Equivalent deposit rate in foreign currency [o]	-0.3	-0.8	0.3	0.3	-1.1	0.0	3.2	2.8	1.2
				Percentages of GDP					
Non-financial public sector									
Current income	29.9	31.6	31.9	34.5	38.2	34.8	31.4	30.1	31.5
Current expenditure	27.4	25.3	26.5	26.9	28.2	26.2	27.0	29.5	28.0
Saving	2.4	6.3	5.4	7.7	10.0	8.6	4.5	0.5	3.5
Capital balance	-15.4	-17.9	-20.0	-15.0	-13.0	-21.1	-19.0	-16.6	-12.7
Primary balance	-0.7	1.7	-1.4	4.1	6.4	-0.5	-3.7	-6.2	3.4
Overall balance	-6.1	-2.5	-5.0	-1.8	0.7	-3.8	-7.3	-10.0	-1.2
Public debt	666.9	574.8	342.7	353.0	347.3	331.8	318.0	313.1	329.9
External	656.4	558.5	317.4	304.9	304.0	295.8	273.5	249.2	252.3
Domestic	10.5	16.3	25.3	48.1	43.3	36.0	44.5	63.9	77.6
Interest payments (% of current income)	18.2	13.3	11.1	17.0	14.7	9.5	11.5	12.6	14.8
Money and credit [p]									
Domestic credit [q]	39.0	32.7	29.7	37.2	41.5	49.1	53.3	43.8	41.3
To public sector	0.2	0.3	0.9	4.9	2.6	3.0	4.6	3.9	3.6
To private sector	38.8	32.4	28.9	32.3	38.9	46.1	48.8	40.0	37.7
Liquidity (M3)	34.6	40.5	49.0	65.5	71.3	73.8	65.3	61.6	67.9
Currency in circulation and domestic currency deposits (M2)	20.0	20.4	21.8	27.1	26.9	28.3	23.3	21.8	22.4
Foreign currency deposits	14.6	20.1	27.2	38.4	44.4	45.6	42.0	39.8	45.5

Source: ECLAC, on the basis of official figures.
[a] Preliminary figures. [b] Based on constant 1995 dollars, at the official adjusted exchange rate. [c] Based on figures in local currency at current prices. [d] In the base year 1995, the difference with respect to calculation at constant prices arises from the use, for this purpose only, of an adjusted official exchange rate. [e] Includes errors and omissions. [f] Refers to the balance on the capital and financial accounts, minus net foreign direct investment plus errors and omissions. [g] A negative sign denotes an increase in reserves. [h] Includes the use of credit and loans from IMF and exceptional financing. [i] Annual average, weighted by the value of exports and exports and imports of goods. [j] Refers to net investment income divided by exports of goods and services from the balance of payments. [k] Economically active population as a percentage of the working-age population, nationwide total. [l] Unemployed as a percentage of the economically active population, nationwide total. [m] Thirty-day deposits in commercial banks. [n] Eighteeen-month loans from commerical banks. [o] Rate on deposits, deflated by the variation in the dollar exchange rate. [p] Average annual values used for monetary figures. [q] Net credit to the public and private sectors extended by commercial banks and other financial and banking institutions.

2001. The decline in the fiscal deficit facilitated the achievement of the targets set for the exchange rate and price stability. Credit extended by the financial system to the non-financial public sector (NFPS), which had increased by 30% in 2001, shrank by 2.5%. Private-sector credit rose by 14.3%, after having been down by 43.5% in 2001. Credit did not begin to expand until the second half of the year, and an analysis of loan portfolios reveals a trend towards higher levels of consumer, commercial and housing loans. A slight contraction in the production sectors' share of credit was observed.

The increase in the money supply resulted in lower nominal interest rates. The financial spread held steady at around seven percentage points. Given the prevailing climate of uncertainty, banks continued to acquire indexed public debt instruments despite their lower

Table 2
NICARAGUA: MAIN QUARTERLY INDICATORS

	2001				2002[a]				2003[a]	
	I	II	III	IV	I	II	III	IV	I	II
Goods exports fob (millions of dollars)	167	179	136	124	163	159	147	127	156	...
Goods imports cif (millions of dollars)	441	466	464	408	447	442	452	454	453	...
International reserves (millions of dollars)	413	368	337	380	409	389	364	448	436	...
Real effective exchange rate (2000=100) [b]	100.6	101.0	100.6	103.7	103.9	104.7	105.6	107.7	107.9	109.5
Consumer prices (12-month variation, %)	7.7	7.7	7.3	4.7	4.2	3.4	4.5	4.0	5.1	5.3
Average nominal exchange rate (córdobas per dollar)	13.2	13.3	13.3	13.7	13.9	14.1	14.4	14.6	14.7	14.8
Nominal interest rates (annualized percentages)										
Deposit rate [c]	9.2	9.0	8.9	9.0	8.8	7.4	6.6	6.4	6.3	...
Lending rate [d]	22.3	22.4	22.8	23.7	22.9	23.1	23.4	23.3	23.3	...
Interbank rate [e]	42.4	40.1	38.3	40.2	40.7	42.1	41.3	41.9	41.6	...
Domestic credit [f] (change from same quarter of preceding year)	-19.4	-1.5	-7.6	-10.7	31.8	...	...	...	...	...
Mature bank credit as a porportion of total credit (%) [g]	5.4	5.3	4.0	3.3	3.8	4.0	3.9	3.4	3.5	...

Source: ECLAC, on the basis of official figures.
[a] Preliminary figures. [b] Quarterly average, weighted by the value of exports and imports of goods. [c] Weighted average for 30-day deposits. [d] Weighted average for short-term loans. [e] Overnight and extra assistance rates. [f] Net credit to the public and private sectors extended by commercial banks and other financial and banking institutions. [g] Total credit extended by the financial system.

yields. It is worth pointing out that the average rate of return on 360-day negotiable investment certificates (CENIs) –the central bank's main instrument of monetary control– slipped from 18.8% in 2001 to 12.9% in 2002.

The monetary base expanded by 7.6% due to the monetization of the central bank's losses, its net purchases of reserve currencies on the foreign-exchange market and the redemption of negotiable certificates. The increase was partly offset by larger NFPS deposits in the central bank and issues of securities.

As a result, broad money (M3) expanded by 11.2%. At the same time, economic agents were shifting financial assets out of demand deposits and into dollar-denominated time deposits, which have now come to account for more than 75% of total deposits.

c) Exchange-rate policy

The system of pre-announced daily mini-devaluations continued to operate at the annual rate of 6% that has applied since November 1999. In this context, the real effective exchange rate against the United States dollar depreciated by 3.9%.

d) Trade policy

The key items on the trade policy agenda were the continuation of the trade liberalization process and the reduction of trade barriers with the country's main trade partners. These measures included the opening of negotiations for a free trade agreement with the United States and progress in the creation of a customs union with the other countries of Central America.

e) Structural reforms

Structural reforms have progressed slowly, but a great deal of headway has been made in strengthening the prudential regulation and supervision of the banking system. As part of the privatization of the generating units of the Nicaraguan electricity company, Empresa Nicaragüense de Electricidad (ENEL), one of these units, the Generadora Eléctrica Occidental, S.A. (GEOSA), was sold to the United States company, Coastal Power. This process continued to be hampered by a series of legal and administrative obstacles, however. Delays in restructuring the Nicaraguan Social Security Institute and in establishing a superintendency for the pension system also held back the start-up of private pension fund administrators.

3. The main variables

a) Economic activity

Economic activity was dampened by the sluggishness of the external market, the further deterioration of the terms of trade, the fiscal adjustment process and the delay in signing another three-year agreement with IMF. The decline in economic activity was also due to the fact that producers and investors were slow to regain confidence following the political uncertainty caused by disagreements between the government and the National Assembly.

In a context of lower exports and cuts in public expenditure, the 0.7% increase in GDP was attributable to higher private-sector investment. This upswing was associated with rising real wages, the high level of family remittances and greater foreign direct investment in the EPZs, the food industry, electrical energy generation and distribution, and telecommunications (especially mobile telephones). The marked increase in gross fixed investment (6.3%) offset the downturn of the last two years, which had been triggered by political and financial uncertainty fueled by the elections and the banking crisis.

On the supply side, GDP expanded more slowly owing to the slippage of the goods production sector, which reflected the contraction in agriculture and fisheries and the near-stagnation of construction. Services, on the other hand, showed growth rates similar to those of the previous year.

The performance of the agricultural sector was hurt by a combination of adverse factors, including unfavourable weather conditions, low international prices for some of its principal exports and problems with respect to financing.

Although the output of staple grains increased (except for rice and soybeans), agricultural activity was down by 7.2%, which was attributable to a slump in export crops, especially coffee. Despite the fact that most producers' debts were rescheduled, the abandonment of low-productivity areas, lower investment (particularly in maintenance) and the muted recovery of international grain prices following their collapse in 2000-2001 combined to drive down coffee output (-32%). The livestock sector performed well (6.7%). This result was largely a reflection of increases in the slaughtering of cattle, since exports of stock on the hoof were hurt by marketing problems and poultry production was up by a smaller amount. Output was down again in the fisheries sector (-3%). This was mostly because of the decline in the lobster catch triggered by over-fishing in recent years and a downturn in the cultivation of shrimp as a glut on the international market caused export prices to sink. Capture fishery production, on the other hand, expanded once more.

Manufacturing activity expanded less (2.3%) than the year before. The main sources of growth were the EPZs and, to a lesser extent, higher output of foodstuffs, beverages, furniture, clothing, footwear and transport equipment. The production of petroleum products contracted as economic activity slackened and international petroleum prices rose.

Construction activity has been slowing over the last three years, primarily as a result of the lower amounts of public financial resources being allocated for the reconstruction programme that was launched in the aftermath of Hurricane Mitch in 1998. Although private investment in residential and industrial construction picked up slightly, especially in the EPZs, overall construction activity declined even further in 2002 owing to the intensive fiscal adjustment, which dampened public investment considerably. One important development was the recovery of the mining sector (16.8%), where activity was spurred by higher international prices for precious metals. Services, which accounted for 43% of GDP, expanded by 2.9%, a rate similar to the previous year's. Finance, trade and telecommunications turned in the strongest performances.

b) Prices, wages and employment

Inflation was lower in 2002 than it had been the year before (3.9% compared with 4.7% in 2001). This was attributable to the sluggish growth of domestic demand, tight fiscal and monetary policies, the relative abundance of farm produce for domestic consumption, more stable public utility rates and charges, and the National Assembly's decision to apply a zero tax rate to the 53 products included in the basket of staple goods. This decision fuelled a slight increase in the price of foodstuffs and beverages (1.2%), which make up the largest category of items in the shopping basket used to calculate the consumer price index.

The real average wage improved substantially (by 4%), thanks to an 8.8% increase in the minimum wage, pay adjustments in the public sector and wage hikes in a number of other sectors. Nonetheless, the economy's growth rate has remained below the level it needs to reach in order to bring down the country's high unemployment rate over the long term and improve the substandard conditions in which a large portion of the population lives. Formal urban employment shrank by 7.3%, with much of the decrease being in construction, transport and public utilities. In contrast, the number of people working in the informal economy swelled by 8.3% and thus came to represent nearly 60% of total employment. The rate of open unemployment consequently rose from 11.3% to 11.6%.

c) The external sector

The sluggish pace of economic activity was reflected in a reduction of the external imbalance. The current account deficit amounted to US$ 888 million, which represented a decrease of 6.1%. The deficit therefore shrank from 37% to 35.2% of GDP as a result of lower interest, profit and dividend remittances and an increase in current transfers, especially family remittances, which remained on the upward trend seen in preceding years. Interest payments were lower thanks to the forgiveness of debts by various bilateral creditors and the temporary relief afforded by the HIPC Debt Initiative.

The balance-of-payments deficit (8.3% of GDP) narrowed in 2002. This was attributable to the reduction in the current account deficit, since the balance on the capital and financial accounts remained constant. In this context, disbursements for balance-of-payments support and project loans that were granted after the agreement with IMF was signed in December helped to finance the current account deficit and contributed to the build-up of net international reserves to US$ 275 million (the equivalent of 1.7 months' worth of merchandise imports). In 2002, foreign direct investment picked up (15.6%) thanks to the sale of State assets and the increase in the number of firms operating under the export processing zone (EPZ) regime.

The merchandise trade deficit remained very high at 37% of GDP, especially in view of the lower level of economic activity. Imports rose slightly (1%), while exports (including those produced in the EPZs) remained virtually the same as in 2001.

Traditional goods exports (f.o.b.) fell sharply (-12%) in 2002 as a consequence of the steep drop in coffee exports (-29%), plummeting sugar sales (-42%), a slump in banana exports (-5.2%) and the virtual stagnation of lobster and shrimp exports. Because of the smaller volume of export shipments, earnings from the sale of these products were down by 21%. Only beef and gold exports trended upward, thanks to sales on the Central American and Mexican markets and the upswing in gold mining that came in response to higher international prices. Exports of non-traditional products expanded once again, this time by 15%, with particularly good performances being turned in by tropical fruits, peanuts, fish and manufactures (especially of food products for other Central American countries). Net EPZ sales (with a notable component being maquila textile production) climbed by 11.6% to US$ 105 million (4.2% of GDP).

The slow growth of output and of domestic demand was reflected in the small size of the increase in imports, which represented slightly less than US$ 1.8 billion (71% of GDP). Imports of intermediate and consumer goods were down owing to the reduction in public investment expenditure, but imports of capital goods exhibited a robust increase (8.6%), mainly as a result of the expansion of the manufacturing sector (and the EPZs, in particular). This reversed the contraction of capital goods imports seen in the two preceding years.

In the first quarter of 2003, the trade deficit was up 7.2% on the same period in 2002. This was a consequence of the 4.5% slump in exports, which was the net effect of downturns in sales of both traditional products (-1.6%) and non-traditional products (-8.1%). The current account deficit increased by only 1.7%, however, thanks to the 11% rise in family remittances that offset most of the increase in the trade gap. Even so, the reductions posted on the capital and financial accounts resulted in a drop in international reserves.

Panama

1. General trends

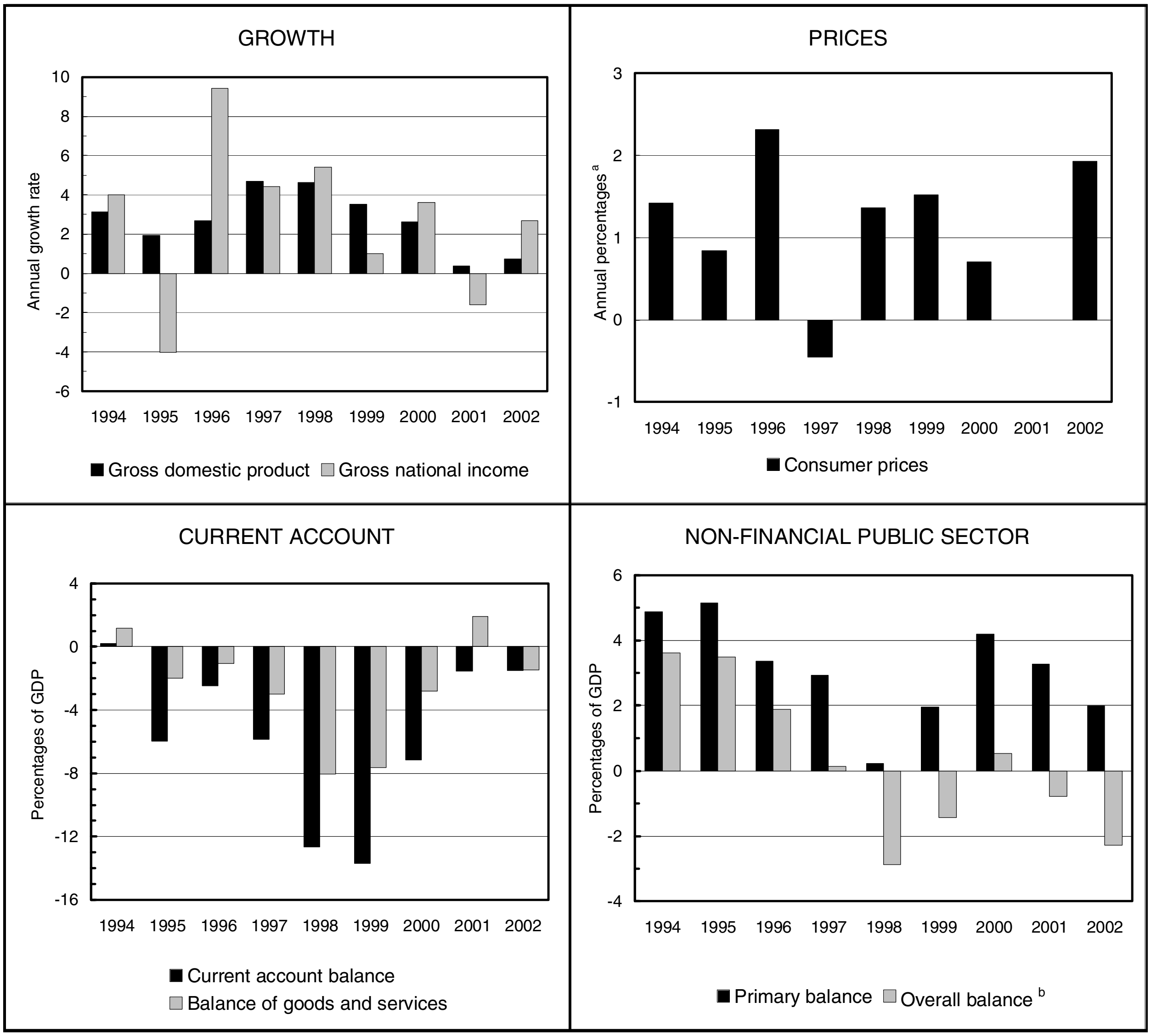
Already faltering external demand weakened still further in 2002, with serious repercussions for the economy as a whole. Productive activity expanded by 0.8%, which was slightly higher than the previous year's growth rate of 0.4%, but per capita GDP diminished again. Growth was driven by an upturn in consumption, as investment retreated for the third year in a row. Inflation at 1.9% remained low, while the labour market registered a slight improvement. The public-sector deficit came in at 2.3% of GDP, compared to 0.8% in 2001, while the balance-of-payments current account deficit held steady at 1.5% of GDP.

The international economic environment was exceptionally unfavourable, causing downturns in three of the four sectors that rely on external demand, namely the International Banking Centre, the Colón Free Zone and national exports; only the Panama Canal reported positive figures. In addition to this, debates in the framework of the national dialogue on public administration had a negative impact in the short term. Although headway was made in defining a legal framework for fiscal policy, the process added a further element of uncertainty to the private-sector investment process.

For 2003, the authorities are forecasting a growth rate of between 2% and 2.5%, low inflation and a non-financial public-sector (NFPS) deficit of under 2%. These projections are largely based on an expected rebound in domestic demand, especially investment; but they also assume some improvement in the South American economies, which are important trading partners for Panama. First-quarter results bore out these projections in terms of GDP growth, which expanded by 2.4%, but not in respect of external demand; and the Colón Free Zone and the International Banking Centre both posted further declines.

The Government plans to strengthen public investment by drawing US$ 200 million from the Development Trust Fund, and bringing into use part of the 2,541 hectares of reverted areas from the former Canal Zone. This is in addition to a number of private projects that can be expected to boost domestic demand. The economic upswing already showed through in the first quarter, with headway being made in most areas except for agriculture and the two sectors mentioned above.

Figure 1
PANAMA: MAIN ECONOMIC INDICATORS



Source: ECLAC, on the basis of official figures.
[a] December-to-December variation.
[b] Includes interest.

2. Economic policy

The main objective of economic policy in 2002 was twofold: to define a stable medium-term framework for economic policy, in the context of the debates taking place within the national dialogue for economic recovery; and to revive sluggish economic activity by means of counter-cyclical fiscal policy. Despite a considerable delay, the first objective was achieved with the passage of a tax reform package in December; but the fragile state of public accounts hindered achievement of the second. Structural reform figured further down the Government's list of priorities, which were rearranged in 2003 to concentrate on economic recovery.

a) Fiscal policy

Three pieces of legislation were approved during the year: one on the transparency of public administration; a second on economic recovery and fiscal responsibility, and a third on restructuring and simplification of the tax system. Under this legislation public borrowing was restricted in order to reduce the debt/GDP ratio to 50% and the external debt/GDP ratio to 35% in the medium term; and a ceiling of 2% of GDP was established for the fiscal deficit. This latter target was met, since the NFPS posted a smaller deficit.

The central government deficit, including the surpluses generated by the Panama Canal Authority, came in at 1.9% of GDP, slightly higher than the previous year's 0.7%. Total revenues were down by 1.1% in nominal terms, as also occurred in 2001, in contrast to the double-digit growth rates recorded a few years ago. The results for the first quarter of 2003 herald a stronger performance from fiscal revenues and expenditures alike. NFPS revenues rose by 18% during the period, and spending by 13%, to produce a deficit of 1.4% of GDP compared to 1.6% a year earlier. Capital expenditure, in particular, grew strongly (40%), reflecting the start-up of a number of public infrastructure projects.

Current fiscal income decreased by 2.6% in 2002, as a result of a 6.5% fall in non-tax revenues, which, in turn, reflected a smaller contribution by the Development Trust Fund to central government coffers. Tax income climbed by 1.2%, thanks mainly to indirect receipts.

Expenditure crept up slightly (0.8%) to US$ 2.306 billion. Current spending remained stable, despite a 3.6% wage hike, since operational expenditures, transfers and debt interest payments all declined. Capital spending grew by 4.1% (a modest figure in comparison to the two preceding years) since the Government cur expenditure on three separate occasions in 2002, and only 60% of programmed investments were actually accomplished.

A development that gave cause for concern was the operational deficit registered by the Social Security Fund (CSS) in 2002. This stemmed mainly from its old-age, survivor and disability pension programme, which reported an actuarial shortfall of between US$ 2.2 and US$ 2.5 billion. The Government set up a dialogue mechanism in 2001 to tackle the gradual deterioration of the programme, but this failed to reach a solution acceptable to all parties. To hasten the process, the Government itself put forward a proposal that combines contributions from the State, workers and employers, with improvements to CSS administration.

The Government continued with its active public-debt management policy, seeking to extend the profile of the debt, reduce the outstanding balance on Brady bonds, partly anticipate funding requirements for the coming year, diversify its sources and develop the secondary market.

During the year Panama issued global bonds amounting to US$ 930 million, maturing in 2012 and 2023. External debt was reduced by US$ 546 million through amortization payments, including a US$ 342 million payment in respect of Eurobonds falling due in 2002. Brady bonds were also redeemed at a cost of US$ 488 million. Amortization and interest payments amounted to US$ 1.395 billion, up from US$ 950 million the year before. The result of these operations was an increase in the net balance of external debt to US$ 6.349 billion, equivalent to 62% of GDP. However, US$ 151 million of this corresponded to advance funding for 2003.

Medium-term domestic bonds –Treasury Notes– were also issued in 2002, in the amount of US$ 160 million. This was the first issue of fixed-income securities of this type, since only short-term Treasury Bills had been issued previously. The balance of domestic debt was US$ 2.172 billion, or 21% of GDP. It should be noted, however, that new national accounts estimates revised GDP upwards, thereby lowering public-debt coefficients in relative terms.

Table 1
PANAMA: MAIN ECONOMIC INDICATORS

	1994	1995	1996	1997	1998	1999	2000	2001	2002[a]
	Annual growth rates[b]								
Gross domestic product	3.1	1.9	2.7	4.7	4.6	3.5	2.6	0.4	0.8
Per capita gross domestic product	1.0	-0.1	0.6	2.6	2.6	1.5	0.7	-1.5	-1.1
Gross national income	4.0	-4.0	9.4	4.4	5.4	1.0	3.6	-1.6	2.7
Gross domestic product by sector									
Agriculture	2.7	3.2	1.1	0.0	6.3	2.1	1.6	0.8	-1.9
Mining	9.6	-5.5	-16.3	88.9	22.8	15.6	-6.7	-12.8	-5.7
Manufacturing	4.3	0.2	-1.3	6.4	3.9	-7.5	-5.3	-5.7	-4.9
Electricity, gas and water	6.3	1.9	17.7	0.8	-4.6	17.9	11.8	0.1	7.7
Construction	2.2	4.1	-4.1	5.5	6.7	16.0	2.5	-9.7	-10.0
Wholesale and retail commerce, restaurants and hotels	4.9	-0.7	-1.0	8.9	2.2	-2.9	1.7	-1.8	3.9
Transport, storage and communciations	4.4	9.4	2.5	5.7	10.9	10.5	10.0	4.6	3.3
Financial establishments, insurance, real estate and business services	4.4	-0.9	8.2	2.1	6.6	8.5	3.3	1.8	-1.0
Community, social and personal services	3.8	2.7	2.6	4.7	3.1	2.9	-0.5	3.2	2.8
Gross domestic product by type of expenditure									
Consumption	0.3	-3.4	9.5	12.3	10.5	-2.1	2.9	-4.1	4.1
General government	-0.4	4.6	3.4	7.0	4.3	-2.0	5.5	4.0	5.6
Private	0.5	-5.5	11.3	13.7	12.1	-2.1	2.3	-6.1	3.7
Gross domestic investment	14.2	10.9	6.0	1.1	11.7	13.2	-9.6	-10.4	-1.2
Exports of goods and services	-3.7	10.2	-9.4	12.7	-2.4	-8.5	6.5	5.0	-1.8
Imports of goods and services	-3.1	9.0	-4.1	17.2	4.5	-8.3	1.4	-3.0	0.4
	Percentages of GDP								
Investment and saving									
Gross domestic investment [b]	27.8	30.3	31.3	30.2	32.2	35.2	31.0	27.7	27.1
Gross domestic investment [c]	26.8	30.3	30.5	31.1	32.1	33.1	28.7	25.6	24.5
National saving [c]	29.9	29.8	28.9	26.0	22.5	22.7	22.1	24.0	23.0
External saving [c]	-3.1	0.5	1.6	5.0	9.6	10.4	6.5	1.6	1.5
	Millions of dollars								
Balance of payments									
Current account	16	-471	-201	-507	-1,182	-1,320	-715	-154	-154
Goods balance	-250	-589	-644	-685	-1,365	-1,386	-1,143	-675	-1,176
Exports fob	6,045	6,091	5,823	6,670	6,350	5,303	5,839	5,996	5,284
Imports fob	-6,295	-6,680	-6,467	-7,355	-7,715	-6,689	-6,981	-6,672	-6,460
Services balance	339	432	558	428	614	650	864	868	1,027
Factor income balance	-222	-466	-249	-400	-591	-755	-614	-545	-217
Current transfers balance	149	153	135	151	159	171	177	198	213
Capital and financial balance [d]	-378	139	467	850	803	1,173	388	-150	557
Net foreign direct investment	402	223	416	1,299	1,296	652	603	513	57
Financial capital [e]	-779	-84	52	-449	-493	520	-216	-663	500
Overall balance	-362	-331	267	343	-380	-148	-328	-304	403
Variation in reserve assets [f]	-106	-78	-298	-611	20	-185	109	-479	-130
Other financing [g]	467	409	31	268	360	332	219	783	-273
Other external sector indicators									
Real effective exchange rate (index 2000=100) [h]	98.7	103.7	104.0	104.0	103.0	101.3	100.0	102.8	103.2
Terms of trade for goods (index 1997=100)	106.5	96.7	98.0	100.0	99.9	102.4	96.5	97.0	96.0
Net resource transfer (% of GDP)	-1.7	1.0	3.1	8.3	6.1	7.8	-0.1	0.9	0.6
Gross external public debt (millions of dollars)	5,505	5,891	5,070	5,051	5,349	5,568	5,604	6,263	6,349
Gross external public debt (% of GDP)	71.2	74.5	62.2	58.3	57.2	57.8	55.9	62.1	61.8
Net interest and earnings (% of exports) [i]	-4.3	-7.4	-4.3	-5.3	-7.7	-11.1	-7.8	-6.8	-2.9

Table 1 (concluded)

	1994	1995	1996	1997	1998	1999	2000	2001	2002[a]
	Percentages								
Employment									
Labour force participation rate [j]	60.7	61.7	60.6	61.5	62.2	62.8	59.9	60.5	62.4
Unemployment rate [k]	14.0	14.0	14.3	13.2	12.7	11.8	13.5	14.0	13.2
	Annual percentages								
Prices									
Variation in consumer prices	1.4	0.8	2.3	-0.5	1.4	1.5	0.7	0.0	1.9
Variation in real minimum wage	-1.4	-0.6	4.3	-1.2	2.7	3.4	3.7	7.2	-1.0
Real deposit rate [l]	...	...	...	6.8	5.6	5.3	6.4	6.0	3.7
Real lending rate [m]	...	...	...	10.4	9.6	8.4	9.8	10.1	9.3
Equivalent deposit rate in foreign currency [n]	...	...	...	7.0	6.8	6.9	7.1	6.8	5.0
	Percentages of GDP								
Non-financial public sector									
Current income	23.0	24.8	24.5	24.5	24.8	27.4	28.2	27.4	26.1
Current expenditure	21.8	22.6	22.4	24.2	24.4	25.2	25.9	26.9	27.0
Saving	1.3	2.3	2.1	0.2	0.4	2.2	2.3	0.6	-0.9
Capital balance	-3.1	-3.1	-3.5	-3.5	-5.3	-4.5	-2.9	-3.0	-2.9
Primary balance	4.9	5.2	3.4	2.9	0.2	2.0	4.2	3.3	2.0
Overall balance	3.6	3.5	1.9	0.1	-2.9	-1.4	0.5	-0.8	-2.3
Public debt	94.5	95.8	84.0	78.2	75.8	79.8	77.2	83.3	82.9
External	71.2	74.5	62.2	58.3	57.2	57.8	55.9	62.1	61.8
Domestic	23.3	21.2	21.8	19.8	18.6	22.1	21.2	21.2	21.1
Interest payments (% of current income)	5.5	6.7	6.1	11.4	12.5	12.4	13.0	14.8	16.4
Money and credit [o]									
Domestic credit [p]	63.0	71.5	75.2	79.1	88.7	102.7	110.6	116.0	110.7
To public sector	1.8	1.4	1.5	0.8	1.2	1.1	1.6	1.4	1.6
To private sector	61.2	70.1	73.7	78.3	87.4	101.5	108.9	114.6	109.1

Source: ECLAC, on the basis of official figures.
[a] Preliminary figures. [b] Based on constant 1995 dollars. [c] Based on figures in local currency at current prices. [d] Includes errors and omissions. [e] Refers to the balance on the capital and financial accounts, minus net foreign direct investment plus errors and omissions. [f] A negative sign denotes an increase in reserves. [g] Includes the use of credit and loans from IMF and exceptional financing. [h] Annual avarege, weighted by the value of exports and imports of goods. [i] Refers to net investment income divided by exports of goods and services from the balance of payments. [j] Economically active population as a percentage of the working-age population, nationwide total. [k] Unemployed as a percentage of the economically active population, nationwide total. Includes hidden unemployment. [l] Six-month deposits in local banks. [m] One to five-year loans for corporate activities. From 2000 on, local banks. [n] Rate on deposits, deflated by the variation in the dollar exchange rate. [o] Average annual values used for monetary figures. [p] Net credit extended to the public and private sectors by commercial banks and other financial and banking institutions.

b) The International Banking Centre and credit policy

In 2002, activity in the International Banking Centre suffered from the effects of a harsh environment on both the domestic and the external fronts. External factors included crises in several South American countries and stagnation in the developed economies. Domestic factors included the fact that the Panamanian economy entered a recessionary phase, as domestic demand adjusted following several years of burgeoning expenditure financed mainly by consumer loans. Other domestic factors included implementation of the Basel standards, which imply a more conservative banking policy; and efforts to combat money-laundering, which assumed new proportions in the wake of the attacks of 11 September 2001.

Assets held by the International Banking Centre shrank by 10.6% with respect to the previous year, to stand at US$ 34.022 billion in late 2002. This trend carried over into the first quarter of 2003, but the fall was less steep (-7.4%). Of this downturn, 73% corresponded to international operations, which meant that asset positions among international private banks worsened much more severely than those of their local

Table 2
PANAMA: MAIN QUARTERLY INDICATORS

	2001				2002[a]				2003 [a]	
	I	II	III	IV	I	II	III	IV	I	II
International reserves (millions of dollars)	1,255	1,149	984	1,092	1,157	1,072	947	1,183	1,405	...
Real effective exchange rate (2000=100) [b]	102.3	102.6	103.1	103.2	102.3	103.5	103.4	103.5	104.9	106.8
Consumer prices (12-month variation, %)	0.3	-0.4	0.3	0.0	0.9	1.2	0.7	1.9	1.6	1.4
Nominal average exchange rate	1.0	1.0	1.0	1.0	1.0	1.0	1.0	1.0	1.0	1.0
Nominal interest rates (annualized percentages)										
Deposit rate [c]	7.2	7.1	6.8	6.2	5.3	5.0	4.8	4.9	4.6	4.6
Lending rate [d]	11.0	11.3	11.0	10.6	10.5	10.5	11.0	10.3	10.1	10.0
Interbank rate [e]	...	...	...	...	1.9	2.6	2.4	2.0	1.6	1.6
Sovereign bond spread (basis points)	472	389	479	411	348	447	553	439	402	372
Domestic credit [f] (change from same quarter of preceding year)	7.2	6.2	3.0	6.4	-2.0	-4.4	-6.2	-6.9	…	...

Source: ECLAC, on the basis of official figures.
[a] Preliminary figures. [b] Quarterly average, weighted by the value of exports and imports of goods. [c] Six-month deposits in local banks. [d] One-year loans for corporate activities, local banks. [e] Thirty-day interbank deposits. [f] Net credit to the public and private sectors extended by commercial banks and other financial and banking institutions.

counterparts (20.7% compared to –2.4%, respectively). Conversely, assets held by official banks grew by 1.5%, in the wake of stronger corporate lending and housing loans.

In response to this situation, the banks adopted a more conservative stance, prioritizing portfolio quality and liquidity over expansion. The ratio of capital to risk-weighted assets was 16.5%, and the financial liquidity ratio reached 33%. Net profits in the banking sector were down by 44% owing to losses incurred by Banco Latinoamericano de Exportaciones, S.A., (BLADEX); but when this bank's results are excluded from the calculations, net profits rise by 29%.

In 2002 the lending portfolio to the domestic private sector registered its first decrease (6.8%) for 13 years. This came on top of a much sharper contraction of 31.8% in foreign loans, which meant that national bank lending operations declined by 15.7%, concentrated especially in corporate and personal loans, while mortgage lending was up slightly. Investments in national bank securities expanded by 7.7% thanks to a 15.4% increase in investment in foreign instruments. Sight deposits rose by 5.2%, while time and savings deposits dropped by 7.6%. Lastly, the non-performing portfolio continued to account for a small proportion of total lending (3.1%), with overdue loan provisions covering 137% of this amount.

The loan portfolio continued to contract in early 2003, albeit at the slower rate of 11.7%; domestic credit retreated by 2% and external credit by 21% in the first quarter.

In contrast to the previous year, interest rates moved lower during 2002 in line with international trends. Rates on six-month time deposits decreased by 186 basis points, from an average of 6.83% in 2001 to 4.97% in 2002. The rate on loans with maturities of under a year fell by much less, however: the rate on credits to commerce and industry dropped by 140 and 53 basis points, respectively, while interest rates on consumer loans actually rose by 90 points. As a result the intermediation spread widened, which helped to perpetuate the listlessness of the economy.

c) Trade policy

Trade negotiations made progress in 2002. A free trade agreement was signed with El Salvador, which applies a zero tariff to around 80% of traded goods in the framework of an understanding regarding the signing of a similar agreement with the other Central American countries. In addition, Panama entered into a dialogue with the United States on a possible bilateral agreement, and opened discussions with the Dominican Republic and Taiwan Province of China with a view to opening these markets to Panamanian products. Also worthy of mention was the fact that Panama hosted the Secretariat of the Free Trade Area of the Americas (FTAA) from March 2001 to early 2003.

Lastly, in 2002 import tariffs on some products rose to the ceiling level of 15% permitted by the World Trade Organization (WTO), but declined for a number of intermediate goods.

3. The main variables

a) Economic activity

The slight growth in activity recorded in 2002 reflected domestic expansionary factors, since external demand contracted. In early 2003, external demand recovered somewhat and domestic demand gathered momentum, producing GDP growth of 2.4% for the first quarter. Exports weakened by 1.8% in 2002, in contrast to 5% growth during the previous year. Conversely, domestic demand expanded by 2.4% following a contraction of 5.4% in 2001. This upturn reflected an increase in both public and private consumption.

Investment dropped for the third straight year, particularly private investment, but improved in early 2003. In 2002, capital formation receded by 5% in the construction sector and by 3% in the machinery and equipment category.

The strongest performing sectors were basic services and “other services”, which expanded by 4.4% and 1.4%, respectively. In contrast, goods-producing activities shrank by 4.8%, the steepest fall occurring in construction (10%) while mining declined by 6%, manufacturing by 4.9% and agriculture by 1.9%.

The poor performance of agriculture was attributable to several factors. The banana segment has been fraught with various difficulties, which in 2002 included labour disputes, weather problems, worsening health conditions and a downturn in productivity. Coffee production has encountered similar problems, compounded by three straight years of low prices on the international market. By contrast, sugar, melon and watermelon performed very well. Livestock activity was flat, except for milk and beef production. Fishing activity dropped by 5.7%, because of problems with the shrimp harvest (white spot virus) and stiff international competition in the fish meal and fish oil markets.

Manufacturing, which contracted for the fourth year in a row, is going through a lengthy process of adaptation to trade liberalization. With a few exceptions, including food production, most segments either stagnated or contracted. The output of electricity, gas and water, however, expanded by a robust 7.7%, on the back of an upturn in hydroelectric power generation, thanks to abundant rains. But industrial electricity consumption was down by a fifth, thereby giving another indication of hard times in manufacturing industry.

The transport, storage and communications sector expanded by 3.3%. Activity on the Panama Canal was 3% up on the year before, even though it was a difficult period for international trade. Although cargo volumes were slightly down, toll revenues grew by 6.1%. Toll rates were increased by an average of 6.5% in October, and are scheduled to rise by a further 8% in July 2003.

Commerce, restaurants and hotels enjoyed an upturn of 3.9% following their 1.8% contraction in 2001. Domestic commerce benefited from higher consumption, while activity in the Colón Free Zone slipped by 8.8%. Hotel and restaurant activity rose by 17.5%. Financial services, insurance and real estate contracted by 1%, owing to difficulties in the banking sector, while domestic, social and health services expanded by 9%.

Data for the first quarter of 2003 point to a recovery in economic activity, except in agriculture, financial services and the Colón Free Zone. Expansion has been particularly strong in the secondary sector (5.8%), thanks to headway made in construction (15%) and port activity (14.3%). Industry ventured a small upturn (0.6%); while tourism and commerce also performed well, (7% and 6.5%, respectively). Government and personal services advanced at a slower pace than in previous years.

b) Prices, wages and employment

Inflation remained low in 2002, with prices rising by 1.9% over the year, and this trend has continued up to mid-2003. Wholesale prices fell substantially for the second consecutive year. The rise in the consumer price index is attributable to the unification of urban transport fares and higher gasoline prices. Clothing prices dropped by 0.3%, and food, by 0.5%, the latter for the second year running. The price of the basic household shopping basket fell by 0.6% with respect to 2001.

The household survey conducted in August 2002 shows that the rate of unemployment dropped from 14% in 2001 to 13.2%, while the employed population expanded by 6.8%, and the labour force participation rate rose from 60.5% to 62.4%. It is highly likely that the increase in employment took place in the informal sector, since activity in labour-intensive sectors, such as construction and manufacturing, contracted sharply. Real income slipped slightly, according to partial data, while the nominal minimum wage was unchanged and average wages fell in segments such as manufacturing, hotels and restaurants and retail commerce. In contrast, there were small increases in the public sector, wholesale trade and “other services”.

c) The external sector

The sluggishness of the world economy, and particularly the weakened state of productive activity in Latin America, made themselves felt in the Panamanian economy. Merchandise exports sagged, but more robust services exports partly offset the negative effect on the balance-of-payments current account, which again posted a deficit of US$ 154 million, or 1.5% of GDP. Excluding errors and omissions, flows on the financial account slumped to half the previous year's figure, mainly because of low levels of FDI.

Merchandise exports declined by 11.9%, as their largest component –re-exports from the Colón Free Zone– contracted by 12%. Admittedly, this is part of a longer-term decline in the attractiveness of the Free Zone caused by the trade liberalization now underway in other Latin American countries; but in 2002 and the first half of 2003 the Free Zone also felt the backwash from problems beleaguering its main clients.

The remainder of merchandise exports, classified as "national exports", also lost ground and turned in a very mixed performance. Certain traditional export products such as bananas and coffee maintained their downward trend, contracting by 10.4% and 16.2%, respectively. Exports of shrimp and shrimp larvae were also down, as were fishmeal, fish oil and other marine products.

Conversely, exports of melon and watermelon held up well, with increases of 77% and 30% respectively, more than tripling the amount of foreign exchange earned by these products during the last three years. Beef exports also surged by a quarter, and sugar exports rose by almost 9%. In the first four months of 2003, national exports dropped by 4.3%, broadly repeating the previous year's pattern.

Merchandise imports shrank by 3.2%, mainly because of a drop of nearly 7% in imports into the Colón Free Zone. Other imports strengthened by 3.6%, thanks to stronger purchases of food products (11%) and other consumer and intermediate goods (18%). Capital goods imports, by contrast, slipped by 5%, closely reflecting the weakened state of investment. Thanks to the economic upturn, imports rebounded by 2.5% in the first four months of 2003, driven mainly by a 26% rise in capital goods imports, as the slide in the Free Zone became steeper (-20%).

The surplus on trade in services grew by US$ 160 million to over US$ 1 billion. The value of services exports expanded strongly, with a 9% increase in receipts of the Panama Canal Authority making for a rise of almost 10% in transport revenues. Income from tourism also grew by a healthy 8.6%, reflecting new opportunities in the field of recreational tourism and the arrival of cruise liners in Panamanian ports.

The capital and financial account, excluding errors and omissions, registered practically half the earnings received in 2001. This was partly attributable to a sharp decline in FDI, which dwindled to US$ 57 million –just one tenth of the 2001 figure. Other capital movements registered a positive balance as a result of public debt floatations on the international market.

Paraguay

1. General trends

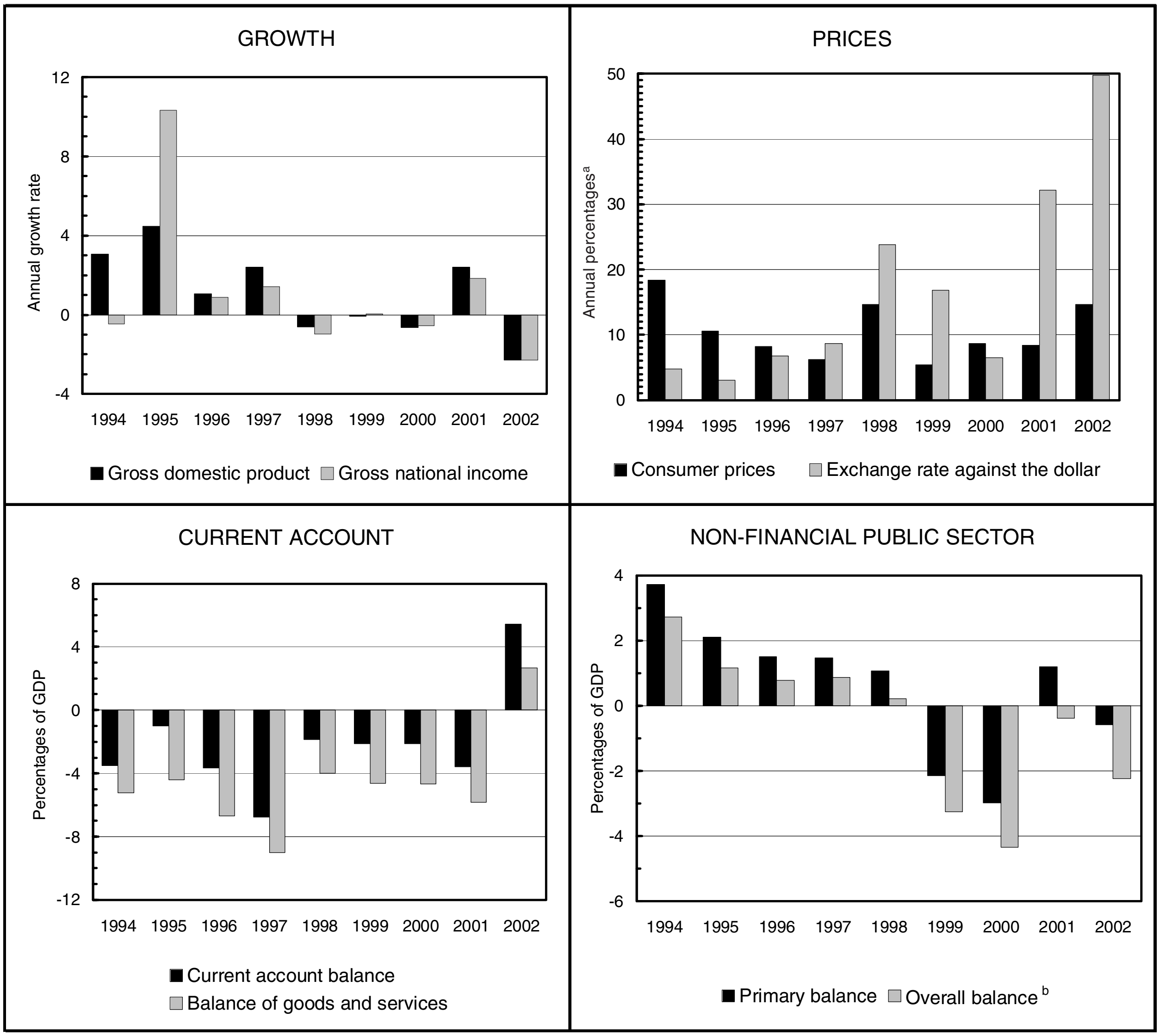
While debate over economic reform raged, severe economic crisis, compounded by poor crop harvests due mainly to inclement weather conditions, conspired in 2002 to produce the sharpest contraction since 1983, in which output shrank by 2.3%. Given Parguay's rate of population growth, per capita GDP declined by 4.7%, falling back to the level recorded in the early 1990s. Domestic demand sagged (-6%), although total demand decreased by only half that figure thanks to more buoyant exports. Both private and public consumption weakened by around 5%, while gross domestic investment declined for the sixth year running. Unemployment rose to 14.7%, up from 10.8% in 2001.

The performance of the Paraguayan economy in 2002 revealed the country's external vulnerability and domestic instability. On the external front, the authorities had to cope with the impact of devaluations in Argentina and Brazil, in addition to dwindling capital inflows and reduced family remittances. At home, public finances steadily worsened, and the banking and financial sector was buffeted by backwash from the liquidation of one of the country's most solvent banks, in the wake of losses suffered in Argentina and an evaporation of confidence among its depositors.

Although the central government deficit widened from 1.1% of GDP in 2001 to 3.3% in 2002, this partly reflected a recovery in capital expenditure. Foreign-exchange policy in general remained flexible, despite episodes of intervention aimed at absorbing the sharp volatility of the guaraní, especially in mid-2002 and again late in the year. Monetary policy remained tight; the Central Bank of Paraguay raised the rates on its monetary regulation instruments, which pushed up interest rates sharply especially towards the end of the year. The steep depreciation of the guaraní sent inflation soaring to 14.6% per year, twice the 2001 rate. Privatizations were suspended by the National Congress midway through the year.

Official projections for 2003 point to a recovery in output equivalent to the fall recorded in 2002, with GDP growth of around 2% forecast for the year as a whole. This figure is based on projections of an excellent crop year boosted by favourable weather conditions and supported by depreciation of the guaraní. Soybean production is expected to reach a record level of 4.2 million tons, but cattle-rearing is set to contract following the closure of a number of markets in the early months of the year because of an outbreak of foot-and-mouth disease in late 2002. In contrast, non-agricultural sectors as a whole are unlikely to recover from the sharp falls recorded in the 2001-2002 biennium. The fiscal deficit is expected to narrow to 2.7% of GDP, thanks to improved tax and non-tax revenue collection, while the rally in capital expenditure looks set to continue.

Figure 1
PARAGUAY: MAIN ECONOMIC INDICATORS



Source: ECLAC, on the basis of official figures.
[a] December-to-December variation.
[b] Includes interest.

2. Economic policy

In recent years, the sizable central government deficit has begun to cause fiscal problems in the Paraguayan economy. Although substantial deficits had emerged in 1999-2000 (4% of GDP), at that time there were abundant external resources available to bridge the gap between income and expenditure. In 2001, the deficit narrowed thanks to significant cutbacks in capital expenditure, but in 2002 it widened once more. In the second half of that year, failure to reach an agreement with the International Monetary Fund (IMF) led to a shortage of external funding and made it increasingly difficult to close the fiscal deficit. Consequently, the payment of domestic and external commitments was deferred, and this remained the situation in mid-2003.

The authorities redoubled their efforts to secure an accord with IMF in 2002. Early in the year, progress was made towards an initial agreement, with privatization of the telephone company COPACO being added to reforms in the fiscal and banking sectors. Nonetheless, the fierce controversy that arose over the transparency with which this enterprise was to be sold, and the advisability of privatization in general, led Congress to suspend the measure indefinitely. Since the middle of the year, a second agreement has been negotiated without privatizations; this involves a bill to increase fiscal revenue, together with a bank restructuring law to deal with liquidation proceedings among financial institutions. These initiatives proved unsuccessful and, by mid-2003 a very watered-down version of the first bill was all that had reached the final phase of legislative process.

The subregional crisis had a major impact on the Paraguayan economy, with contagion occurring through commercial and financial channels. Exports to Argentina, one of Paraguay's main trading partners, plummeted in the first few months of 2002 following the drastic currency devaluation in that country.

In terms of the financial channel, the Argentine devaluation caused a substantial drop in family remittances from Paraguayans living in Argentina. Moreover, in June 2002, the authorities took emergency action by intervening in one of the country's most solvent banks which had sustained losses in Argentina and suffered a run on deposits by its savers. Between 1995 and 1998, the banking sector had endured successive crises and, following the financial reform that was implemented, steps were taken to wind up non-viable financial entities (16 banks and 40 other financial institutions), a process which lasted into the early months of 2003.

a) Fiscal policy

In 2002, Paraguay's central government deficit showed a sharp and progressive deterioration, widening to 3.3% of GDP and interrupting the recovery achieved in 2001, when the deficit had narrowed by 1.1% of GDP from the record 4.3% recorded in 2000. The 2002 deficit is larger because total revenue declined by 1.6 percentage points of GDP, while expenditure continued to grow. Maintaining the trend that had begun in 1997, tax pressure eased to 9.5% of GDP, this time aggravated by the fact that the economy was in recession.

Capital expenditure was increased substantially in the 2002 budget, following cutbacks in the previous year. The authorities were hoping to finance the increased expenditure with part of the resources generated by privatization of the telephone company, COPACO, which was expected to generate exceptional revenue of some US$ 100 million. Nonetheless, these funds never materialized since Congress decided to halt the privatization process altogether in June.

In this context, the authorities attempted to curb the fiscal deficit by applying new regulations whose main objective was to bolster government revenue. The main proposals involved increasing the rate of value added tax (VAT) from 10% to 12%, raising public-sector utility charges, and cutting wages in public administration and a number of other sectors –all this with a view to boosting tax collection. These legislative proposals failed to gain approval in the pre-electoral context prevailing in 2002, however, and their discussion had to be delayed until mid-2003. This made it even harder to close the fiscal shortfall, and towards the end of the year the Government was forced to default on some of its domestic and external obligations. In June 2003, overdue but unpaid government debt amounted to US$ 33 million.

The positive trend in total revenue as a percentage of GDP that had lasted from 1996 to 2001 was broken in 2002, when it slipped from 17.9% to 16.5%. This development was the outcome of similar falls in tax and non-tax revenue (0.7% of GDP in each case). In recent years, the trend of total income has been determined by a steady deterioration in tax revenues, offset until 2001 by growing non-tax income mostly deriving from binational entities. In 2002, however, the latter also

Table 1
PARAGUAY: MAIN ECONOMIC INDICATORS

	1994	1995	1996	1997	1998	1999	2000	2001	2002[a]
	Annual growth rates [b]								
Gross domestic product	3.0	4.5	1.1	2.4	-0.6	-0.1	-0.6	2.4	-2.3
Per capita gross domestic product	0.4	1.7	-1.6	-0.2	-3.2	-2.6	-3.1	-0.1	-4.7
Gross national income	-0.5	10.3	0.9	1.4	-1.0	0.0	-0.5	1.8	-2.3
Gross domestic product by sector									
Agriculture	-0.6	8.1	1.3	5.3	0.2	3.2	-4.4	10.5	-0.6
Mining	5.0	2.9	1.5	2.0	2.5	2.2	2.5	-15.2	-8.0
Manufacturing	1.5	3.0	-2.2	-0.2	1.0	0.0	1.0	1.3	-3.0
Electricity, gas and water	20.6	14.7	6.1	3.6	1.6	14.7	7.8	0.7	0.0
Construction	3.6	4.0	3.0	1.0	1.0	2.5	2.0	-22.7	-10.0
Wholesale and retail commerce, restaurants and hotels	4.3	1.6	-1.0	0.2	-4.2	-9.2	-4.9	2.4	-3.5
Transport, storage and communciations	3.9	3.5	2.5	3.8	3.0	2.6	10.9	8.6	1.0
Financial establishments, insurance, real estate and business services	3.5	3.0	3.0	2.0	2.0	2.0	2.0	1.0	1.5
Community, social and personal services	3.9	4.1	5.8	4.5	0.5	4.2	3.5	0.0	-2.7
Gross domestic product by type of expenditure									
Consumption	8.3	7.9	2.2	2.9	-0.9	-4.1	0.4	6.2	-5.0
General government	3.9	12.1	10.0	2.0	0.7	3.7	14.1	-12.5	-5.0
Private	8.6	7.6	1.5	3.0	-1.0	-4.8	-1.0	8.3	-5.0
Gross domestic investment	4.3	6.9	0.1	-1.9	-4.3	-3.5	-0.5	-17.7	-10.9
Exports of goods and services	14.5	8.7	-11.6	-5.9	-7.2	-27.0	-15.1	-0.4	14.3
Imports of goods and services	23.4	14.8	-6.1	-4.0	-7.0	-27.1	-6.7	-1.6	-6.3
	Percentages of GDP								
Investment and saving									
Gross domestic investment [b]	23.4	23.9	23.7	22.7	21.8	21.1	21.1	17.0	15.5
Gross domestic investment [c]	23.4	23.9	23.4	23.6	22.9	23.0	21.8	19.8	19.8
National saving [c]	5.3	8.4	7.9	8.4	7.3	9.9	8.5	4.3	18.0
External saving [c]	18.0	15.5	15.5	15.1	15.6	13.2	13.3	15.5	1.8
	Millions of dollars								
Balance of payments									
Current account	-274	-92	-353	-650	-160	-165	-163	-245	294
Goods balance	-243	-270	-587	-865	-393	-441	-537	-555	-71
Exports fob	3,360	4,219	3,797	3,328	3,549	2,312	2,329	1,952	2,319
Imports fob	-3,604	-4,489	-4,383	-4,192	-3,942	-2,753	-2,866	-2,507	-2,391
Services balance	-167	-127	-58	0	50	82	175	157	215
Factor income balance	114	110	110	33	6	18	22	-13	34
Current transfers balance	23	195	182	181	177	175	177	167	116
Capital and financial balance [d]	575	137	306	435	177	-136	-181	195	-390
Net foreign direct investment	137	98	144	230	336	89	98	90	-20
Financial capital [e]	438	39	162	205	-160	-224	-280	106	-370
Overall balance	301	45	-47	-216	17	-301	-344	-50	-96
Variation in reserve assets [f]	-339	-60	39	206	-23	-117	215	45	82
Other financing [g]	39	15	7	10	7	418	129	5	14
Other external sector indicators									
Real effective exchange rate (index 2000=100) [h]	100.6	101.2	98.7	95.1	102.8	97.6	100.0	102.7	111.1
Terms of trade for goods (index 1997=100)	105.2	100.1	100.1	100.0	92.5	87.8	84.3	84.2	84.2
Net resource transfer (% of GDP)	9.3	2.9	4.4	5.0	2.2	3.9	-0.4	2.7	-6.3
Gross external public debt (millions of dollars)	1,271	1,741	1,801	1,927	2,133	2,697	2,819	2,653	2,700
Gross external public debt (% of GDP)	16.2	19.3	18.7	20.0	24.8	34.8	36.5	38.7	50.1
Net interest and earnings (% of exports) [i]	-0.9	-0.9	-1.2	-3.1	-3.3	-3.5	-3.6	-5.5	-2.5

Table 1 (concluded)

	1994	1995	1996	1997	1998	1999	2000	2001	2002[a]
	Percentages								
Employment									
Labour force participation rate[j]	59.1	64.8	63.0	61.9	60.6	58.8	62.8	59.6	60.5
Open unemployment rate[k]	4.4	5.3	8.2	7.1	6.6	9.4	10.0	10.8	14.7
Visible underemployment rate[k]	5.1	6.1	6.1	6.3	5.9	5.3	8.2	7.4	8.1
	Annual percentages								
Prices									
Variation in consumer prices	18.3	10.5	8.2	6.2	14.6	5.4	8.6	8.4	14.6
Variation in wholesale prices	...	10.5	41.0	1.8	18.1	6.8	10.4	8.6	36.8
Variation in nominal exchange rate	4.7	3.1	6.7	8.7	23.8	16.8	6.5	32.1	49.7
Variation in average real wage	1.5	7.5	3.1	-0.4	-1.9	-2.1	1.3	1.4	-6.4
Real deposit rate[l]	5.3	9.9	9.1	5.8	2.9	12.5	6.3	7.9	4.0
Real lending rate[m]	15.9	21.5	22.8	19.7	15.1	22.3	16.4	19.1	13.6
Equivalent deposit rate in foreign currency[n]	17.6	17.6	9.7	3.9	-5.8	2.5	8.7	-12.1	-17.9
	Percentages of GDP								
Non-financial public sector									
Current income	26.0	27.1	27.0	31.6	30.8	30.6	30.2	32.9	31.0
Current expenditure	19.6	20.3	21.7	22.6	23.1	22.6	28.3	27.8	27.3
Saving	6.4	6.8	5.3	9.0	7.7	8.0	1.9	5.1	3.6
Capital balance	-3.7	-5.6	-4.5	-8.2	-7.5	-11.3	-6.3	-5.5	-5.9
Primary balance	3.7	2.1	1.5	1.5	1.1	-2.2	-3.0	1.2	-0.6
Overall balance	2.7	1.2	0.8	0.9	0.2	-3.3	-4.4	-0.4	-2.2
Public debt	...	...	...	...	...	...	...	...	...
External	15.8	15.6	14.5	15.0	18.6	27.2	28.9	32.1	42.4
Domestic	...	...	...	...	...	...	...	...	...
Interest payments (% of current income)	3.8	3.4	2.7	1.9	2.8	3.6	4.5	4.8	5.4
Money and credit[o]									
Domestic credit[p]	20.4	22.5	21.3	23.0	24.2	23.4	22.5	23.8	23.4
To public sector	-2.0	-0.7	-2.1	-3.2	-2.5	-1.7	-1.4	-1.7	-1.5
To private sector	22.4	23.2	23.4	26.2	26.7	25.1	23.9	25.5	25.0
Liquidity (M3)	19.5	20.3	22.6	25.1	25.7	26.9	28.1	29.6	27.8
Currency in circulation and domestic currency deposits (M2)	11.4	13.1	14.4	15.4	13.5	12.7	12.7	12.7	11.6
Foreign currency deposits	8.0	7.3	8.2	9.7	12.2	14.2	15.3	16.9	16.2

Source: ECLAC, on the basis of official figures.
[a] Preliminary figures. [b] Based on constant 1995 dollars. [c] Based on figures in local currency at current prices. [d] Includes errors and omissions. [e] Refers to the balance on the capital and financial accounts, minus net foreign direct investment plus errors and omissions. [f] A negative sign denotes an increase in reserves. [g] Includes the use of credit and loans from IMF and exceptional financing. [h] Annual average, weighted by the value of exports and imports of goods. [i] Refers to net investment income divided by exports of goods and services from the balance of payments. [j] Economically active population as a percentage of the working-age population, total urban areas. [k] Rates of unemployment and underemployment are percentages of the economically active population, total urban areas. [l] Up to 1997: 180-day deposit certificates. From 1998 on:90- to 180-day deposit certificates in commercial banks. [m] Weighted average for corporate, development, personal and other loans extended by commercial banks. [n] Rate on deposits deflated by the variation in the dollar exchange rate. [o] Average annual values used for monetary figures. [p] Net credit to the public and private sectors extended by commercial banks and other financial and banking institutions.

diminished owing to the slower flow of royalties and energy compensations from Itaipú (US$ 100 million), and to a longer delay in remittances from Yaciretá. Nevertheless, non-tax revenues continued to contribute almost seven percentage points of GDP to total revenues, and in practice made it possible to defer measures to improve tax administration and increase tax collection.

In real terms, tax revenues declined on a broad front (11.5% on average), the steepest falls occurring in income tax (-14.5%) and excise duty (-25%), while VAT revenues declined by the average mentioned above. Although these problems on the income side had been foreseen, spending could not be adjusted and remained at the same average in relation to GDP as in the 2000-2001 biennium. Over half of the government deficit is generated by the *Caja Fiscal* –an institution responsible for social security for pensioners. Unlike the previous year, there was a significant recovery in capital

Table 2
PARAGUAY: MAIN QUARTERLY INDICATORS

	2001				2002[a]				2003[a]	
	I	II	III	IV	I	II	III	IV	I	II
Gross domestic product (change from same quarter of preceding year) [b]	2.1	7.3	-2.2	2.0	-9.8	...	...	...	...	...
Goods exports fob (millions of dollars)	417	581	555	398	459	707	700	453	588	...
Goods imports cif (millions of dollars)	634	642	617	613	578	620	572	621	519	...
International reserves (millions of dollars)	597	680	682	713	575	589	571	629	688	...
Real effective exchange rate (2000=100) [c]	97.6	97.1	105.1	111.0	107.4	106.6	113.5	116.8	119.2	118.7
Consumer prices (12-month variation, %)	7.8	6.7	6.4	8.4	6.5	9.4	13.8	14.6	20.2	15.7
Average nominal exchange rate (guaraníes per dollar)	3,672	3,839	4,289	4,624	4,855	5,121	6,185	6,704	6,959	6,537
Nominal interest rates (annualized percentages)										
Deposit rate [d]	15.8	13.4	17.2	18.5	21.5	20.7	25.2	24.0	25.4	21.3
Lending rate [e]	26.5	26.7	29.3	30.5	31.6	31.3	36.6	37.4	39.6	33.8
Interbank rate [f]	12.9	15.6	26.8	24.3	25.7	20.7	30.0	26.1	23.7	14.0
Domestic credit [g] (change from same quarter of preceding year)	8.2	10.3	14.0	11.9	10.0	7.5	2.7	2.8	-2.2	...
Mature credit as a porportion of total credit (%) [h]	17.8	17.2	17.5	16.2	18.3	18.9	21.3	19.4	21.7	21.4

Source: ECLAC, on the basis of official figures.
[a] Preliminary figures. [b] Based on figures in local currency at constant 1982 prices. [c] Quarterly average, weighted by the value of exports and imports of goods. [d] Effective rate for time deposits in the banking system. [e] Weighted average of effective rates for corporate, development, personal and other loans in the banking system. [f] Monetary regulation instruments (IRMs). [g] Net credit to the public and private sectors extended by commercial banks and other financial and banking institutions. [h] Total credit extended by the banking system.

expenditure in 2002, which rose from 3.4% to 4.3% of output, while current expenditure was virtually unchanged at 15.5% of GDP.

b) Monetary and exchange-rate policy

The upheavals in Brazil and the worsening crisis in Argentina put strong pressure on the guaraní exchange rate in 2002. The first few months of the year saw little variation in the parity, which hovered around 5,000 guaraníes to the dollar. In June, however, faced with the intense debate over privatization and intervention in Paraguay's third largest bank, the exchange rate began to shoot up and by the end of the year it had passed the 7,000 mark. Nonetheless, in view of the sharp devaluation of neighbouring currencies, the real effective exchange-rate variation was no more than 5%. In the first few months of 2003, thanks to currency appreciations in neighbouring countries, the exchange rate dropped back to 6,800 guaraníes to the dollar in April. Then a sizable inflow of foreign currency pushed the rate down further, and by June it stood at 6,200, implying a real depreciation of just 2% for the first half-year.

In keeping with its policy of avoiding major exchange-rate fluctuations, the Central Bank intervened in July 2002 with measures designed to reduce commercial-bank activity in the foreign-exchange market. As a result, the banks' overbought position in the spot market was reduced from 7% to 4% of risk-weighted assets and contingencies, while the legal cash reserve in guaraníes was increased (5% for short-term deposits), and the legal cash reserve in foreign exchange was also raised (1.5% for deposits of all kinds). In the fourth quarter, a mechanism was designed to repeal this measure, which has made it possible to free up additional liquidity.

Monetary policy was kept tight throughout 2002 in response to foreign-exchange market volatility. The authorities made intensive use of monetary regulation instruments, the balance of which grew by 128% during the year, while the average yield on these instruments climbed from 21% in late 2001 to an average of 30% in the third quarter of 2002. In the ensuing months, however, the yield dropped back to 23% in March 2003 and 12% in June. Local currency liquidity contracted by 3.8%, while total liquidity, which includes deposits in foreign currency, diminished slightly. However, given the acceleration of inflation since the middle of the year, the growth rates of these monetary aggregates in real terms were clearly negative, a trend which was reversed in March 2003.

The difficulties being faced by the banking sector are revealed in the corresponding arrears indices; non-performing loans rose from 11.1% of the total portfolio in 2001 to almost 14% in late 2002. This deterioration became clearly evident from the middle of the year and stemmed from the growth of non-performing loans in foreign currency (attributable to the sharp depreciation of the guaraní). In contrast, arrears on loans in local currency actually diminished.

As a result of the regional and domestic factors mentioned above, private-sector deposits in the banking system declined by US$ 385 million during the first half of 2002. During the second half of the year, however, a slow and moderate recovery in these deposits began to be discernable, which was still in evidence in mid-2003.

c) Structural reforms

The State has implemented reforms in a number of areas in recent years. Tax reform, in particular, has served to rationalize the tax system, which nonetheless continues to pose serious management problems, as reflected in the high rate of evasion and the consequently reduced level of revenue collection. The new authorities due to take office in August 2003 have announced their intention to take aggressive steps to reduce evasion, with intervention by the Office of the Under-Secretary of Taxation and Customs.

Another problem being faced by the fiscal sector is the proliferation of tax exemptions adopted since the tax reform, which in some sectors have become relatively widespread; the loss of potential revenue as a result of these exemptions is estimated at some US$ 150 million. In order to raise tax pressure, initiatives for improving tax management need to be supplemented by measures to remove exemptions. As this involves legislation, however, the effects are unlikely to be felt until 2004.

As regards public enterprises, the new authorities have stated that they will not promote privatization; but they will support the establishment of mixed management enterprises with participation from private capital to make them profitable. The Government is expected to maintain control of these companies, however.

The new administration, whose mandate begins in August 2003, attaches high priority to social security reform. The current structure, based on the *Caja Fiscal*, generates almost half of the government deficit –a situation which is unsustainable in both the short and medium term.

In the banking sector, following the demise of the country’s third most solvent private bank (as a direct effect of the Argentine crisis), a bill designed to safeguard savers’ deposits at times of crisis is now before Congress. During the past year, the banking authorities have given priority to supporting viable financial entities; three banks and one other financial institution were wound up during the early months of 2003.

3. The main variables

a) Economic activity

The 2.3% drop in GDP in 2002 reversed the recovery staged in 2001, and total output fell back to 1997 levels. Given Argentina’s rapid population growth of nearly 2.2%, per capita GDP returned to levels similar to those seen at the start of the 1990s.[1]

Agricultural performance was lacklustre in 2002, with production down by 0.6% following the previous year’s record growth of almost 10%. The reduction affected all the main crops but was particularly acute in the case of cotton (-58%) and to a lesser extent in two other major products: soybeans (-6%) and maize (-8.5%).

The steep fall in cotton output reflected areas taken out of cultivation following the slump in prices in 2001. In the case of soybeans, bad weather conditions and pests, especially in the Itapúa and Paraná regions, led to

1 The Central Bank of Paraguay is reviewing estimates of the system of national accounts, and the current version in constant 1982 prices is to be replaced by another series based on 1994 prices. This entails changes in weightings which may have an effect on the GDP calculation.

poorer yields. By contrast, the production of other crops increased substantially, including wheat (63%) and sesame (54%), thanks mainly to larger areas under cultivation; the boom in sugar cane (25%) was attributable to higher yields.

In the merchandise sector, there were widespread output reductions, averaging 5% overall. Construction was the worst performer, accumulating a 30% decline during the 2001-2002 biennium and slipping back to early-1980s levels. Manufacturing output dropped by a further 3% to complete half a decade of poor performance. Against the recessionary backdrop, commerce contracted by 3.5%, while the services sector declined by 3%.

b) Prices, wages and employment

Inflation almost doubled, with the consumer price index (CPI) rising from 8.4% in 2001 to 14.6% in 2002. This upsurge began in June and continued until April 2003, when the increase over 12 months reached as high as 21%. In July, the 12-month variation fell back to 12%, reflecting deflation for the first time in two years over three consecutive months. The trend of inflation between June 2002 and April 2003 reflected steep depreciation in the guaraní: during this period, in which the exchange rate rose by close to 40%. Nonetheless, inflationary pressures in 2002 were mitigated by the sharp fall-off in domestic demand. Predictably, the effects of devaluation during this period were seen more in the prices of tradable goods than in those of non-tradables.

The net effect of faster inflation and small nominal pay increases was a 6.4% loss in the purchasing power of manual workers' wages, thereby entirely wiping out the 1.4% recovery recorded in 2001. In addition, the minimum wage fell in real terms (-0.7%) interrupting the recovery staged in 2000-2001. Although the minimum wage set by the Government is equivalent to about US$ 120, in practice this is often ignored.

Total open unemployment climbed from 7.6% in 2001 to 10.8% in 2002, continuing the deterioration that had begun in 1998, and coinciding with the period of stalled economic growth. Sluggish economic activity caused a significant rise in urban unemployment, from 10.8% to 14.7%, together with a slight decline in the participation rate. As in 2001, construction was one of the sectors hit hardest by unemployment.

c) The external sector

The greater competitiveness of the Paraguayan economy (the real effective exchange rate rose by more than 10%) was reflected in a near 20% expansion in total exports, while total imports were down by 5%. As a result, the merchandise deficit narrowed significantly and, given the traditional surplus in services, the total goods and services position improved from a deficit of US$ 400 million in 2001 to a surplus of US$ 150 million in 2002. Current transfers were smaller, in the wake of reduced family remittances from Argentina, while net interest payments doubled. Thus, the current account deficit of US$ 245 million in 2001 was replaced by a surplus of US$ 300 million in 2002. Nonetheless, there was a substantial outflow of foreign capital estimated at some US$ 400 million, which meant the authorities had to draw down international reserves by nearly US$ 100 million to cover the overall deficit.

Steep devaluations in neighbouring countries led to a fall in registered exports (which account for only 40% of the total) in the early months of 2002. In the second half-year, however, and particularly in the first six months of 2003, they picked up again briskly. Soya exports were down slightly, although in 2003 they are projected to attain record levels. In the fourth quarter of 2002, meat exports were hit by an outbreak of foot and mouth disease and the closure of markets in the European Union and Chile, but this situation should be overcome by mid-2003. Registered imports (equivalent to 70% of the total) contracted by about 20%, although half of this had been recovered in the first quarter of 2003. The steepest slide (33%) occurred in imports of consumer goods, while purchases of intermediate and capital goods declined more moderately.

In a year beset by major difficulties in obtaining external financing, Paraguay's external debt remained virtually unchanged at approximately US$ 2.7 billion. Private-sector debt decreased, but public debt maintained its upward trend of the last five years, during which time it has virtually doubled.

External debt service amounted to US$ 190 million in 2002 (US$ 115 million in amortization payments and US$ 75 million in interest). As of December 2002, overdue payments on the external debt stood at US$ 69 million, of which US$ 44 million was principal and US$ 25 million represented financial costs. This level of arrears represents approximately 3% of Paraguay's external public debt. The external debt burden was equivalent to 117% of the country's exports (an improvement on the previous year's figure), but 49% of GDP (a sharp deterioration). Of total external commitments, only 6.2% has a maturity of five years or less, while 60% of the external debt will only fall due in over 15 years' time.

Peru

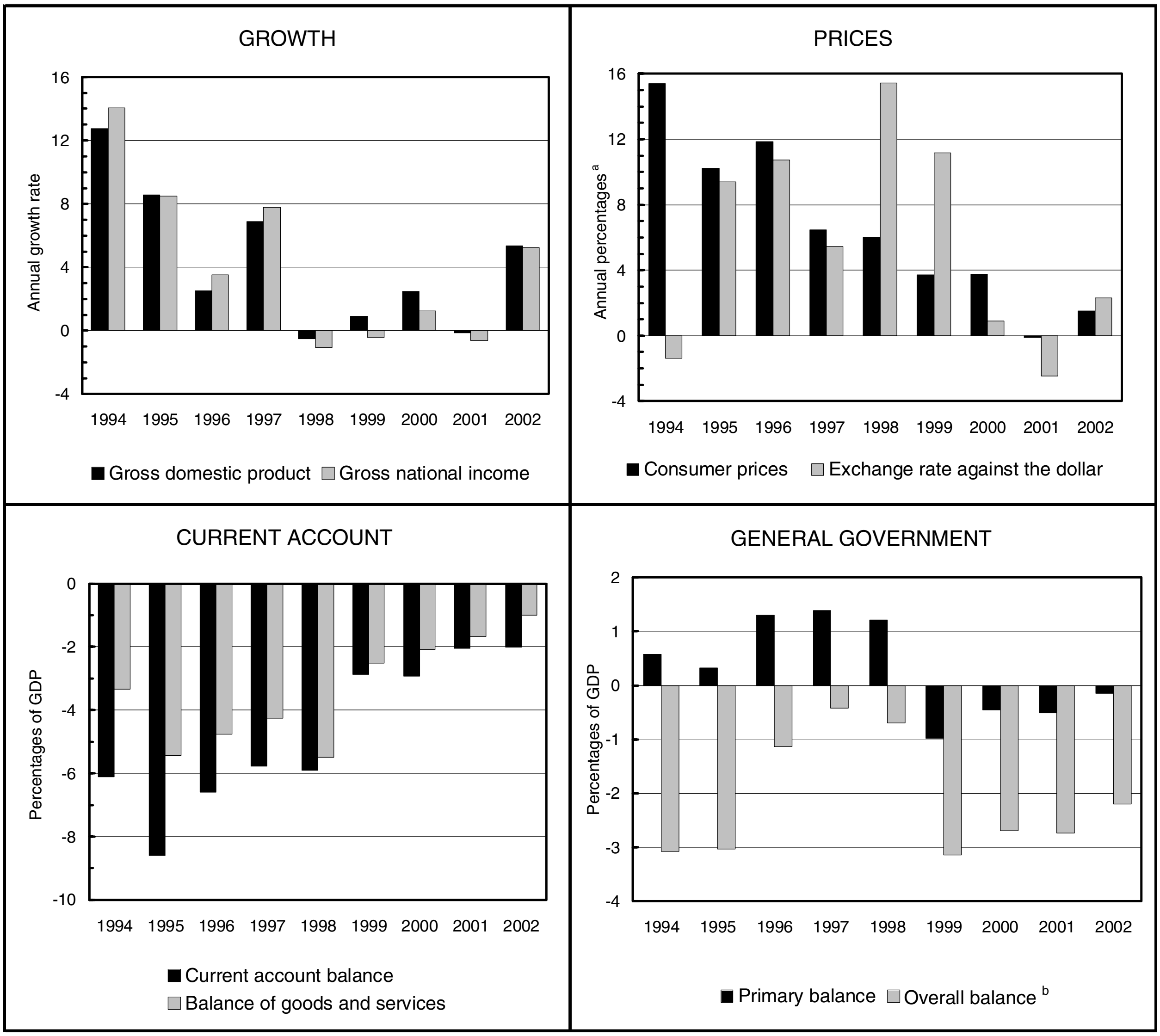
1. General trends

Notwithstanding the unfavourable regional environment and the sluggish pace of the global economy, the Peruvian economy rallied strongly in 2002 and, in a move that ran counter to regional trends, growth projections were revised upward in the course of the year. The 5.3% economic growth rate was based initially on mining exports, but increasingly on an upturn in domestic demand, which was boosted by a moderately expansionary monetary policy and some degree of recovery in the labour market. Fiscal policy was less important as a contributing factor, and the non-financial public-sector deficit declined slightly from 2.5% of GDP in 2001 to 2.3% in 2002.

This faster growth did not erode the progress made in curbing inflation (1.5% at the end of the year) and did not adversely affect the external sector's performance, since the boom in mining exports created a surplus on the merchandise balance, which helped to keep the balance-of-payments current-account deficit no higher than 2% of GDP. Regional economic instability in the third quarter pushed up the exchange rate and interest rates and accentuated the volatility of both indicators, but these phenomena began to subside in the fourth quarter.

For 2003 a growth rate of 3.5% is predicted, based on good export prospects and the increase in domestic demand. A slight resurgence in inflation at the beginning of the year, caused by the increase in international oil prices, was later overcome and price rises have remained within the range established by the monetary authorities. In the early months of the year tax collection remained brisk, but pressures to increase current expenditure are making the fiscal target (reduction of the non-financial public-sector deficit to 1.9% of GDP) harder to achieve. Thanks to the strong surge in exports, the balance-of-payments current-account deficit will be similar to the one posted in 2002, despite the high price of oil.

Figure 1
PERU: MAIN ECONOMIC INDICATORS



Source: ECLAC, on the basis of official figures.
[a] December-to-December variation.
[b] Includes interest.

2. Economic policy

The authorities' objectives were to maintain macroeconomic stability, improve conditions for economic growth and provide a moderate degree of direct economic stimulus by means of monetary policy measures and the targeting of fiscal expenditure. To bolster confidence in the management of macroeconomic policy, a system of explicit inflation targets was introduced and an agreement was signed on a new stand-by arrangement with the International Monetary Fund (IMF), in which goals and policies for the biennium 2002-2003 were defined.

On the whole, the measures applied were successful and proved to be flexible in the face of a worsening regional context in the third quarter of the year. Markets reacted favourably to these developments and to the positive variation in the trade balance, as shown by the narrow spreads for Peru's sovereign bonds in relation to the regional average and by a further significant narrowing of spreads in the fourth quarter and into the first few months of 2003. This reduction in spreads was halted in the second quarter, when political conflicts put increasing pressure on fiscal policy. The exchange rate nevertheless remained relatively stable, and with inflation under control, interest rates fell further.

a) Fiscal policy

One of the objectives for 2002 was to reduce the consolidated public-sector deficit from 2.5% of GDP in 2001 to 1.9%, with a view to guaranteeing the sustainability of public debt. Over the first six months, however, the central government's revenue fell considerably owing to the lowering of the rate of the special solidarity tax starting in the second half of 2001, the reduction of tariffs and a plan for the settlement of back taxes. In the second half of the year these losses were offset by an upturn in economic activity, the steps taken to expand the tax base and an increase in the marginal rate of personal income tax from 20% to 27%. As non-tax revenue also expanded, total central government revenue remained stable in terms of GDP (14.3%), although this level is low in comparison to past years, since central government revenue had averaged 15.6% of GDP between 1995 and 2000.

On the expenditure side, fiscal policy had to contend with the difficulty of whittling down current expenditure because of the wage increases granted the preceding year, the expansion of transfers (especially pension outlays) and the payment of interest, so that this item could be reduced only slightly, from 14.7% to 14.5% of GDP, through cutbacks in purchases of goods and services. Capital expenditure therefore bore the brunt of the adjustment, dropping from 2.3% to 2% of GDP. The central government deficit shrank substantially, but that of the non-financial public sector as a whole only dipped from 2.5% to 2.3% of GDP owing to a downturn in the performance of other public entities. In any event, fiscal policy did not have significant expansionary effects, although certain initiatives such as the "A trabajar" employment programme had a direct impact on domestic demand.

Most of the deficit (2.1% of GDP) was financed from external resources, especially sovereign bonds, while privatizations and concessions contributed 0.7% of GDP; the rest of net domestic financing was negative.

For 2003 the target for the consolidated public-sector deficit was set at 1.9% of GDP. The economic programme also provided for a steady reduction of the deficit and a primary surplus in the coming years in order to deal with the voluminous public debt of more than 46% of GDP. Deficit reduction is expected to be based primarily on an expansion of the tax base. In fact, in the first half of 2003 current income grew by 11% in real terms. Despite the intention to give priority to its recovery, investment fell by 5% in real terms over the same period, while current expenditure grew by 6%. Thanks to the revenue increase, in those six months the central government deficit declined to just over half the level recorded in the same period of 2002. However, in the second quarter, strong pressures arose for an increase in current expenditure, despite the executive branch's difficulties in generating the necessary additional revenues; this situation jeopardizes the chances of achieving the established target. To cover these higher outlays, the general sales tax was temporarily increased. The fiscal deficit is expected to be financed mainly through new international issues (in the first six months of the year a bond issue totalling US$ 750 million was launched), multilateral financing and, to a lesser degree, domestic debt.

A new system was established for resuming bond issues on the domestic market following their suspension in the third quarter of 2002 owing to an unstable regional context and more demanding market requirements in terms of maturities and rates. Under this system, treasury bonds will be the basis for the creation of a capital market for the trading of both public and private securities with different and increasingly long maturities.

Table 1
PERU: MAIN ECONOMIC INDICATORS

	1994	1995	1996	1997	1998	1999	2000	2001	2002[a]
	Annual growth rates [b]								
Gross domestic product	12.7	8.6	2.5	6.9	-0.5	0.9	2.5	-0.1	5.3
Per capita gross domestic product	10.8	6.7	0.7	5.0	-2.2	-0.8	0.8	-1.7	3.8
Gross national income	14.0	8.5	3.5	7.8	-1.1	-0.4	1.2	-0.6	5.2
Gross domestic product by sector									
Agriculture	13.8	7.5	4.5	5.0	0.7	13.2	5.9	-1.3	5.6
Mining	12.0	4.2	5.1	9.0	3.7	13.1	2.3	13.9	11.3
Manufacturing	16.6	5.5	1.5	5.3	-3.2	-1.0	5.6	-0.6	4.1
Electricity, gas and water	10.9	0.2	5.9	12.7	6.2	3.5	4.7	3.7	4.5
Construction	36.1	17.4	-2.3	14.9	0.6	-10.5	-5.8	-6.9	8.3
Wholesale and retail commerce, restaurants and hotels	15.4	9.6	1.4	7.5	-2.7	-1.3	3.9	-0.3	3.8
Transport, storage and communciations	7.2	11.5	5.6	5.6	-1.0	2.1	2.6	-0.3	4.5
Financial establishments, insurance, real estate and business services	7.3	11.8	5.3	8.2	0.4	-1.0	-0.7	-1.1	4.5
Community, social and personal services	5.3	4.0	2.2	2.8	0.4	3.9	1.6	-0.4	4.5
Gross domestic product by type of expenditure									
Consumption	9.7	8.8	3.5	4.8	-0.6	-0.6	2.5	0.2	4.9
General government	8.7	8.5	4.4	7.6	2.5	3.5	5.1	-0.5	2.4
Private	9.8	8.8	3.3	4.4	-1.1	-1.2	2.1	0.4	5.3
Gross domestic investment	32.9	20.0	-4.8	14.8	-1.8	-13.4	-3.6	-7.9	6.5
Exports of goods and services	18.8	6.4	10.7	13.2	4.9	13.5	10.1	7.0	3.8
Imports of goods and services	27.5	24.2	2.4	12.5	1.4	-13.6	2.8	0.4	2.6
	Percentages of GDP								
Investment and saving									
Gross domestic investment [b]	22.5	24.8	23.1	24.8	24.5	21.0	19.7	18.2	18.4
Gross domestic investment [c]	22.2	24.8	22.8	24.0	23.6	21.5	20.1	18.8	19.1
National saving [c]	16.4	16.9	16.5	18.7	17.3	18.0	17.3	16.6	17.0
External saving [c]	5.9	7.9	6.3	5.3	6.3	3.5	2.9	2.2	2.1
	Millions of dollars								
Balance of payments									
Current account	-2,741	-4,618	-3,681	-3,413	-3,357	-1,483	-1,568	-1,094	-1,128
Goods balance	-998	-2,168	-1,986	-1,723	-2,462	-632	-317	-90	261
Exports fob	4,597	5,587	5,898	6,831	5,757	6,116	7,034	7,108	7,688
Imports fob	-5,595	-7,755	-7,884	-8,554	-8,219	-6,748	-7,351	-7,198	-7,426
Services balance	-502	-748	-673	-787	-661	-669	-793	-800	-821
Factor income balance	-1,992	-2,511	-1,912	-1,824	-1,212	-1,148	-1,452	-1,203	-1,474
Current transfers balance	751	809	890	921	978	966	993	999	906
Capital and financial balance [d]	4,293	4,026	4,378	5,468	2,116	616	1,437	1,511	1,909
Net foreign direct investment	3,289	2,550	3,487	2,056	1,580	1,811	662	1,063	2,390
Financial capital [e]	1,004	1,476	891	3,412	536	-1,195	775	448	-481
Overall balance	1,552	-592	697	2,055	-1,241	-867	-131	417	781
Variation in reserve assets [f]	-3,059	-921	-1,784	-1,493	1,142	985	190	-448	-832
Other financing [g]	1,507	1,513	1,087	-562	99	-118	-58	31	51
Other external sector indicators									
Real effective exchange rate (index 2000=100) [h]	93.3	92.5	91.3	91.3	93.0	101.7	100.0	98.0	97.4
Terms of trade for goods (index 1997=100)	92.7	96.9	93.5	100.0	86.9	80.7	78.3	75.1	77.3
Net resource transfer (% of GDP)	8.5	5.6	6.4	5.2	1.8	-1.3	-0.1	0.6	0.9
Gross external public debt (millions of dollars)	30,191	33,378	33,805	28,642	29,477	28,704	28,150	27,508	27,999
Gross external public debt (% of GDP)	67.2	62.2	60.6	48.5	51.9	55.6	52.6	51.6	49.9
Net interest and earnings (% of exports) [i]	-35.2	-37.4	-26.2	-21.8	-16.1	-14.9	-16.9	-14.0	-16.0

Table 1 (concluded)

	1994	1995	1996	1997	1998	1999	2000	2001	2002[a]
					Percentages				
Employment									
Labour force participation rate [j]	59.7	62.4	60.3	63.3	65.4	66.9	64.4	66.7	68.4
Open unemployment rate [k]	8.8	8.2	8.0	9.2	8.5	9.2	8.5	9.3	9.4
Visible underemployment rate [k]	...	...	16.1	14.5	11.6	11.3	11.3	11.7	10.7
					Annual percentages				
Prices									
Variation in consumer prices	15.4	10.2	11.8	6.5	6.0	3.7	3.7	-0.1	1.5
Variation in wholesale prices	10.5	8.8	11.4	5.0	6.5	5.5	3.8	-2.2	1.7
Variation in nominal exchange rate	-1.4	9.4	10.7	5.4	15.4	11.1	0.9	-2.4	2.3
Variation in average real wage	15.6	-8.4	-4.8	-0.7	-1.9	-2.2	0.8	-0.9	4.7
Real deposit rate [l]	-3.4	-1.4	-0.7	3.2	5.5	7.7	5.7	8.4	1.2
Real lending rate [m]	34.6	14.4	13.6	21.6	24.5	26.0	23.2	26.0	18.1
Equivalent deposit rate in foreign currency [n]	11.4	0.2	-0.5	4.7	-3.9	0.6	8.8	10.2	1.2
					Percentages of GDP				
General government									
Current income	17.3	17.8	18.5	18.9	18.7	17.6	17.7	17.3	17.2
Current expenditure	15.5	16.1	15.5	14.8	15.4	16.7	17.0	17.2	16.8
Saving	1.8	1.7	3.0	4.1	3.3	0.9	0.7	0.1	0.4
Capital balance	-4.9	-4.7	-4.1	-4.5	-4.0	-4.0	-3.4	-2.9	-2.6
Primary balance	0.6	0.3	1.3	1.4	1.2	-1.0	-0.5	-0.5	-0.1
Overall balance	-3.1	-3.0	-1.1	-0.4	-0.7	-3.1	-2.7	-2.7	-2.2
Public debt	...	...	...	...	...	47.1	46.4	45.7	46.6
External	53.4	47.9	45.2	31.8	34.4	37.8	36.9	35.0	36.4
Domestic	...	...	...	...	...	9.3	9.5	10.7	10.2
Interest payments (% of current income)	21.1	18.9	13.2	9.6	10.2	12.2	12.6	12.9	11.9
Money and credit [o]									
Domestic credit [p]	11.3	13.0	16.1	20.3	25.3	27.6	26.9	26.6	25.2
To public sector	...	-1.0	-1.9	-1.1	-0.5	-0.3	0.9	1.3	1.7
To private sector	11.3	14.0	18.0	21.4	25.8	27.9	26.0	25.2	23.6
Liquidity (M3)	17.7	18.2	22.0	21.9	22.9	24.1	22.9	25.1	25.2
Currency in circulation and domestic currency deposits (M2)	6.1	6.4	6.8	7.2	6.5	6.7	6.4	7.7	7.9
Foreign currency deposits	11.6	11.8	15.2	14.6	16.3	17.3	16.5	17.4	17.4

Source: ECLAC, on the basis of official figures.
[a] Preliminary figures. [b] Based on constant 1995 dollars. [c] Based on figures in local currency at current prices. [d] Includes errors and omissions. [e] Refers to the balance on the capital and financial accounts, minus net foreign direct investment plus errors and omissions. [f] A negative sign denotes an increase in reserves. [g] Includes the use of credit and loans from IMF and exceptional financing. [h] Annual average, weighted by the value of exports and imports of goods. [i] Refers to net investment income divided by exports of goods and services from the balance of payments. [j] Economically active population as a percentage of the working-age population, metropolitan Lima; 1996 to 2000, urban total. [k] Rates of unemployment and underemployment are percentages of the economically active population in metropolitan Lima. [l] Local currency deposit rate (TIPMN). [m] Local currency lending rate (TAMN). [n] Rate on deposits deflated by the variation in the dollar exchange rate. [o] Average annual values used for monetary figures. [p] Net credit to the public and private sectors extended by commercial banks and other financial and banking institutions.

b) Monetary and exchange-rate policy

At the beginning of 2002, in view of the inflation rate's clear tendency to decline, the authorities introduced a system of explicit inflation targets in which 2.5% was set as the goal with a lower limit of 1.5% and an upper limit of 3.5%. The exchange rate was generally allowed to float freely, with intervention only in situations of volatility.

Negative growth in the consumer price index at the start of the year and the very low inflation posted subsequently prompted the authorities to apply an expansionary monetary policy in the first half of the year. The interbank rate accordingly fell to 2.5% in the second quarter, from an average of 8.6% in 2001. The real exchange rate showed little variation, evincing the greater calm on the markets following the end of the uncertainty surrounding the 2001

Table 2
PERU: MAIN QUARTERLY INDICATORS

	2001				2002[a]				2003[a]	
	I	II	III	IV	I	II	III	IV	I	II
Gross domestic product (change from same quarter of preceding year)[b]	-2.5	-0.9	1.8	4.1	2.7	6.7	5.8	5.9	5.2	...
Goods exports fob (millions of dollars)	1,663	1,740	1,915	1,790	1,578	1,985	2,136	1,990	2,028	...
Goods imports cif (millions of dollars)	1,848	1,760	1,849	1,740	1,643	1,861	1,965	1,957	2,036	...
International reserves (millions of dollars)	8,111	8,342	8,679	8,613	8,786	9,126	9,857	9,598	10,443	9,997
Real effective exchange rate (2000=100)[c]	99.0	99.3	97.4	96.4	95.8	95.8	99.2	98.6	98.1	100.1
Unemployment rate	...	9.5	9.5	8.9	10.6	9.9	8.5	8.7	10.0	9.3
Consumer prices (12-month variation, %)	3.6	2.5	0.9	-0.1	-1.1	0.0	0.7	1.5	3.4	2.2
Average nominal exchange rate (new soles per dollar)	3.5	3.6	3.5	3.4	3.5	3.5	3.6	3.6	3.5	3.5
Real average wage (change from same quarter of preceding year)	-3.3	-1.5	0.3	0.8	5.8	5.9	3.0	...	...	...
Nominal interest rates (annualized percentages)										
Deposit rate [d]	8.7	8.3	7.5	5.7	4.1	3.2	3.2	3.7	3.5	3.3
Lending rate [e]	25.3	25.8	25.8	23.1	22.1	19.9	20.0	21.1	20.2	20.2
Interbank rate	10.7	13.7	6.6	3.7	2.6	2.5	3.7	4.1	3.8	3.8
Sovereign bond spread (basis points)	648	628	670	520	418	622	874	606	480	504
Stock price indexes (indexes, June 1997=100)	48.1	49.2	50.4	49.9	56.1	51.7	55.1	65.3	76.1	82.7
Domestic credit [f] (change from same quarter of preceding year)	-2.0	0.3	-2.2	-0.9	-0.6	-1.4	4.5	-0.2	-2.7	...
Mature credit as a porportion of total credit (%)[g]	10.3	9.9	9.9	9.0	9.0	8.0	8.1	7.6	7.7	7.7

Source: ECLAC, on the basis of official figures.
[a] Preliminary figures. [b] Based on figures in local currency at constant 1994 prices. [c] Quarterly average, weighted by the value of exports and imports of goods. [d] Deposits up to 30 days. [e] Local currency lending rate (TAMN). [f] Net credit to the public and private sectors extended by commercial banks and other financial and banking institutions. [g] Refers to total credit extended by multiple banks.

election, the improvement in the external accounts and low inflation.

With regional markets more volatile in the third quarter, the authorities opted to defend the exchange rate, which led to an increase in the interbank rate (up to a monthly average of 5.4% in September) and a real depreciation of the local currency against the dollar. Once the volatility of regional markets had passed, the nuevo sol strenghtened; at the end of 2002 the year-on-year decline in the bilateral real exchange rate was only 3.2%, while the multilateral real exchange rate was up by 1.8%. Given the calm prevailing on the markets, the authorities again cautiously eased monetary policy, although the interbank rate did not return to its former low levels and in December reached a monthly average of 3.8%.

For 2003 the authorities again set an inflation target of 2.5% with a one-point margin in each direction, and explicitly established that the interbank rate should stay within a range defined by the lending and deposit rates of the central bank's monetary operations with the banking system; they also agreed to curb the interbank rate's volatility. In fact, with international rates low and regional markets relatively calm, the interbank rate hovered around 3.8% for the first few months. Taking advantage of the degrees of freedom afforded by the decline in inflation, the authorities decided in mid-year to lower the rates. The nuevo sol remained relatively stable and, between December 2002 and June 2003, appreciated by 1.2% against the dollar in real terms.

The credit bubble created by the 1998 crisis had left the financial sector and many debtors in a difficult situation. This problem was complicated by lethargic economic growth in subsequent years. Bank balances continued to improve slowly throughout 2002, however, and the percentage of delinquent loans declined from 9% to 7.6%. Despite lower interest rates, credit from the banking system to the private sector did not pick up and, at the end of the year, showed year-on-year growth of only 0.3%. Mortgage and consumer loans were the most dynamic, increasing their share of bank loans from 9.6% to 10.7% and from 8.6% to 9.4%, respectively. At the aggregate level, in the first few months of 2003 the demand for credit remained weak and bank loans to the private sector actually showed negative year-on-year growth. However, mortgage and consumer loans continued to expand.

c) Structural reforms

In order to foster the recovery of growth, tariffs on a series of capital goods were lowered from 12% to 7% and then, in some cases, to 4%. The renewal by the United States of the Andean Trade Preference Act (ATPA), now termed the Andean Trade Promotion and Drug Eradication Act (ATPDEA), extended the benefits of this Act to Andean garment exports.

Within the framework of the Andean Community, discussions have been continuing on the common external tariff (CET) and on the definition of a starting point for negotiations concerning the Free Trade Area of the Americas (FTAA). Peru adopted the CET in respect of 62% of its tariff items, which represent between 30% and 40% of its foreign trade. Because of these changes, the average tariff rate declined, although tariff dispersion increased. In the interests of intensifying trade integration, the authorities also hope to conclude bilateral agreements with Brazil, Canada, Mexico and the United States.

In 2002 the authorities planned to pursue the privatization and concession programme and expected to raise US$ 700 million this way. However, strong opposition to the privatization of two power generation companies in the southern part of the country prevented this operation from being completed. Thus, only US$ 418 million was collected, most of which came from the concession of two power transmission companies. In addition, the process of regionalization began with a constitutional reform and a basic law on the subject, as well as the election of regional presidents.

3. The main variables

After four years of stagnation, economic activity rallied in 2002, with a moderately positive effect on the labour market. At the same time, inflation stayed low and the balance-of-payments current-account deficit was stable and manageable, although the problem of high external debt and its financing remained.

a) Economic activity

Output increased faster than had been projected at the beginning of the year owing to a surge in domestic demand in the second half, while exports showed the expected buoyancy. Extraction from the Antamina deposit, the world's largest combined copper and zinc mine, which had come on stream in 2001, contributed significantly to this performance. Thanks especially to mining exports, the volume of external sales grew by 5.7%.

The upsurge in household consumption in the second half was based on an increase in labour income (attributable to the rise in the level of employment and, to a lesser extent, to the level of real wages in the formal sector) and on an increase in credit, which led to an annual growth rate of 4.4%. Towards the end of the year private investment also showed greater dynamism, but its annual rate was only 0.7%. As the control of fiscal expenditure caused public investment to contract by 8.9%, gross fixed capital formation fell from 18.2% to 17.2% of GDP. Nevertheless, there was a major build-up of inventories (especially of fish meal), which accounted for a quarter of the increase in GDP and pushed gross domestic investment up by 7.9%. Overall domestic demand grew by 4.8%, which was similar to the rate of GDP growth.

As mentioned above, export growth was driven by the buoyancy of the mining industry, which posted double-digit growth for the second year in a row; there were particularly noteworthy increases in copper, zinc and gold output. Oil and gas production was flat owing to the exhaustion of the oilfields being exploited. However, the exploitation of the Camisea gas field beginning in 2004 will give new impetus to this sector. In addition to the outstanding performance of the mining industry, the other primary sectors –agriculture (5.8%)

and fisheries (3.1%)– posted good results and grew faster than they had in 2001.

While raw materials-processing industries as a whole stagnated, non-primary manufacturing, with an expansion of 5.3%, clearly reflected the strengthening of domestic demand in the second half and the opportunities opened up by the ATPDEA in the last quarter. Branches such as textiles, leather and footwear, paper and printing, non-metallic minerals and metal products picked up smartly beginning in mid-year. The manufacturing industry as a whole grew by 4.2%.

After mining, construction showed the highest growth rate (8.3%), continuing the expansion it had begun in the last quarter of 2001. Contributing factors included an upturn in residential construction –boosted by two government programmes aimed at the middle- and low-income sectors of the population, respectively, and by the increase in mortgage loans–, construction work for the Camisea gas fields and other public works on roads and highways, and reconstruction in the region affected by the earthquake that struck in 2001. Commerce and other services expanded at below-average rates (by 3.8% and 4.9%, respectively), but both sectors grew faster in the second half of the year, which coincided with the boom in domestic demand.

In 2003 external demand has remained relatively buoyant, especially for mining exports, while increases in the wage bill and consumer credit continue to fuel private consumption. In view of the high level of idle capacity in many areas, private investors continue to take a cautious approach, although the Camisea project, other mining projects, residential and commercial construction, telecommunications and the expansion of productive capacity in the textile industry are expected to generate the first increase in gross fixed capital formation since 1997.

Over the first five months of 2003 GDP expanded by 4.3%, albeit from a relatively low basis for comparison. Mining output (especially gold and silver) continued to grow, although the rates are no longer in the double digits, and non-primary manufacturing maintained the dynamism seen at the end of 2002. Agricultural production expanded more slowly and the fisheries sector experienced negative growth. For the year as a whole, growth of 3.5% is projected, starting from higher levels of comparison.

b) Prices, wages and employment

The year 2002 began with slight deflation, but the level of consumer prices rose slowly as the months went on. By the end of the year inflation had reached the floor of the band which the authorities had established as a target (1.5%). The wholesale price index reflected deflation of 3.1% in February, but the economic upturn reversed this trend, and in December an increase similar to that of the CPI was recorded (1.7%).

At the beginning of 2003 international tension and conflict continued to push up oil prices. Owing largely to higher fuel and transport costs, in March inflation rose to 3.4%, nearly reaching the ceiling of the inflation target band. However, with the end of major combat operations in Iraq, oil prices trended downward and annual inflation abated to 2.2% in June; thus, it is perfectly feasible that the inflation target for this year will be met.

In previous years economic crisis and stagnation had dragged down real wages in the formal sector, reducing them by almost 10% between 1995 and 2001. In 2002 the brief period of deflation and the subsequent period of low inflation partially restored the purchasing power of wages and salaries in the formal sector, which experienced real increases of 4.7% and 0.9%, respectively. By contrast, the nominal minimum wage was maintained, with the result that the annual average suffered a small loss of 0.2% in real terms.

Aggregate employment improved significantly in the course of 2002. The employment rate in Lima went from 60.5% to 62%. Many of the new jobs were based on informal activities and on emergency employment programmes, so that visible underemployment increased. Since the labour supply expanded substantially because of the perception of more work opportunities (with an increase in the participation rate from 66.7% to 68.5%), open unemployment scarcely changed remaining at an annual average of 9.4%.

While new jobs were concentrated in the informal sector, employment in the formal sector did not pick up until the second half of the year, with the result that the annual average level of employment remained unchanged. At the start of 2003 the expansion of formal employment, which had begun in late 2002, was still continuing and the generation of new jobs was becoming more concentrated in large commercial and service establishments. Over the first six months the rise in the level of employment resulted in a moderate reduction in the unemployment rate.

c) The external sector

In 2002 Peru posted an unusual merchandise trade surplus of US$ 260 million as its brisk export growth outpaced the increase in imports, which, for their part, started to reflect the upturn in economic activity.

The increase in the value of exports of goods and services (7.3%) was attributable largely to expanded sales of mining products as a result of a volume increase (copper, gold, lead, zinc) and, in the case of gold and silver, better prices due to the uncertainty prevailing on global markets. Gold alone represented 19% of the country's exports and accounted for 54% of the increase posted in 2002. Traditional agricultural exports were flat and fisheries exports diminished. Non-traditional products increased slightly (3.9%), with strong growth in exports of vegetables, fruit and wood and, beginning in the last quarter, textiles.

The value of imports of goods and services rose by 3.1%; consumer goods imports were particularly strong from the second quarter onward, growing by 11.3% over the year as a whole. Input purchases increased by 4.3%, while capital goods did not record positive growth rates until the last few months, netting a 3.6% decline for the whole year.

With this improvement in the merchandise trade balance and a stable deficit in non-factor services, the trade deficit declined from 1.7% to 0.9% of GDP. Factor income transfers showed a wider deficit and current transfers declined, reflecting both the difficult situation in some neighbouring countries and the depreciation of their currencies, which eroded remittances from Peruvians working in those countries. Consequently, the current-account deficit remained at the previous year's level of 2% of GDP.

By contrast, the surplus on the financial and capital account increased markedly, from 2.8% to 3.4% of GDP. The main contributing factors were foreign direct investment (especially the purchase of a beer company and new investments in copper) and public-sector borrowing; on the other hand, there was an outflow of short- and long-term capital from the private sector (due to both loan amortizations and bond purchases), and income from privatizations declined. The overall result was a surplus equivalent to 1.4% of GDP, which boosted the central bank's international reserves by US$ 985 million. This trend continued in the first few months of 2003, causing reserves to exceed US$ 10 billion.

Foreign trade continued to expand in the first five months of 2003. The increase in export value (22%) was attributable mainly to commodities, and the increase in import value (13%), to fuels, but with significant increases in other items as well.

In 2002 the Peruvian authorities returned to international markets with two sovereign bond issues. At the beginning of the year global bonds were issued for an amount of US$ 500 million plus US$ 930 million for a Brady bond swap, while another US$ 500-million bond issue was launched in November. In January and March 2003 two more issues (of US$ 500 million and US$ 250 million, respectively) were placed on the market in order to take advantage of the favourable trend in Peru's country risk, which, while affected by the regional market upheavals in the second and third quarters of 2002, stayed far below the regional average and fell once again in the last quarter of 2002 and the first quarter of 2003.

In 2002 the amount of Peru's external debt fell below 50% of GDP, since the increase in public debt was more than offset by a reduction in private debt.

Dominican Republic

1. General trends

Economic growth in the Dominican Republic was again satisfactory in 2002, but it took place in a context of serious macroeconomic instability that worsened in the first half of 2003, with rising inflation, currency depreciation, losses in international reserves and a banking crisis. The expansionary fiscal policy applied at the beginning of the year to compensate for the weakness of external demand had to be abandoned in later months because of macroeconomic imbalances.

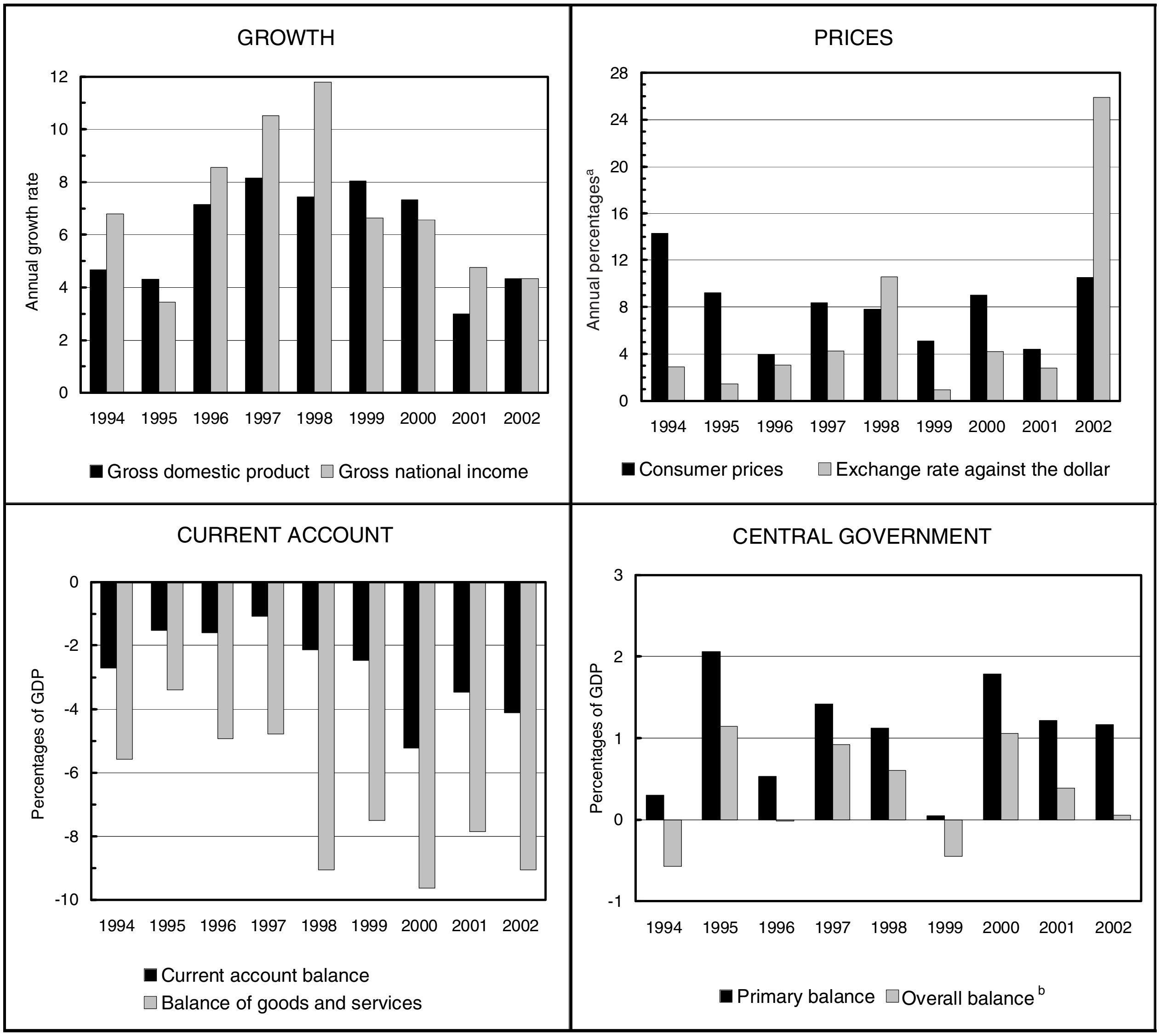
In contrast with the modest results achieved in the rest of Latin America and the Caribbean, activity in the Dominican Republic increased by 4.3% in 2002 and per capita GDP rose once again, despite the weakness of external demand on account of the poor performance of the United States economy. The central factor behind this development was domestic demand, which was boosted by increases in public spending and private consumption; the latter, in turn, was buoyed by a larger inflow of family remittances from abroad, which amounted to over 11% of private consumption.

For the second consecutive year, increased public spending compensated for the lack of dynamism in exports, and was financed in part with resources still available from the sovereign bonds issued in 2001. In view of the worrying signs of macroeconomic instability, the authorities curbed spending and tightened monetary restrictions. Moreover, at the end of the year the government and the business sector, in an effort to support stabilization, signed a Pact for Stability and Economic Development that involved extending fiscal and monetary austerity into 2003. The most significant adjustments were undoubtedly in the areas of foreign exchange and interest rates for local-currency transactions. The increased perception of uncertainty and risk accelerated the dollarization of loans and deposits, thereby increasing exposure to foreign-currency risk.

Employment expanded in 2002, but real wages were down slightly and inflation more than doubled (10.5%). The central government accounts closed the year with a small surplus, and the balance-of-payments current-account deficit rose marginally. Net capital inflows from abroad slackened and there was a significant loss of international reserves, owing to the currency stabilization efforts and the outflow of private capital.

In the first half of 2003 the export sector continued the recovery it had begun in the final months of 2002 with regard to both exports from the free zones and tourist arrivals, due in part to the substantial currency depreciation. The economic picture became more complicated, however, when a crisis broke out in the banking system, requiring administrative intervention in a major bank and the allocation of financial resources in an amount that could reach 15% of GDP, while exchange-rate volatility became more acute. Interest rates increased, the inflation rate went up and further capital flight appears to have taken place. Accordingly, the economic uncertainty triggered by the war in Iraq in the first quarter grew stronger in the second quarter.

Figure 1
DOMINICAN REPUBLIC: MAIN ECONOMIC INDICATORS



Source: ECLAC, on the basis of official figures.
[a] December-to-December variation.
[b] Includes interest.

In the face of financial and institutional fragility, the authorities redoubled their efforts to stabilize the economy by applying significant monetary restrictions and fiscal austerity measures. Negotiations with international financial institutions (the International Monetary Fund, the World Bank and the Inter-American Development Bank) to obtain about US$ 1.5 billion to alleviate the crisis culminated at the end of June with the submission of a letter of intent to the International Monetary Fund, linked to a two-year stand-by arrangement. The announcement that the country would soon enter into such an arrangement, which would impose greater fiscal and monetary discipline, in addition to banking supervision and regulation, helped to stabilize the foreign-exchange market and reduce uncertainty. The severity of the austerity measures, however, makes it unlikely that the country will meet the goal, established early in the year, of increasing GDP growth from 2.5% to 3%. The annual inflation target, meanwhile, was already overshot in the first half of the year.

2. Economic policy

Economic policy went through two clearly differentiated stages in 2002. At the beginning of the year public expenditure was increased to compensate for the drop in external demand. However, as external demand failed to recover to the extent hoped, income from abroad remained low and oil became more expensive, signs of unsustainable macroeconomic imbalances emerged and prompted the authorities to switch from an expansionary monetary policy to a restrictive one, with a consequent hike in interest rates. The authorities also modified their exchange-rate policy, substituting indirect measures for direct intervention in the foreign-exchange market. Moreover, an adjustment of electricity and fuel prices had a considerable impact on the rate of consumer price increases. The adoption of the Monetary and Financial Act and the introduction of a pension fund system represented significant progress in modernizing the financial sector.

In the first half of 2003, in the face of exchange-rate volatility and the banking crisis, the authorities intensified the stabilization measures by placing more severe restrictions on monetary liquidity. They also increased fiscal austerity in the context of the negotiations with the International Monetary Fund for a US$ 1.5-billion stand-by arrangement to shore up the banking system, which the crisis in one of the country's major banks had seriously damaged.

a) Fiscal policy

The most striking aspect of fiscal policy was the considerable real increase in public spending in the first half of the year, financed in part with resources still available from the sovereign bond issue of 2001. In any case, the central government's financial accounts were practically balanced at the end of the year, while the consolidated public sector showed a deficit of nearly 1.5% of GDP, compared to 2% the previous year. The fiscal reform proposal submitted by the executive branch to the Congress, which included various tax adjustments, will be reconsidered in the context of the Pact for Stability and Economic Development.

In real terms, central government receipts rose by 6.6% thanks to the expansion of domestic demand and the reforms introduced the previous year. Tax revenues were up by 5.1% owing to the increase in indirect tax receipts. The amount contributed by the tax on the transfer of goods and services increased by 11.2%, in view of higher receipts from internal and external trade and specific taxes, but income tax receipts, which account for 26% of the government's tax revenue, remained virtually stagnant.

Public expenditure rose by 8.8% in real terms as a result of increases in both operating costs and investment. Payroll expenses grew by 10.2% as new employees were hired, partly because of the establishment of three new secretariats of State. In addition, adjustments were made to real wages, in particular for lower-income employees.

The elimination of the subsidy for liquefied petroleum gas and the focusing of the electricity consumption subsidy on low-income families in mid-2001 brought about a welcome reduction in current contributions to decentralized institutions in 2002. In contrast, there was an increase in costs associated with public debt, namely the payment of internal liabilities (especially bank loans and amounts owed to suppliers) and external liabilities stemming from the 2001 sovereign bond issue. In early 2003 the government launched a second sovereign bond issue for US$ 600 million, which it used to pay short-term domestic debt and to build up international reserves. In the first half of the year capital expenditure rose by more than 50% in nominal terms, but the annual average increase was 16.9% in real terms, owing to cutbacks in the second half.

The year-end balance of public and publicly guaranteed external debt was US$ 4.459 billion, which was US$ 282 million more than the year before, while the debt ratio was 21% of GDP, or one and a half percentage points higher than in 2001. Larger increases were observed in official liabilities, both with governments and with multilateral institutions.

In mid-2002 the Congress took up the tax reform proposal, which includes fiscal changes such as corrections to the tax on the transfer of services deducted by companies, the reduction of the inheritance tax from 7% to 3%, an extension of the period of fiscal amnesty for individuals and the exemption of housing loans from tax. In line with the commitments made in the Pact concluded with the business sector, however, the government postponed the fiscal reform proposal, introduced an austere spending policy and agreed to produce a fiscal surplus and to keep a tight rein on public borrowing.

The fiscal reform proposal was taken up again in the first few months of 2003, but by mid-year had not

Table 1
DOMINICAN REPUBLIC: MAIN ECONOMIC INDICATORS

	1994	1995	1996	1997	1998	1999	2000	2001	2002[a]
				Annual growth rates [b]					
Gross domestic product	4.7	4.3	7.2	8.2	7.4	8.0	7.3	3.0	4.3
Per capita gross domestic product	2.9	2.5	5.3	6.3	5.6	6.2	5.5	1.3	2.6
Gross national income	6.8	3.4	8.6	10.5	11.8	6.6	6.5	4.8	4.3
Gross domestic product by sector									
Agriculture	-1.8	5.2	9.2	3.3	1.1	8.7	5.6	8.1	2.5
Mining	88.2	9.4	2.4	3.1	-15.9	-1.5	13.3	-15.2	-3.2
Manufacturing	3.5	1.3	3.1	7.5	5.7	6.0	7.5	-1.3	4.0
Electricity, gas and water	3.8	-4.1	10.3	10.1	13.9	8.1	6.9	18.4	7.8
Construction	6.6	6.9	13.4	17.1	19.6	17.7	5.6	0.5	3.2
Wholesale and retail commerce, restaurants and hotels	6.8	6.6	10.1	12.4	9.4	8.6	10.7	-1.2	3.8
Transport, storage and communciations	6.1	10.1	10.0	11.7	13.6	10.1	11.3	10.5	10.3
Financial establishments, insurance, real estate and business services	0.6	1.2	2.1	2.8	3.0	3.2	2.8	2.5	2.6
Community, social and personal services	2.9	2.0	5.1	3.8	4.6	3.7	4.3	6.2	3.8
Gross domestic product by type of expenditure									
Consumption	7.9	2.5	8.9	8.1	9.3	5.8	10.5	3.2	5.6
General government	7.2	-0.5	10.7	1.3	6.6	3.5	-1.0	14.9	8.5
Private	8.0	2.7	8.8	8.5	9.4	5.9	11.0	2.7	5.5
Gross domestic investment	-10.3	2.7	7.5	18.9	29.0	11.9	7.4	2.7	2.2
Exports of goods and services	5.2	9.8	7.3	11.6	11.3	7.7	9.3	-6.8	-2.0
Imports of goods and services	4.1	5.5	10.3	14.9	21.4	6.2	13.4	-4.6	0.4
				Percentages of GDP					
Investment and saving									
Gross domestic investment [b]	18.4	18.1	18.2	20.0	24.0	24.9	24.9	24.8	24.3
Gross domestic investment [c d]	21.4	19.5	19.0	19.8	23.4	24.2	24.0	23.1	23.2
National saving [c]	18.7	18.0	17.4	18.7	21.3	21.7	18.7	19.7	19.1
External saving [c]	2.7	1.5	1.6	1.1	2.1	2.5	5.2	3.5	4.1
				Millions of dollars					
Balance of payments									
Current account	-283	-183	-213	-163	-338	-429	-1,027	-741	-875
Goods balance	-1,451	-1,391	-1,674	-1,995	-2,617	-2,904	-3,742	-3,503	-3,699
Exports fob	3,453	3,780	4,053	4,614	4,981	5,137	5,737	5,276	5,183
Imports fob	-4,903	-5,170	-5,727	-6,609	-7,597	-8,041	-9,479	-8,779	-8,883
Services balance	867	985	1,019	1,275	1,182	1,602	1,854	1,826	1,771
Factor income balance	-682	-769	-725	-795	-890	-975	-1,041	-1,092	-1,135
Current transfers balance	983	992	1,168	1,352	1,987	1,848	1,902	2,028	2,188
Capital and financial balance [e]	-228	329	173	254	350	581	978	1,256	322
Net foreign direct investment	207	414	97	421	700	1,338	953	1,079	961
Financial capital [f]	-435	-85	76	-167	-350	-757	25	177	-639
Overall balance	-511	146	-40	91	11	151	-48	515	-553
Variation in reserve assets [g]	385	-131	15	-40	-98	-194	70	-519	526
Other financing [h]	126	-15	25	-51	87	42	-22	4	27
Other external sector indicators									
Real effective exchange rate (index 2000=100) [i]	107.3	102.5	99.4	98.8	103.6	104.2	100.0	96.2	98.5
Terms of trade for goods (index 1997=100)	93.7	98.0	95.8	100.0	101.1	101.9	100.0	101.5	100.9
Net resource transfer (% of GDP)	-7.5	-3.8	-4.0	-3.9	-2.9	-2.0	-0.4	0.8	-3.7
Gross external public debt (millions of dollars)	3,946	3,999	3,807	3,572	3,537	3,636	3,682	4,177	4,459
Gross external public debt (% of GDP)	37.8	33.5	28.6	23.7	22.3	20.9	18.8	19.6	20.9
Net interest and earnings (% of exports) [j]	-13.6	-14.1	-12.3	-11.9	-12.7	-13.4	-13.1	-14.8	-16.4

Table 1 (concluded)

	1994	1995	1996	1997	1998	1999	2000	2001	2002[a]
				Percentages					
Employment									
Labour force participation rate [k]	53.3	51.9	52.6	54.1	52.6	53.5	55.2	54.3	55.1
Unemployment rate [l]	16.0	15.8	16.5	15.9	14.3	13.8	13.9	15.4	16.1
				Annual percentages					
Prices									
Variation in consumer prices	14.3	9.2	4.0	8.4	7.8	5.1	9.0	4.4	10.5
Variation in nominal exchange rate	2.9	1.4	3.0	4.2	10.6	1.0	4.2	2.8	25.9
Variation in real urban minimum wage	6.4	0.5	0.6	1.4	4.3	4.9	-0.1	5.5	-0.5
Real deposit rate [m]	-0.2	9.1	6.6	7.8	10.2	8.6	6.4	12.8	2.6
Real lending rate [n]	...	...	15.7	14.7	17.2	16.9	14.9	20.5	10.2
Equivalent deposit rate in foreign currency [o]	11.8	15.5	10.7	9.1	6.8	15.1	12.7	12.4	-7.5
				Percentages of GDP					
Central government									
Current income	15.2	15.2	14.2	15.9	15.9	15.6	15.9	16.5	16.7
Current expenditure	7.6	7.8	8.1	11.0	11.1	11.2	11.4	12.0	12.2
Saving	7.6	7.4	6.1	4.9	4.7	4.4	4.5	4.5	4.5
Capital balance	-8.3	-6.4	-6.1	-4.1	-4.3	-5.0	-3.6	-4.2	-4.6
Primary balance	0.3	2.1	0.5	1.4	1.1	0.0	1.8	1.2	1.2
Overall balance	-0.6	1.1	0.0	0.9	0.6	-0.5	1.1	0.4	0.1
Public debt	...	...	...	...	...	...	...	...	...
External	24.2	21.5	...	...	...	...	...	...	...
Domestic	...	...	...	...	...	...	...	...	...
Interest payments (% of current income)	5.7	6.0	3.9	3.1	3.3	3.2	4.5	5.0	6.6
Money and credit [p]									
Domestic credit [q]	23.3	22.8	25.3	25.4	28.2	31.0	33.3	35.9	39.5
To public sector	0.1	0.2	1.5	1.3	1.0	1.7	2.0	1.9	2.6
To private sector	23.1	22.6	23.7	24.2	27.1	29.3	31.3	34.0	37.0

Source: ECLAC, on the basis of official figures.
[a] Preliminary figures. [b] Based on constant 1995 dollars, at the official adjusted exchange rate. [c] Based on figures in local currency at current prices. [d] In the base year 1995, the difference with respect to calculation at constant prices arises from the use, for this purpose only, of an adjusted official exchange rate. [e] Includes errors and omissions. [f] Refers to the balance on the capital and financial accounts, minus net foreign direct investment plus errors and omissions. [g] A negative sign denotes an increase in reserves. [h] Includes the use of credit and loans from IMF and exceptional financing. [i] Annual average, weighted by the value of exports and imports of goods. [j] Refers to net investment income divided by exports of goods and services from the balance of payments. [k] Economically active population as a percentage of the working-age population, nationwide total. [l] Unemployed as a percentage of the economically active population, nationwide total. Includes hidden unemployment. [m] 30-day financial certificates, multiple banks. [n] 90-day loans, multiple banks. [o] Rate on deposits, deflated by the variation in the dollar exchange rate. [p] Average annual values were used for monetary figures. [q] Net credit to the public and private sectors extended by commercial banks and other financial and banking institutions.

yet been adopted by the Congress. In the first four months tax revenue stagnated in real terms, partly because of the reduction in imports on account of new taxes on imported luxury goods and a decline in fuel consumption. Public spending was also more tightly controlled to help stabilize the foreign-exchange market and the banking system.

b) Monetary and exchange-rate policy

In view of the export sector's continued weakness and the rise in oil prices, monetary policy in 2002 tended to be restrictive and oriented towards stabilization, especially of the foreign-exchange market, which came under intense pressure. The variation in parity from December to December reached 25.3%, which represented a significant depreciation in real terms. At the close of the year the Central Bank's net international reserves amounted to US$ 376 million, or US$ 586 million less than the amount posted on the same date in 2001.

As the currency continued to depreciate, in the last quarter of the year significant complementary measures were taken. In addition to the above-mentioned tightening of fiscal austerity in line with the Pact for Stability and

Table 2
DOMINICAN REPUBLIC: MAIN QUARTERLY INDICATORS

	2001				2002[a]				2003[a]	
	I	II	III	IV	I	II	III	IV	I	II
Gross domestic product (change from same quarter of preceding year) [b]	-1.4	1.1	6.5	6.7	5.1	7.6	2.0	2.7	1.5	...
Goods exports fob (millions of dollars)	1,333	1,356	1,357	1,230	1,270	1,309	1,350	1,255	1,351	...
Goods imports cif (millions of dollars)	2,134	2,201	2,223	2,222	2,079	2,185	2,242	2,377	1,971	...
International reserves (millions of dollars)	554	668	1,148	1,099	884	876	578	468	561	...
Real effective exchange rate (2000=100) [c]	96.5	95.8	96.3	96.4	95.9	96.8	97.1	104.3	109.9	117.7
Consumer prices (12-month variation, %)	11.1	10.2	5.9	4.4	3.9	4.0	5.4	10.5	18.7	26.1
Average nominal exchange rate (pesos per dollar)	16.9	16.8	16.9	17.1	17.6	17.9	18.4	20.6	23.2	25.5
Nominal interest rates (annualized percentages)										
Deposit rate [d]	19.1	17.7	13.7	11.8	13.4	15.7	17.8	19.2	20.3	20.2
Lending rate [e]	28.2	24.6	20.5	20.6	21.7	24.0	26.7	27.8	28.9	28.4
Interbank rate	17.9	15.8	10.8	9.4	12.3	13.1	15.6	17.1	19.7	23.0
Sovereign bond spread (basis points)	...	...	...	...	323	378	...	504	488	826
Domestic credit [f] (change from same quarter of preceding year)	19.8	18.1	21.6	23.1	21.5	23.4	16.7	18.7	17.0	...
Mature bank credit as a porportion of total credit (%) [g]	3.5	2.9	2.7	2.4	2.7	3.1	6.2	5.9	6.2	...

Source: ECLAC, on the basis of official figures.
[a] Preliminary figures. [b] Based on figures in local currency at constant 1970 prices. [c] Quarterly average, weighted by the value of exports and imports of goods. [d] 30-day financial certificates, multiple banks. [e] 90-day loans, multiple banks. [f] Net credit to the public and private sectors extended by commercial banks and other financial and banking institutions. [g] Total credit extended by the consolidated financial system.

Economic Development, limits were placed on commercial bank loans and on securities investments by financial institutions. The central bank suspended its direct intervention in the foreign-currency market in November, and international reserves recovered somewhat.

Interest rates on local-currency transactions rose considerably. In December lending rates stood at 28.6% and deposit rates, at 19.4%; both rates were 7 points higher than they had been a year earlier. In contrast, rates on dollar transactions rose only slightly, to 10.3% and 6.6% for loans and deposits, respectively.

The money supply (M1) grew by only 3.1% in 2002 in real terms, but broad money (M3) increased by 14%. Savings and time deposits in local currency rose by 18.6%. Credit to the private sector, which represents almost 90% of all bank loans, rose by 15% in real terms and was used mainly for commercial and service activities and for other purposes, as shown by the increase in personal loans. Meanwhile, the growth of credit to the central government sped up considerably. Lastly, international reserves contracted significantly owing to the outflow of private capital as a result of exchange-rate volatility.

In May 2003, in view of the continuing instability of the foreign-exchange market and the banking crisis, the Monetary Board decided to tighten monetary restrictions. The reserve requirement for local-currency deposits was gradually raised to 20% over an eight-month period and an additional 5% reserve requirement was established for foreign-currency deposits. The central bank substantially increased its issuance of certificates of investment (by 5 billion pesos). Interest rates, which had already risen in the second half of 2002, went up by a further two percentage points in the first quarter of 2003 for local-currency transactions. As exchange-rate volatility worsened, the dollar reached 34 pesos in June, which represented a nominal depreciation of 58% in relation to December and 89% in relation to June of the previous year.

c) Trade agreements and reforms

The talks with the United States concerning a bilateral free trade agreement brought results in mid-2003, when the parties agreed in principle that the agreement would be negotiated jointly with the Central American countries. Progress was also made in the negotiations for a free trade agreement with Panama, with the signing of a 10-year partial-scope agreement, renewable for another 10-year period, covering 204 products. There was also an initiative to start trade negotiations with Colombia.

3. The main variables

a) Economic activity

Production activity went through two very distinct phases. In the first six months it grew briskly (by 6%), driven largely by the increase in public spending, while in the second half of the year its growth rate slowed considerably, amounting to only 2.4%.

The growth of production was driven entirely by domestic demand. Consumption increased by 5.6%, with substantial upturns in both public and private consumption. Private consumption was influenced by the steady increase in family remittances, which represented 11.3% of that expenditure.

Private investment, which had grown rapidly until 2000, contracted significantly for the second year in a row. The deterioration in the international environment, the interest-rate hike and the changes in fiscal policy dissuaded private investors from making new outlays. Although foreign direct investment was down slightly, it remained at its average level of recent years. In contrast, public investment rose substantially (27.6%) for the second year in a row, more than offsetting the decline in private investment, even though it was sharply reduced in the second half of the year as part of the macroeconomic stabilization effort.

At the sectoral level, basic services expanded steadily (by 10%) in the areas of both electric power and communications and transport. Telecommunications continued to show robust growth (17.4%) as the expansion of mobile telephone services picked up speed. Electric power generation was up by 6.7%, with increases in both thermal and hydroelectric generation, in the latter case because of higher water levels in the reservoirs. The energy supply was still insufficient, however, and rationing was continued.

The goods-producing sectors and the "other services" category showed a modest increase of close to 3%. The expansion of agriculture was moderate (2.5%) in comparison to the excellent 8.1% posted the previous year. Agricultural output retreated by 2% after correcting for the excess supply of some products in 2001. The cultivation of rice and sweet potatoes stalled, while that of corn, beans, tomatoes and bananas went down and that of pigeon peas, peanuts and some other products increased. There was a steady upturn in production for export, especially of leaf tobacco, coffee beans, cocoa beans and sugar cane.

Livestock-raising expanded by a mere 0.7%. There were significant increases in the production of fresh milk (23%), eggs (5.3%), beef and pork, and a decrease in that of chicken (7.1%) for the second straight year. Forestry production jumped by 33% owing to the increased consumption of firewood and coal, especially in low-income households. Fishing made substantial progress (33%), especially in farmed tilapia and carp.

Mining output shrank for the second year running (3.2%) as a result of reduced salt and limestone production. Nickel production rose by 1.9% after having slid sharply the previous year, and construction inputs also increased.

Manufacturing grew by 4%, recovering from its downturn of 2001. The sugar subsector increased by 6.6% thanks to the advance production of raw sugar and molasses, which also increased the output of refined sugar. At the same time, public investment gave a strong impetus to construction and its primary inputs. In addition, there was an upturn in the production of food and beverages, including evaporated milk, rum, cigarettes and beer.

Activity in the free zones contracted for the second year in a row, although at a more moderate rate in the second half of the year. The slump was concentrated mainly in the footwear, tobacco and textile segments, while jewellery, electronics and pharmaceuticals, among others, showed positive results.

The services included under the heading restaurants and hotels increased by scarcely 1% as the number of tourist arrivals remained low. The hotel occupancy rate went down by an annual average of 3.5%, although it made a significant recovery towards the end of the year.

b) Prices, wages and employment

Inflation reached 10.5% in 2002, which was more than double the 2001 rate. As a result of the significant currency devaluation and the increase in fuel prices, by the end of the first half of 2003 prices had already risen by 16.6%, far exceeding the inflation target established under the monetary programme for 2003.

In 2002 increases were observed in housing (34.3%), health care and transport. The elimination of the subsidy for electric power consumption for all but the poorest sectors raised electricity rates considerably. Domestic gas also became more expensive (36.5%) owing to an increase in international prices, while rents went up by 10.4%.

Transport showed an increase of 13.8% in 2002, mainly because of the currency depreciation; transport charges rose by an annual average of scarcely 5.1%, which reflected part of the 25% increase in gasoline prices. Health care costs (11.1%) also rose faster than the average price increase, while food, beverages and tobacco together showed an increase of 9% due to the higher cost of imports.

Employment increased by 4.4%, reflecting the addition of 18,500 more jobs. The sectors that generated the most employment were services and agriculture, which accounted for 86% of the increase, and to a lesser extent commerce, the financial sector and public administration. Open unemployment fell from 6.5% to 5.9%. However, the increase in the overall rate of participation from 54.3% to 55.1% had the effect of raising the unemployment rate from 15.4% to 16.1%.

The leading employers raised wages at different times during the year. Civil servants and free-zone workers received increases early in 2002. In the final quarter the remaining private firms agreed to a two-stage wage hike: an 8% increase in October followed by a 5% increase in March 2003. In real terms, however, average wages declined.

c) The external sector

The balance-of-payments current-account deficit climbed to US$ 875 million in 2002, or 4.1% of output, compared to 3.5% in 2001. The deficit was offset by the rising tide of private transfers from abroad, mainly family remittances, which were equivalent to 11.6% of GDP. As a result, gross national disposable income was 9% higher than GDP. These resources covered a large proportion of the merchandise trade deficit and payments of interest and dividends, although net financial capital inflows were down from the previous year owing to the reduction in net public borrowing and the slight drop in foreign direct investment. Moreover, the errors and omissions account showed a large negative balance as a result of capital flight, which translated into a substantial loss of reserves.

Total merchandise exports contracted (1.8%) to US$ 5.183 billion. Free-zone sales, which represent 84% of the total, declined by 3.3%, although they began to rebound in the final months of the year, partly because of the currency depreciation, and continued to grow in 2003. Exports from outside the free zones performed better, expanding by 6.6%, after having slid steeply the previous year (-17.7%). Increases were seen in exports of traditional products, including raw sugar and molasses, coffee, cocoa and cocoa products and nickel-iron, whose international price went up.

The greater buoyancy of the domestic market drove imports up by 4.8%. Growth was observed in purchases of consumer goods (7.3%) and raw materials (4%). Sharp upturns were seen in imports of certain products, including transport vehicles (58.5%), cereals (37.5%) and fats and vegetable oils (23.3%). Imports of inputs for maquila activity, however, shrank by 6.4%, so that the total value of imports was US$ 8.883 billion, which is just 1.2% higher than the previous year's figure.

Although international oil prices rose sharply in the final quarter of 2002, the annual average increase was close to 3%. Accordingly, the oil bill, which represents 20.8% of the country's imports, reached US$ 1.297 billion, exceeding the previous year's figure by only 3.6%.

Tourist arrivals increased in the last quarter, but the total for the year as a whole was 2.8 million, representing a 2.5% decline from the 2001 figure, while tourism revenues amounted to US$ 2.736 billion. The proportion of tourists from North America rose while the proportion from Europe (especially Germany, Spain and Italy) fell. As usual, the services account posted a surplus (of US$ 1.771 billion), but the amount was down by US$ 55 million in comparison to the 2001 surplus. Consequently, the goods and services trade deficit was 15% higher than in 2001.

A key factor that continued to shore up the external accounts was the inflow of family remittances, which contrasted with the weakness of goods and services exports. Although the faltering United States economy kept remittances from growing as quickly as they had in the past, they nonetheless totalled US$ 1.939 billion, exceeding by 7.3% the amount received in 2001.

Net capital inflows, excluding errors and omissions, fell by 24.3% in comparison to their 2001 level, but were still more than enough to offset the current-account deficit. Foreign direct investment was down by 10.9%, to US$ 961 million, approximately 30% of which consisted of reinvestments. The balance of medium- and long-term loans was positive and exceeded the previous year's figure. However, the abundant outflow of capital recorded in the errors and omissions account –on the order of US$ 997 million– brought the overall total down to US$ 553 million. To a large extent, these outflows reflected private capital movements and portfolio adjustments triggered by the currency instability that became more pronounced in the second half of the year.

In the initial months of 2003 the improvement in external demand observed in the final quarter of the previous year seemed to gain strength, as earnings from the free zones and tourism continued to climb. Textile exports from the free zones increased by 7.6% in the first four months, while tourist arrivals (non-resident travellers), which had slid by 14% in the first five months of 2001, surged by 18% over the same period of 2002.

Uruguay

1. General trends

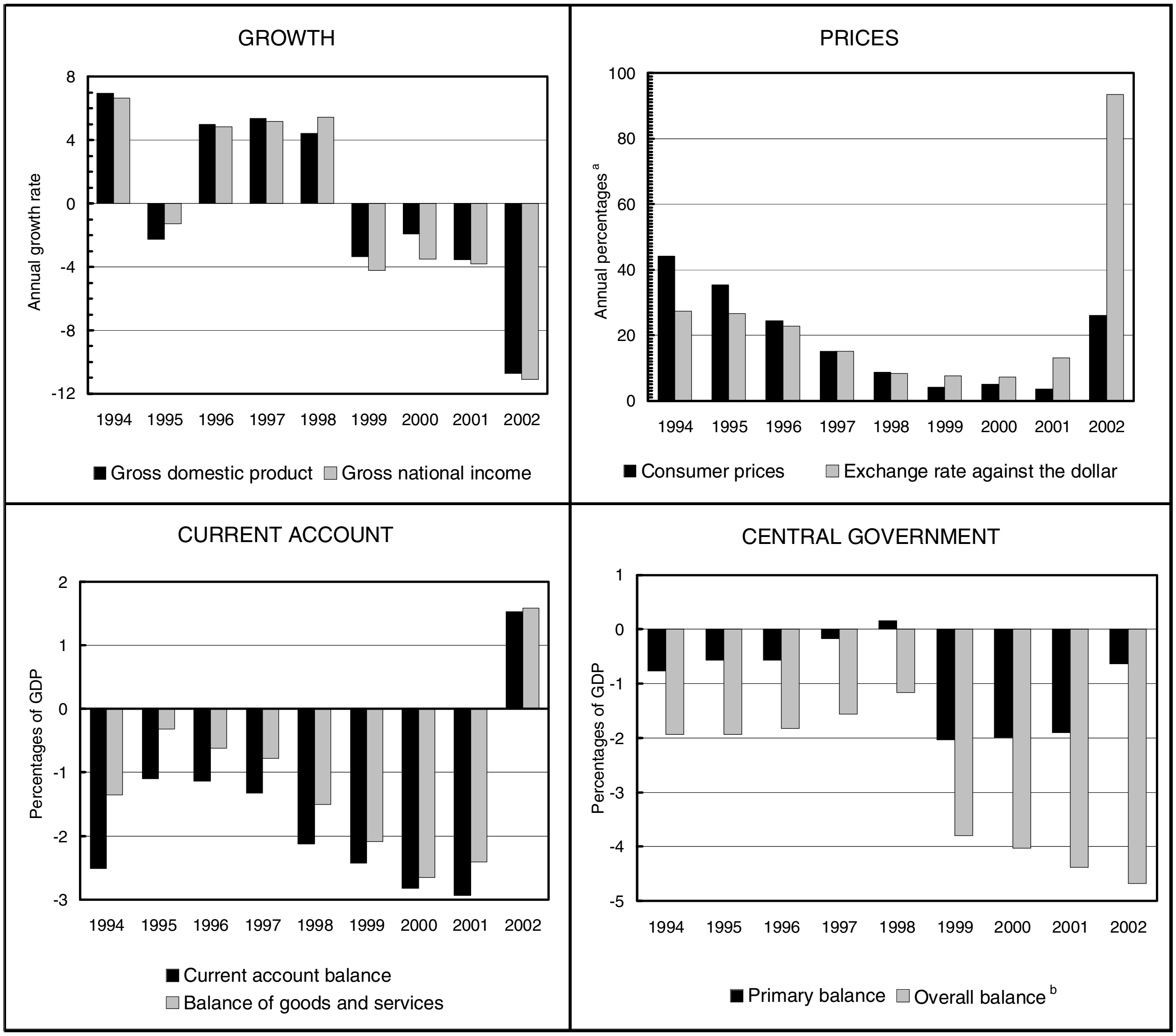
Following three years of recession and in the midst of a serious economic and financial crisis, economic activity dropped sharply. In 2002, gross domestic product (GDP) fell by 12% and was 17% lower than the maximum reached in 1998, thereby pulling per capita GDP back down to its 1991 level. Such a dramatic decrease resulted in an unemployment rate of 17% of the economically active population, while inflation, after several years of low figures, rose to an annual rate of around 26%. Despite the reduction in real expenditure, the loss of income resulting from the recession thwarted the authorities' efforts to reduce the public-sector deficit to less than 4% of GDP. Meanwhile a steep downturn in imports, owing to a sharp fall in domestic demand, helped to narrow the trade gap.

In the first half of the year, a persistently high level of deposit withdrawals sparked a serious financial crisis. The crisis affected first the banking system –which had long been a recipient of financial flows from other countries in the region, mainly Argentina– and subsequently the State's ability to pay. The resulting domestic and external credit squeeze was such that the effects were still resonating in mid-2003. This grave situation followed several years of recession and coincided with a sudden fall in external demand, particularly demand from other MERCOSUR countries. The severe shrinkage of domestic demand that went hand in hand with the financial crisis reduced GDP and imports even further.

Against this backdrop of deep recession, tax revenues declined significantly, and the public deficit consequently remained at the same high level as in previous years. The great uncertainty that prevailed throughout the year prompted caution on the part of the private sector, which registered a savings rate equivalent to five percentage points of GDP. Following several years of deficits, the country posted a balance-of-payments current account surplus of over 1% of GDP. Given the economy's degree of dollarization, the steep depreciation of the Uruguayan peso in the third quarter weakened the equity position of the public and private sectors to such an extent that the State was forced to reschedule its debt and deposits in official banks.

In mid-2003, the financial and economic situation was showing some signs of a recovery in production activity, mainly thanks to increased exports and production in import-substitution sectors. GDP was expected to fall by 2.5%, but to trend upward as the year progressed, and inflation is likely to be considerably lower than in 2002. The public-sector debt was refinanced, thereby improving its maturity profile, but the interest burden, which poses a major problem in terms of fiscal policy, remained unchanged. A speedy return to sustained growth is needed in order to overcome the problem and reduce the large proportion of public spending that is absorbed by debt sevicing.

Figure 1
URUGUAY: MAIN ECONOMIC INDICATORS



Source: ECLAC, on the basis of official figures.
[a] December-to-December variation.
[b] Includes interest.

2. Economic policy

In the recent past, uncertainty in Argentina's financial market had resulted in considerable capital flows to Uruguay. The fact that the situation in 2002 had little in common with that of previous years led institutions to act very differently, however. In 2002, Uruguay's economy was highly exposed to Argentina's financial and trade risk. The proportion of deposits made by non-residents (chiefly Argentines) in Uruguay's main commercial banks, which have close ties to Argentine banking institutions in terms of both their assets and credit risk, rose to 45%.

In early 2002, international credit rating agencies withdrew the investment-grade sovereign debt rating they had assigned to the country several years previously. This immediately prompted a major sell-off of Uruguayan securities, whose value plummeted on the secondary market. The high dollarization of public and private liabilities markedly increased the perceived exchange risk in corporate balance sheets, while the rate of devaluation quickened under the sliding-band system and factors such as the sudden termination of Argentina's convertibility regime dealt a blow to the real bilateral exchange rate.

During the first seven months of 2002, foreign-currency deposits (almost 60% of which were made by non-residents) were therefore reduced by US$ 6.4 billion, thus falling to 45% of the total as it stood at the end of 2001. The central bank's international reserves were seriously depleted by the continued flight of deposits as banks continued to withdraw their funds and as the central bank was repeatedly called upon to provide financial assistance to official and private banking institutions. The first consequences were the closure of the Uruguayan branch of one of the main Argentine banks in February and the recapitalization of the country's largest commercial bank on an emergency basis. In June, two other commercial banks that had formed a financial group had their licences suspended owing to the fraudulent actions of their owners.

The exchange rate was floated in late June following several years under a sliding-band system. There was also a change in senior staff at the Ministry of Economic Affairs and in the board of directors of the central bank. Towards the end of July, the bank run and the decrease in international reserves became so severe that a bank holiday was declared and the operations of two other locally-owned banks were suspended.

Following intense negotiations with the relevant international organizations, a new financial programme was agreed upon with the International Monetary Fund (IMF). The package, which was designed to restore confidence in the banking system, included US$ 1.5 billion in loans from IMF, the Inter-American Development Bank (IDB) and the World Bank. As part of this programme, a fund to help stabilize the banking system was also set up. This fund has paved the way for the adoption of measures for maintaining the payment chain through return of all sight and savings deposits held in official and suspended banks. Given the urgent need to normalize banking activity, the United States Treasury Department granted a bridge loan of US$ 1.5 billion pending finalization of the arrangements with these international lending institutions. The four-day bank holiday was terminated following the adoption of a law extending the maturity date of time deposits in dollars in official bank by three years. Under this provision, 25% of the deposit can be redeemed the first year, 35% the second and the remaining 40% the third; periodic interest payments are to be made on the established dates. The suspended banks did not reopen their doors, but foreign banks continued to operate as normal.

In 2002, Uruguay and IMF concluded three agreements that gave the country access to financing from IMF itself, the World Bank and IDB. However, those agreements lapsed as a result of the country's inability to meet the agreed objectives. It was not until February 2002 that a new agreement was reached on a financial programme for the biennium starting in April. The programme projects a 2% fall in GDP in 2003, but economic activity is expected to pick up during the year, thus improving upon the low levels recorded at the end of 2002. The programme is intended to increase the primary public-sector surplus to 3.2% of GDP. This would reduce the overall deficit to just over three percentage points of GDP, taking into account the fact that interest on the public debt represented 6.3% of GDP. As part of the exchange-rate float instituted the year before, the aim of the monetary programme is to maintain inflation at its 2002 level. In addition, the balance-of-payments current account surplus is expected to amount to 2.4% of GDP. A mid-year programme review showed performance to be as foreseen, although the rates of inflation and depreciation of the peso were lower than expected.

Table 1
URUGUAY: MAIN ECONOMIC INDICATORS

	1994	1995	1996	1997	1998	1999	2000	2001	2002[a]
	Annual growth rates [b]								
Gross domestic product	7.0	-2.3	5.0	5.4	4.4	-3.4	-1.9	-3.5	-10.7
Per capita gross domestic product	6.2	-3.0	4.2	4.6	3.6	-4.1	-2.6	-4.2	-11.4
Gross national income	6.6	-1.3	4.8	5.2	5.4	-4.3	-3.5	-3.8	-11.1
Gross domestic product by sector									
Agriculture	11.8	5.5	9.4	-6.1	5.2	-7.5	-3.0	-7.1	6.7
Mining	7.1	20.8	7.6	22.1	29.4	-5.8	-8.8	-5.2	-21.0
Manufacturing	4.0	-2.8	4.0	5.9	2.3	-8.4	-2.1	-7.6	-13.8
Electricity, gas and water	-3.3	7.3	4.3	6.7	11.5	-0.1	5.0	1.7	-0.6
Construction	8.5	-10.3	-1.8	2.4	9.8	8.9	-11.1	-8.7	-21.2
Wholesale and retail commerce, restaurants and hotels	11.0	-9.6	6.0	8.8	2.4	-3.4	-5.3	-3.2	-24.7
Transport, storage and communciations	18.5	6.2	8.0	6.0	4.5	3.7	1.5	0.3	-9.3
Financial establishments, insurance, real estate and business services	1.0	0.5	5.2	5.4	6.8	6.4	2.2	1.7	-2.0
Community, social and personal services	0.4	-0.4	2.2	3.4	2.7	-0.5	-0.6	-2.3	-3.4
Gross domestic product by type of expenditure									
Consumption	6.8	-3.7	6.2	5.0	5.4	-3.1	-1.7	-2.9	-12.7
General government	4.5	0.2	5.0	2.3	4.0	0.6	-0.3	-2.9	-9.4
Private	7.2	-4.3	6.4	5.5	5.6	-3.7	-1.9	-2.9	-13.3
Gross domestic investment	12.8	3.9	-2.3	7.3	12.5	-8.0	-12.7	-8.9	-29.6
Exports of goods and services	11.9	0.4	11.1	10.4	-1.2	-5.7	5.2	-7.8	-13.7
Imports of goods and services	15.6	-1.2	10.5	10.3	8.2	-7.8	-1.8	-8.6	-33.6
	Percentages of GDP								
Investment and saving									
Gross domestic investment [b]	14.5	15.4	14.3	14.6	15.8	15.0	13.3	12.6	9.9
Gross domestic investment [c]	15.9	15.4	15.2	15.2	15.9	15.1	14.0	13.8	12.2
National saving [c]	13.7	14.1	14.1	14.2	14.1	12.9	11.1	10.1	13.4
External saving [c]	2.2	1.3	1.2	1.1	1.8	2.3	2.8	3.6	-1.2
	Millions of dollars								
Balance of payments									
Current account	-438	-213	-233	-287	-476	-508	-567	-545	188
Goods balance	-706	-563	-687	-704	-772	-897	-927	-771	59
Exports fob	1,918	2,148	2,449	2,793	2,829	2,291	2,384	2,144	1,931
Imports fob	-2,624	-2,711	-3,135	-3,498	-3,601	-3,187	-3,311	-2,915	-1,873
Services balance	469	502	560	536	436	459	394	324	136
Factor income balance	-243	-227	-189	-193	-198	-144	-61	-125	-77
Current transfers balance	41	76	83	74	59	74	28	27	71
Capital and financial balance [d]	547	440	386	687	831	398	733	847	-4,077
Net foreign direct investment	155	157	137	113	155	235	274	319	100
Financial capital [e]	393	284	249	574	676	163	459	528	-4,177
Overall balance	109	228	152	400	355	-110	167	302	-3,889
Variation in reserve assets [f]	-99	-218	-141	-392	-515	110	-167	-302	2,322
Other financing [g]	-11	-10	-12	-8	160	0	0	0	1,566
Other external sector indicators									
Real effective exchange rate (index 2000=100) [h]	114.7	110.7	111.5	109.2	107.1	98.5	100.0	101.5	121.6
Terms of trade for goods (index 1997=100)	98.2	103.8	100.4	100.0	107.0	98.5	89.5	90.4	89.9
Net resource transfer (% of GDP)	1.7	1.1	0.9	2.2	3.5	1.2	3.3	3.9	-21.0
Gross external public debt (millions of dollars)	4,251	4,426	4,682	4,754	5,195	5,618	6,116	5,855	6,981
Gross external public debt (% of GDP)	24.3	22.9	22.8	21.9	23.2	26.9	30.4	31.5	56.6
Net interest and earnings (% of exports) [i]	-7.5	-6.5	-4.9	-4.6	-4.8	-4.0	-1.7	-3.8	-2.9

Table 1 (concluded)

	1994	1995	1996	1997	1998	1999	2000	2001	2002[a]
				Percentages					
Employment									
Labour force participation rate [j]	58.1	59.1	58.2	57.7	60.5	59.3	59.6	60.6	59.1
Open unemployment rate [k]	9.2	10.3	11.9	11.5	10.1	11.3	13.6	15.3	17.0
Visible underemployment rate [k]	3.7	5.1	6.0	5.2	4.7	6.5	10.3	13.0	15.3
				Annual percentages					
Prices									
Variation in consumer prices	44.1	35.4	24.3	15.2	8.6	4.2	5.1	3.6	25.9
Variation in producer prices, local products	41.0	27.7	23.5	13.3	3.3	-0.3	9.5	3.8	64.6
Variation in nominal exchange rate	27.3	26.6	22.7	15.1	8.3	7.6	7.3	13.1	93.5
Variation in average real wage	0.9	-2.9	0.6	0.2	1.8	1.6	-1.3	-0.3	-10.7
Real deposit rate [l]	-4.8	3.3	3.1	4.5	6.7	10.0	6.8	9.7	...
Real lending rate [m]	35.6	48.7	54.0	49.8	46.4	47.5	41.9	45.6	75.5
Equivalent deposit rate in foreign currency [n]	7.5	9.2	4.4	3.9	6.3	6.2	4.5	1.1	...
				Percentages of GDP					
Central government									
Current income	17.4	17.5	17.8	18.8	19.5	19.4	19.0	19.8	20.1
Current expenditure	16.8	17.3	17.9	18.5	18.5	20.8	21.3	22.5	23.6
Saving	0.6	0.2	-0.1	0.3	1.1	-1.4	-2.2	-2.7	-3.4
Capital balance	-2.5	-2.1	-1.7	-1.9	-2.2	-2.4	-1.8	-1.6	-1.3
Primary balance	-0.8	-0.6	-0.6	-0.2	0.2	-2.0	-2.0	-1.9	-0.6
Overall balance	-1.9	-1.9	-1.8	-1.6	-1.2	-3.8	-4.0	-4.4	-4.7
Public debt	...	...	...	...	...	25.6	30.9	37.8	76.4
Interest payments (% of current income)	6.7	7.8	7.0	7.4	6.8	9.1	10.7	12.6	20.1
Money and credit [o]									
Domestic credit [p]	21.3	22.4	24.8	26.4	31.3	50.4	53.7	55.7	67.6
To public sector	2.6	2.0	1.9	2.1	1.6	3.4	3.3	3.6	7.1
To private sector	18.7	20.4	22.9	24.3	29.7	47.0	50.4	52.1	60.5
Liquidity (M3)	30.3	30.7	33.1	35.0	38.2	46.8	49.9	54.3	59.6
Currency in circulation and domestic currency deposits (M2)	9.6	9.4	9.5	9.4	9.6	10.3	10.3	10.5	9.1
Foreign currency deposits	20.7	21.3	23.6	25.6	28.6	36.5	39.6	43.8	50.5

Source: ECLAC, on the basis of official figures.
[a] Preliminary figures. [b] Based on constant 1995 dollars. [c] Based on figures in local currency at current prices. [d] Includes errors and omissions. [e] Refers to the balance on the capital and financial accounts, minus net foreign direct investment plus errors and omissions. [f] A negative sign denotes an increase in reserves. [g] Includes the use of credit and loans from IMF and exceptional financing. [h] Annual average, weighted by the value of exports and imports of goods. [i] Refers to net investment income divided by exports of goods and services from the balance of payments. [j] Economically active population as a percentage of the working-age population, urban total. [k] Rates of unemployment and underemployment are percentages of the economically active population, urban total. [l] Average of the rates most commonly offered for deposits of one to six months, on the last three days of the month by the five most representative private banks. [m] Average of the most common rates for loans of six months or less, offered on the last day of the month by the five most representative private banks. [n] Rate on deposits, deflated by the variation in the dollar exchange rate. [o] Average annual values used for monetary figures. [p] Net credit to the public and private sectors extended by commercial banks and other financial and banking institutions.

a) Fiscal policy

Rising fiscal revenues during most of the 1990s, and the closely related average annual increase in GDP of about 4.5% between 1990 and 1998, steadily reduced the consolidated public-sector deficit to a low of 0.4% of GDP by 1998. That year also marked the beginning of a recession, however, which, given the close link between the tax system and the business cycle, hurt fiscal revenues. Yet spending continued to increase, especially social security expenditure, which came to represent 16% of GDP in 2001, i.e., half of total operating expenditure. As a result of both these factors, and despite an increase in the tax burden, the public-sector deficit exceeded 4% of GDP during 1999-2001. The deficit was financed through external borrowing at the low interest rates made possible by the country's investment-grade sovereign debt rating during that period.

Table 2
URUGUAY: MAIN QUARTERLY INDICATORS

	2001				2002[a]				2003[a]	
	I	II	III	IV	I	II	III	IV	I	II
Gross domestic product (change from same quarter of preceding year)[b]	-1.6	-1.6	-4.6	-5.3	-10.2	-5.3	-12.9	-13.1	-9.1	...
Goods exports fob (millions of dollars)	595	500	482	480	452	510	439	460	438	...
Goods imports cif (millions of dollars)	805	770	735	751	524	593	420	427	471	519
International reserves (millions of dollars)	2,667	2,764	2,750	3,097	2,194	1,451	732	769	784	1,164
Real effective exchange rate (2000=100)[c]	100.4	100.3	101.0	104.2	99.4	107.2	141.5	138.3	145.7	151.8
Urban unemployment rate	14.9	16.0	15.4	14.9	14.8	15.6	19.0	18.6	18.6	17.2
Consumer prices (12-month variation, %)	4.7	4.3	3.9	3.6	5.1	8.9	23.5	25.9	28.5	24.6
Average nominal exchange rate (pesos per dollar)	12.6	13.1	13.5	14.0	14.7	17.1	26.1	27.1	28.3	28.2
Real average wage (change from same quarter of preceding year)	-1.0	-0.5	0.0	0.4	-1.8	-6.4	-15.8	-18.0	-19.9	-16.7
Nominal interest rates (annualized percentages)										
Deposit rate[d]	11.4	12.2	17.1	16.6	23.0	39.9	45.9	...	...	...
Lending rate[e]	48.8	49.5	51.7	56.8	77.8	111.3	155.3	159.9	...	...
Interbank rate[f]	13.3	14.0	31.8	29.3	71.7	95.4	118.3	72.1	80.0	...
Sovereign bond spread (basis points)	237	200	263	208	538	1,364	2,094	1,902	2,068	1,390
Domestic credit[g] (change from same quarter of preceding year)	5.8	7.8	4.5	10.3	11.9	17.7	49.5	37.6	51.1	...
Mature credit as a porportion of total credit (%)[h]	9.1	9.5	10.3	9.9	14.3	20.1	26.4	24.5	21.2	...

Source: ECLAC, on the basis of official figures.
[a] Preliminary figures. [b] Based on figures in local currency at constant 1983 prices. [c] Quarterly average, weighted by the value of exports and imports of goods. [d] Average of the rates most commonly offered for deposits of one to six months, on the last three days of the month by the five most representative private banks. [e] Average of the most common rates for loans of six months or less, offered on the last day of the month by the five most representative private banks. [f] Money market rate. [g] Net credit to the public and private sectors extended by commercial banks and other financial and banking institutions. [h] Total credit extended by commercial and private banks and commercial establishments.

In early 2002, the agreement concluded with IMF sought to reduce the fiscal gap to less than 2% of GDP. The first semester saw the adoption of fiscal adjustment measures, including the introduction of new taxes and a reduction in expenditure. However, revenues continued to fall as a result of the deepening financial crisis and recession, while the effects of devaluation on the debt service were to increase outgoing interest payments.

Over the year as a whole, the central government's revenues fell by 5% in real terms. The increased tax burden on wages and the introduction of new taxes failed to offset the downturn in VAT receipts (a 12% drop, in large part due to reduced imports) and in revenues from excise taxes and from the tax on industrial and commercial profits caused by the lengthy recession. Government expenditure, including social security transfers, fell by 4% in real terms. Almost all outlays showed considerable real reductions, particularly investment (down 65%) and wages (down 26%). However, those spending cuts coincided with a considerable increase in interest on the public debt (48% in real terms), which thus came to represent 14% of total expenditure. The larger deficit of the central government was counterbalanced by the increased contribution of State-owned enterprises, however, and the consolidated public-sector deficit for 2002 (4.2% of GDP) was therefore equal to that of 2001.

In the first few months of 2003, fiscal performance was as planned, thanks to this very tight policy, which provided for a nominal 3% wage hike and an increase of less than 2% in pension payments in the first four months of the year.

b) Monetary policy

Until June 2002, the sliding-band exchange rate system had given priority to foreign-exchange policy over monetary policy. Under the floating exchange-rate system, however, monetary policy took on a vital role, a fortiori because the lack of access to external credit placed very strong financing constraints on the public sector. It was in this new context that the government introduced a policy for keeping monetary aggregates in alignment with inflation targets.

From September on, the government sought to use monetary policy to absorb excess liquidity by issuing peso-denominated securities bearing high interest rates. This goal was attained over the following months; in fact, liquidity was 9% lower at the end of 2002 than at the end of the previous year. Although the bank run subsided in the final quarter, deposits in foreign currency (90% of total deposits) at the end of 2002 represented barely more than half the amount registered in December 2001.

While regaining control of monetary policy, the central bank was also faced with the task of reorganizing a banking system that had been profoundly shaken by the massive withdrawal of deposits throughout the year. One decision was to transform the Banco Hipotecario de Uruguay (Mortgage Bank of Uruguay) into a non-banking institution specialized in the financing of housing. Its dollar deposits were transferred to the Banco de la República, which was then capitalized. As previously stated, the deposits of both official banks were rescheduled over three years, with payments to be made annually. The Uruguayan branch of the Argentine bank whose operations had been suspended early in the year reached a private agreement with its creditors. The four locally-owned commercial banks that had also been suspended went into administrative closure. The assets of three of them were used to set up a new bank, a business corporation whose State-owned shares were to be opened for sale in due course. This bank began to operate at the end of March 2003. These institutions' depositors are to receive six-year certificates of deposit with quarterly payouts. Foreign commercial banks, with the support of their parent companies, operated as normal during the entire process.

As a result of the high level of foreign-currency borrowing in the public sector and the considerable depreciation of the local currency, the official debt of US$ 11.4 billion was equivalent to 90% of GDP. Under such conditions, debt servicing was a great burden on the country, particularly as there was a bunching of maturities in 2003-2005. In early 2003, with IMF support, the authorities proposed a "friendly" swap to sovereign creditors, consisting of a five-year extension of maturity, with the original currency of the debt being maintained and no reduction in capital or interest. The proposal was put to those creditors that were not multilateral lending agencies and that held debt paper having a nominal value of US$ 5.2 billion. By mid-May, 90% of creditors had accepted the offer, thereby considerably reducing the pressure of debt servicing for the next few years.

c) Exchange-rate policy

The steep depreciation of the Argentine peso and the great uncertainty affecting the Uruguayan economy during the first half of 2002 prompted the economic authorities to increase the monthly rate of devaluation to 2.4% and the width of the band to 12% in January. Then, at the end of June, the authorities floated the exchange rate after 12 years under the sliding-band system. The price of the dollar shot up in the volatile financial market of the third quarter. Towards the end of the year, however, strict monetary and public expenditure policies slowed the depreciation of the Uruguayan peso, and the exchange rate stabilized at around 28 pesos per dollar, which was double the rate recorded at the start of the year. In mid-2003, as the Argentine and Brazilian currencies appreciated in relation to the dollar, the Uruguayan peso's exchange rate had been even lower. Partly owing to the sharp decline of the Uruguayan peso in 2002 and the appreciation of the euro and the Argentine and Brazilian currencies in mid-2003, Uruguay's real exchange rate was almost 40% higher than at the end of 2001.

3. The main variables

a) Economic activity

In the difficult economic and financial situation of 2002, final demand dropped by more than 16% to a level similar to where it had stood 10 years earlier. Domestic demand fell by 18% as a result of a severe reduction in investment (30%) and private consumption (15%). The volume of exports was also down sharply (14%), for a total reduction of 20% over the last four years.

The fall-off in demand affected both imports and domestic production. Imports, which were hurt by a sudden rise in the exchange rate, decreased by 33% in constant values, while GDP shrank by around 12%. The second semester saw the most significant drop. This will seriously affect output for 2003, since the year thus started out with a decrease of 7% carried over from 2002.

Economic activity contracted across the board, with the sole exception of agriculture. The two most badly affected sectors were construction and commerce, restaurant and hotel services. Construction activity was down by 21% as the flow of financing came to a virtual standstill and public investment dropped off sharply, while commerce, restaurant and hotel services slumped by 25% as a result of weak domestic demand and the severe slowdown in tourism. Manufacturing declined sharply once again in 2002 (14%) for a cumulative decline of 30% over the past four years. Other services also showed major downturns of around 9%. Agricultural output, which was the only item to show an increase, returned to the levels of 2002 thanks to an upturn in beef production and good soybean and sunflower harvests, although it remained significantly lower (10%) than its 1998 peak.

b) Prices, wages and employment

The sharp hike in the price of the dollar in 2002 prompted a rapid change in relative prices and a rise in the price of tradable goods and services. Given the deep recession in the domestic market, there was less of a rise in the price of non-tradables. Under such conditions, consumer prices went up by 25% in 2002, which was a major increase compared to previous years, when the increases had generally been about 4%. In 2003, the stable exchange rate has resulted in a fall in inflation, which is expected to have dropped to below 2002 levels by the end of the year.

Inflation accelerated mainly during the second and third quarters of 2002 amidst the prevailing uncertainty and a rapid depreciation of the peso. The fact that the price of the dollar doubled between January and August 2002 had a knock-on effect on domestic prices, which increased by an annual rate of 70% in the third quarter. Domestic demand faltered as a result of a lack of adjustments in nominal wages in the public and private sectors and pensions, plus increased unemployment. This, in conjunction with a strict monetary policy, brought about a rapid change in relative prices. This was radically different from what had happened in previous periods, when indexing mechanisms linked to the price of the dollar had exerted a strong influence.

Given that nominal wages were not adjusted in 2002 (due to the financial squeeze on the public sector and the sharp contraction of private production), wage earners' purchasing power dropped by an average of 11% during the year. The economic crisis also aggravated unemployment, which reached an annual average of 17% of the economically active population, or two points higher than the previous year and much higher (seven points) than in 1998. During the third quarter, at the height of the financial crisis, the rate of unemployment was nearly 20% (the highest level ever recorded) and job losses were also very high. In mid-2003, unemployment was still above 18% and there was considerable emigration.

c) The external sector

The sudden halt of voluntary external financing (mostly offset by exceptional IMF financing) and the deep recession brought about a rapid turnaround in the main variables of the balance of payments. Following several years of successive gains, reserves fell by US$ 2.3 billion in 2002, which was the equivalent of almost one fifth of GDP or 87% of the year's total export value. These heavy losses coincided with the capital flight discussed above and occurred despite the fact that the current account had a positive balance of almost US$ 200 million for the first time since 1991.

There was a copious outflow of private capital, as may be seen from the negative balance of US$ 2 billion recorded under errors and omissions. The financial account, which measures the flow of public and private capital, also had a negative balance of over US$ 2 billion, which was a major turnaround after last year's positive balance.

The balance-of-payments current account surplus reflected the significant fall in the value of imported goods (34%), which decreased even more significantly than merchandise exports (10%). Uruguayan exports have been declining ever since they peaked in 1998. In 2002, signs of recovery in meat exports and increased external competitiveness due to the devaluation of the Uruguayan peso in real terms failed to offset shrinking Argentine demand and the credit difficulties resulting from the banking crisis. The net result of the above-mentioned factors was a further fall in goods exports, which slipped to a level almost one third lower the level recorded in 1998.

Beef exports increased by more than 20% as sales resumed to countries that accepted the new health standard for Uruguayan livestock, since the country has not been declared free of foot and mouth disease but had no outbreaks for over a year. However, the sharp fall in sales to Argentina (a third of last year's figure) resulted in another reduction in total goods exports. The recession and devaluation in Argentina brought down tourism revenues by 30%. In addition, almost all imports dipped considerably, purchases of consumer and capital goods were almost halved, and intermediate goods were down by more than a quarter.

Exports of goods trended upward in the first few months of 2003 in response to increased demand from non-MERCOSUR countries. Although sales to Argentina rose from the extremely low levels of the preceding year, sales to Brazil slumped.

Venezuela

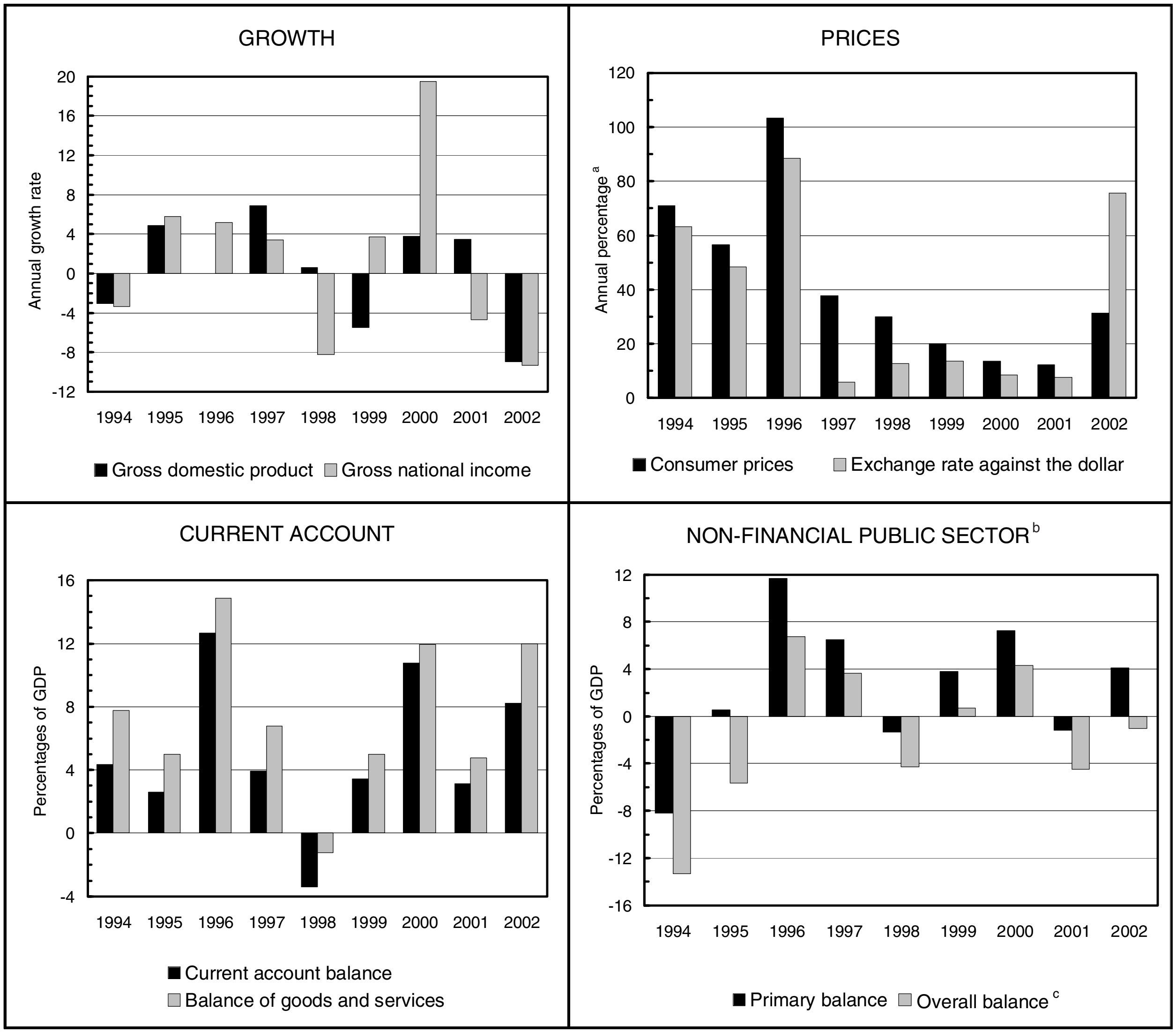
1. General trends

The Venezuelan economy faltered in 2002, as gross domestic product (GDP) shrank by 9%, and gross fixed investment receded by 22%. Inflation soared to an annual rate of 31.2%, compared to 12.3% in 2001, while unemployment climbed to 15.8% from the previous year's 13.3%. Output is set to shrink by a further 12%-14% in 2003, depending on how quickly and thoroughly it manages to bounce back from the 27.6% slump posted in the first quarter, when oil output plummeted by 47.3% and non-oil production plunged by 19%, compared to their 2002 levels. This bleak economic panorama reflects the convergence of several factors.

Firstly, the severe ongoing political crisis took a dramatic turn in April 2002 when the Government was overthrown for two days before being reinstated. Then, towards the end of the year, opposition political parties joined forces with employers' and workers' institutions to convene a general strike that lasted from December 2002 until January 2003, causing a steep drop in oil output and exports. These events, both of which had a major impact on productive activity, unfolded in the midst of tensions that have been steadily rising since late 2001. Against this backdrop, not only did investment decline in 2002, but there was a major capital outflow during the year, estimated at US$ 12 billion. Polarization and uncertainties continued unabated in mid-2003, given the possibility of a referendum being called before the end of the year to revoke the mandate of the President of the Republic.

The second factor concerns economic policies. From 1999 until late 2001 these were aimed at generating a climate of macroeconomic stability that would stimulate private investment and elicit an increase in productive activity and employment. One of the key features was the currency band system, which it was hoped would achieve a steady reduction in inflation. Monetary policy was generally kept tight to discourage persistent outflows of capital, while public expenditure was used to prop up the level of activity. In early 2002, the Government decided to face down pressures in the foreign-exchange market by raising interest rates; and at the same time it reacted to the fall in the oil price (a trend that would subsequently be reversed) by implementing a package of fiscal adjustment measures. As these failed to staunch the capital outflow, the currency-band system was replaced by a floating exchange-rate regime. This produced a rapid depreciation of the local currency and a rise in consumer prices. The consequent erosion of real wages further weakened domestic demand, while the strike at the end of the year aggravated tensions in the foreign-exchange market, reducing reserves and depreciating the local currency once again. In January 2003, the flotation system was replaced by a fixed exchange-rate regime, backed by strict currency controls that were still in force as of June 2003. Through greater government intervention in the economy, including control of prices and foreign-currency transactions, it is been possible to

Figure 1
VENEZUELA: MAIN ECONOMIC INDICATORS



Source: ECLAC, on the basis of official figures.
[a] December-to-December variation.
[b] Since 1998 has referred to the reduced public sector which consists of: central government bubget, PDVSA, a sample of non-financial public companies, the Venezuelan Social Security Institute (IVSS), the Deposit Insurance and Bank Protection Fund (Fogade) and the Venezuela Investment Fund (FIV).
[c] Includes interest.

slow down the loss of reserves. The aim now is to move towards normalization in an economy that has been hard hit by recession and instability. Scarcity of foreign-exchange may afford protection to tradable goods producing sectors, but it could also hinder economic recovery by causing a shortage of imported inputs.

2. Economic policy

The period 2002-2003 has witnessed major changes in macroeconomic policy, reacting to different stages in the crisis that has been afflicting the country. As mentioned above, exchange-rate policy was adapted to the short-term needs arising from massive capital flight in early 2002 and then the strike of December 2002-January 2003. On the fiscal front, use was made of the slack generated in 1999 through creation of the Macroeconomic Stabilization Investment Fund (FIEM); and successive fiscal adjustment measures were implemented mainly on the revenue side. Difficulties in containing inflationary pressures and capital outflows led to the adoption of administrative provisions to control capital movements and the prices of goods making up the basic consumption basket.

a) Fiscal policy

In 2002, the deficit of the non-financial public sector (NFPS) came in at 1% of GDP, compared to the 4.5% recorded in 2001. This reduction is particularly remarkable since it was achieved during a period of sharp economic slowdown.

The explanation for this apparent paradox lies mainly in the fiscal revenue domain. Incomes from oil, which include taxes and, first and foremost, dividends paid by Petróleos de Venezuela S.A. (PDVSA), were significantly higher than in 2001 (10%). Growth in these revenues, despite lower oil production, mainly reflected the devaluation of the bolívar; most hydrocarbon sales are sent to export markets, and their value grew in local-currency terms even after being eroded by inflation. This more than offset the reduction in taxable income imposed by the new Hydrocarbon Statute (Ley Orgánica de Hidrocarburos), which reduced the rate of income tax levied on oil activity from 66.6% to 50%, while raising the rate levied on royalties from 16.6% to 30%. Non-oil revenue remained stable. The new tax on bank debits, together with a rise in the VAT rate from 14.5% to 16%, made up for the decline in other tax-revenue categories. In addition, the Central Bank of Venezuela (BCV) transferred foreign exchange profits in large amounts to the National Treasury.

Current expenditure declined moderately (-1.8%), while capital spending retreated sharply (13%). Interest payments on domestic public debt jumped from 3.3% of GDP in 2001 to 5.1% in 2002, as a result of the rapid expansion of domestic borrowing recorded in 2000 and 2001. This increase was compensated by a reduction in current transfers, equivalent to 1.8% of GDP. The Government drew on FIEM as a funding source in an amount equivalent to 1.6% of GDP, while making payments in bonds amounting to 2.9% of GDP.

The fiscal situation worsened in the early months of 2003. The strike called in December caused oil production in that month and the following January to slump to around one fifth of the volumes produced in the three preceding months. Nonetheless, production and export levels subsequently rebounded more quickly than had been expected. For 2003 as a whole, PDVSA forecasts output of 2.5 million barrels per day (MBD) with exports of 2.3 MBD. This would require production on the order of 3 MBD as from May –an level that is consistent in principle with the 2.9 MBD production quota agreed by Venezuela with the Organization of Petroleum Exporting Countries (OPEC) on 24 April. Assuming an average price of US$ 22 per barrel for Venezuelan crude over the next few months, export earnings are expected to total US$ 18 billion– in other words 15% less than in 2002. The impact of this reduction on fiscal revenues could either be aggravated or moderated by the behaviour of oil industry profits and the exchange rate.

In view of this situation, in early 2003 the national budget was adjusted by extending the period of validity of the tax on bank debits (IDB), and raising the VAT rate. At the same time, expenditure cuts totalling 4 billion bolívares were agreed, affecting capital expenditure in particular. In May, the Government announced a 30% rise in the minimum wage, part of which would take effect in July, and the rest in September, financed with IDB revenues and BCV foreign-exchange profits. In order to reduce expenditures during 2003, part of the domestic debt was refinanced by swapping bonds that matured during the year for others payable in 2004 and 2005. The authorities have announced their intention to seek funding from multilateral agencies and international markets, but no operations have yet been carried out on any significant scale.

Less use will be made of FIEM as a financing source in 2003, given the steep fall in the level of the fund from US$ 6.227 billion to US$ 2.857 billion between the close of 2001 and the end of 2002. The fund is not expected to receive any new inflows during 2003. In the early months of the current year, central government, PDVSA and regional governments between them withdrew a

Table 1
VENEZUELA: MAIN ECONOMIC INDICATORS

	1994	1995	1996	1997	1998	1999	2000	2001	2002[a]
				Annual growth rates [b]					
Gross domestic product	-3.0	4.8	0.0	6.9	0.6	-5.5	3.8	3.5	-9.0
Per capita gross domestic product	-5.1	2.6	-2.1	4.7	-1.4	-7.3	1.8	1.5	-10.7
Gross national income	-3.4	5.8	5.2	3.4	-8.2	3.7	19.5	-4.7	-9.3
Gross domestic product by sector									
Agriculture	-1.1	-0.5	2.0	2.4	0.6	-2.1	2.4	2.6	-1.7
Mining	5.7	6.1	8.2	9.8	1.9	-9.5	4.7	1.1	-12.3
Manufacturing	-2.4	8.0	-3.0	5.1	-3.9	-6.4	2.1	-0.4	-11.2
Electricity, gas and water	1.4	2.6	1.2	4.7	1.3	1.1	2.2	3.8	1.8
Construction	-17.4	-5.0	1.1	17.2	-0.3	-16.5	-2.7	13.5	-19.8
Wholesale and retail commerce, restaurants and hotels	-8.0	1.3	-7.2	4.1	-3.0	-9.6	4.0	3.4	-10.9
Transport, storage and communciations	-3.4	3.3	1.7	9.0	5.9	1.6	8.1	8.8	-3.8
Financial establishments, insurance, real estate and business services	-2.1	0.4	-3.3	3.0	1.0	-3.3	2.2	2.4	-3.5
Community, social and personal services	1.7	1.0	-1.5	-0.5	1.3	0.4	2.2	1.8	-1.1
Gross domestic product by type of expenditure									
Consumption	-5.7	1.7	-3.6	7.3	1.4	-4.2	4.9	6.4	-7.1
General government	-5.9	2.6	-7.6	4.2	1.4	3.0	5.0	6.4	-2.5
Private	-5.7	1.6	-3.2	7.6	1.4	-4.9	4.9	6.4	-7.6
Gross domestic investment	-30.1	39.0	-12.3	36.8	0.8	-15.1	9.3	13.7	-44.9
Exports of goods and services	9.5	7.7	8.3	8.1	4.1	-10.6	7.1	-0.5	-7.6
Imports of goods and services	-19.5	19.1	-10.7	32.6	7.3	-15.2	15.2	13.7	-27.6
				Percentages of GDP					
Investment and saving									
Gross domestic investment [b]	13.7	18.2	16.0	20.4	20.5	18.4	19.4	21.3	12.9
Gross domestic investment [c]	14.2	18.1	16.6	21.0	21.9	18.1	17.2	19.7	11.9
National saving [c]	19.5	21.4	29.7	24.8	18.5	22.0	28.2	22.8	15.8
External saving [c]	-5.4	-3.2	-13.1	-3.8	3.3	-3.9	-11.0	-3.1	-3.9
				Millions of dollars					
Balance of payments									
Current account	2,541	2,014	8,914	3,467	-3,253	3,559	13,030	3,931	7,711
Goods balance	7,625	7,013	13,770	10,025	2,471	7,606	17,507	9,335	13,939
Exports fob	16,105	19,082	23,707	23,703	17,576	20,819	32,998	26,726	26,219
Imports fob	-8,480	-12,069	-9,937	-13,678	-15,105	-13,213	-15,491	-17,391	-12,280
Services balance	-3,096	-3,165	-3,269	-4,006	-3,685	-2,462	-3,051	-3,334	-2,652
Factor income balance	-1,904	-1,943	-1,725	-2,408	-1,931	-1,525	-1,204	-1,453	-2,923
Current transfers balance	-84	109	138	-144	-108	-60	-222	-617	-653
Capital and financial balance [d]	-3,485	-3,458	-2,676	-392	322	-2,520	-7,205	-5,994	-12,050
Net foreign direct investment	455	894	1,676	5,036	4,262	2,789	4,358	3,300	475
Financial capital [e]	-3,940	-4,352	-4,352	-5,428	-3,940	-5,309	-11,563	-9,294	-12,525
Overall balance	-944	-1,444	6,238	3,075	-2,931	1,039	5,825	-2,063	-4,339
Variation in reserve assets [f]	1,145	1,907	-6,271	-2,624	3,379	-589	-5,316	2,261	4,342
Other financing [g]	-201	-463	33	-452	-448	-450	-508	-198	-3
Other external sector indicators									
Real effective exchange rate (index 2000=100) [h]	191.0	150.1	181.3	143.8	117.3	103.0	100.0	95.1	124.5
Terms of trade for goods (index 1997=100)	90.2	90.2	104.3	100.0	72.1	96.6	142.0	118.9	126.7
Net resource transfer (% of GDP)	-9.6	-7.6	-6.2	-3.7	-2.1	-4.4	-7.4	-6.1	-15.9
Gross external public debt (millions of dollars)	40,998	37,537	34,117	31,328	30,248	33,235	31,840	32,274	32,859
Gross external public debt (% of GDP)	70.2	48.5	48.4	35.3	31.6	32.2	26.3	25.6	34.9
Net interest and earnings (% of exports) [i]	-10.7	-9.2	-6.7	-9.5	-10.1	-6.9	-3.5	-5.2	-10.7

Table 1 (concluded)

	1994	1995	1996	1997	1998	1999	2000	2001	2002[a]
					Percentages				
Employment									
Labour force participation rate [j]	59.1	61.6	62.2	63.8	65.1	66.3	64.6	66.5	68.8
Open unemployment rate [k]	8.7	10.3	11.8	11.4	11.3	14.9	13.9	13.3	15.8
Informal sector [l]	48.8	48.4	48.7	47.7	49.8	52.4	53.0	50.0	51.4
					Annual percentages				
Prices									
Variation in consumer prices	70.8	56.6	103.2	37.6	29.9	20.0	13.4	12.3	31.2
Variation in wholesale prices	89.5	43.6	105.8	17.3	23.3	13.6	15.8	10.2	49.4
Variation in nominal exchange rate	63.1	48.3	88.3	5.9	12.6	13.6	8.5	7.7	75.6
Variation in average real wage	-15.7	-4.6	-23.3	25.6	5.5	-4.6	1.5	2.4	-10.0
Real deposit rate [m]	-16.9	-23.8	-34.4	-16.3	4.4	0.9	2.0	2.1	-3.9
Real lending rate [n]	-8.7	-14.9	-27.9	-9.6	12.0	10.6	11.2	11.1	3.3
Equivalent deposit rate in foreign currency [o]	-13.9	-15.7	-32.8	8.1	20.6	6.0	5.8	6.5	-26.8
					Percentages of GDP				
Non-financial public sector [p]									
Current income	28.7	27.2	33.8	29.1	23.0	25.4	31.6	26.5	31.1
Current expenditure	18.6	18.1	16.3	17.5	17.3	17.2	19.0	20.4	21.9
Saving	10.1	9.1	17.6	11.6	5.6	8.2	12.6	6.2	9.2
Balance of capital income and expenditure	-9.8	-10.7	-10.2	-6.9	-9.6	-7.2	-7.2	-9.3	-8.8
Primary balance	-8.2	0.6	11.7	6.5	-1.3	3.8	7.3	-1.2	4.4
Overall balance	-13.3	-5.7	6.8	3.6	-4.3	0.7	4.3	-4.5	-1.1
Public debt	...	...	42.8	31.8	28.7	27.4	26.2	28.8	35.6
External	...	...	36.2	27.0	24.5	22.1	18.0	17.9	23.9
Domestic	...	...	6.6	4.8	4.3	5.3	8.3	10.9	11.7
Interest payments (% of current income)	17.9	22.9	14.5	9.9	12.8	12.3	9.4	12.5	17.7
Money and credit [q]									
Domestic credit [r]	18.8	14.2	9.7	10.2	13.1	12.2	11.4	12.3	12.2
To public sector	3.6	4.9	2.8	0.6	0.4	0.5	0.8	1.5	2.3
To private sector	15.2	9.4	6.9	9.6	12.8	11.6	10.6	10.7	9.9
Liquidity (M3)	...	...	14.4	15.3	17.4	17.2	16.3	16.9	16.0

Source: ECLAC, on the basis of official figures.

[a] Preliminary figures. [b] Based on constant 1995 dollars. [c] Based on figures in local currency at currrent prices. [d] Includes errors and omissions. [e] Refers to the balance on the capital and financial accounts, minus net foreign direct investment plus errors and omissions. [f] A negative sign denotes an increase in reserves. [g] Includes the use of credit and loans from IMF and exceptional financing. [h] Annual average, weighted by the value of exports and imports of goods. [i] Refers to net investment income divided by exports of goods and services from the balance of payments. [j] Economically active population as a percentage of the working-age population, nationwide total. [k] Unemployed as a percentage of the economically active population, nationwide total. [l] Employed in the informal sector as a percentage of the employed population. [m] Ninety-day deposits, six leading commerical and universal banks. [n] Lending by six leading commerical and universal banks. [o] Rate on deposits, deflated by the variation in the dollar exchange rate. [p] From 1998 on, refers to restricted public sector, which consists of: budgetary central government, PDVSA, sample of non-financial public enterprises, IVSS, FOGADE and FIV. [q] Average annual values used for monetary figures. [r] Net credit to the public and private sectors extended by commercial banks and other financial and banking institutions.

further US$ 1.839 billion from FIEM, which left it with a balance of US$ 1.027 billion in late June corresponding to PDVSA. These withdrawals were made possible by legal amendments approved in early 2003.

b) Monetary and exchange-rate policies

Monetary policy in 2002 was determined by events in the foreign-exchange domain. In previous years, use

Table 2
VENEZUELA: MAIN QUARTERLY INDICATORS

	2001				2002[a]				2003[a]	
	I	II	III	IV	I	II	III	IV	I	II
Gross domestic product (change from same quarter of preceding year) [b]	4.0	3.1	3.3	0.9	-3.8	-9.1	-5.6	-16.7	-29.0	...
Goods exports fob (millions of dollars)	7,299	7,112	7,014	5,301	5,479	6,473	8,253	6,014	4,530	...
Goods imports cif (millions of dollars)	3,964	4,443	4,696	4,288	3,438	3,278	3,032	2,532	1,399	...
International reserves (millions of dollars)	20,901	19,992	19,059	18,523	15,029	15,142	14,826	14,861	15,071	17,586
Real effective exchange rate (2000=100) [c]	97.0	95.3	94.5	93.8	103.9	115.1	145.0	134.0	148.7	141.0
Unemployment rate	14.2	13.3	13.4	12.1	15.3	15.6	16.3	16.0	20.3	18.9
Consumer prices (12-month variation, %)	12.5	12.5	12.3	12.3	17.6	19.6	28.2	31.2	34.1	34.2
Average nominal exchange rate (bolívares per dollar)	703	714	732	747	864	1,013	1,387	1,380	1,624	1,598
Nominal interest rates (annualized percentages)										
Deposit rate [d]	11.6	12.7	16.1	18.5	30.5	33.6	24.4	26.7	23.1	16.1
Lending rate [e]	21.5	21.4	27.8	28.6	48.3	40.7	31.5	33.2	34.1	25.9
Interbank rate	7.0	13.0	16.2	22.0	45.4	19.1	23.3	30.1	19.0	9.5
Sovereign bond spread (basis points)	880	847	982	1,128	886	1,115	1,156	1,118	1,419	997
Stock price indexes (indexes, June 1997=100)	51.6	51.0	46.4	37.9	31.8	24.5	22.4	24.6	20.6	34.3
Domestic credit [f] (change from same quarter of preceding year)	27.9	17.7	13.5	15.6	2.3	12.0	16.0	11.6	15.3	...
Mature credit as a porportion of total credit (%) [g]	5.8	6.2	5.8	4.8	7.3	7.1	7.3	6.6	7.9	8.0

Source: ECLAC, on the basis of official figures.
[a] Preliminary figures. [b] Based on figures in local currency at constant 1984 prices. [c] Quarterly average, weighted by the value of exports and imports of goods. [d] Ninety-day deposits, six leading commerical and universal banks. [e] Lending by six leading commerical and universal banks. [f] Net credit to the public and private sectors extended by commercial banks and other financial and banking institutions. [g] Total credit extended by the financial system.

of the exchange rate to stabilize prices resulted in an increasingly overvalued currency –a situation that could be sustained while oil prices were high and international reserves were abundant. As result of the drop in oil prices after 11 September 2001, and the political uncertainties that began to manifest themselves in the final quarter of that year, international reserves fell from around US$ 20 billion, a level that had been maintained throughout most of 2001, to US$ 15 billion in February 2002.[1] In that month, the exchange-rate regime was altered and the currency-band system was replaced by a floating exchange rate. This enabled the Central Bank to control foreign-exchange supply; and market adjustment thenceforth operated mainly through the price. The result was that the exchange rate depreciated sharply and became highly volatile –factors that led to a resurgence of inflationary pressures. The bolívar, which in late December 2001 was quoted at 762 to the dollar, ended

1 In both cases the figures include reserves held in the Macroeconomic Stabilization Investment Fund (FIEM).

2002 at a rate of 1,403. As a counterpart to this, the drain on international reserves was halted, partly thanks to the upswing in oil prices that began in the second quarter of the year.

Before the flotation band system was replaced, monetary tightening measures had been adopted that pushed interest rates to levels above 50%. The aim of this was to strengthen the viability of the exchange-rate system and to conserve international reserves; nonetheless, the measures were insufficient to contain the demand for foreign currency in the weeks leading up to the replacement of the band system.

With the introduction of managed floating, the inflation control strategy centred on using monetary policy to achieve price stability in the medium-term, for which purpose BCV began to engage in open-market operations. This allowed for a steady decline in interest rates, which by September had fallen to around 30%. In the face of inflationary pressures that exceeded the target set by the monetary authority, towards the end of the year interest rates were pushed progressively higher through the rates applied in BCV operations. The non-preferential lending rate of the country's six leading banks stood at 33.9% by the end of 2002, with the rate on 90-day deposits at 27.9%. Bank lending to the private sector shrank by 25.6% in real terms during the year, and the overdue portfolio grew from 5.1% in late 2001 to 6.8% in 2002.

The acceleration of capital outflows in 2002, together with the temporary suspension of oil revenues late in the year, led the authorities to close the foreign-exchange market on 21 January 2003 and establish a fixed exchange rate of 1,600 bolívares per dollar. This was accompanied by a system of currency controls that remain in place today, which have enabled international reserves to be replenished. In addition, a non-authorized parallel market emerged in which the exchange rate is about 50% above the official level.

As a complement to currency controls, controlled prices were set for basic consumption goods and services, encompassing over half of the items making up the consumer price index. As some productive sectors consider that the established prices make it impossible to supply the market on a profitable basis, the Government has been forced to engage in direct importation and distribution of certain basic products, in order to avoid shortages.

After adopting these measures, the authorities attempted to generate sharply lower interest rates in order to boost economic activity. The national government explicitly stated its preference for the BCV to set maximum rates, but the initiative of negotiating an agreement with private banks prevailed. Within this framework, BCV lowered its rediscount rate, and on 30 April 2003 the National Executive, BCV and the banking sector signed an economic stability pact. This includes a commitment by financial institutions to channel at least 500 billion bolívares (US$ 312.5 million) to the private sector at an average interest rate corresponding to 85% of the average lending rate of the six leading banks. The banking sector also undertakes to maintain its public-sector bond holdings at their 31 December 2002 level until the end of the year. The establishment of an interest rate ceiling would have helped ease the financial burden of the central government's domestic debt, since a considerable portion of this uses the lending rate charged by the country's main banks as a benchmark. Nonetheless, given the reluctance of the financial sector to accept new government bonds, administratively determined interest rates would make it harder for the Treasury to obtain new funding on the domestic market.

3. The main variables

In 2002 and during the first quarter of 2003, the behaviour of the main economic variables was recessionary. Domestic output, employment and wages all declined, while inflation moved higher. On the external front, imports dwindled and there was a heavy capital outflow.

a) Economic activity

The economy contracted by 9% in 2002, following expansions of 3.8% and 3.5% in 2000 and 2001. The oil sector cut back production in compliance with OPEC agreements, and, from December onwards, because of the strike. As a result, oil output slumped by 12.5% while production in the non-oil sector contracted by 6.5%. The steepest declines occurred in the second and fourth quarters, reflecting the most critical moments in the ongoing political crisis. Aggregate demand sagged by 12.2%, with each of its components posting reductions.

In 2001, increased public expenditure aimed at reactivating the economy, in conjunction with the fall in the oil price late in the year, produced a fiscal deficit of 4.7% of GDP. This, along with the capital outflow, signified a change in the policies that had been adopted during the three previous years and largely explains the sharp retraction in aggregate demand during 2002.

All sectors suffered activity slowdowns in 2002, except for electricity and communications which have little weight in total output. Among the key sectors, manufacturing contracted by 11%; construction fell by 20%, following 13.5% growth in 2001; and commerce decreased by 10.9%.

Economic activity continued to decline in the first quarter of 2003 –GDP shrank by 27.6%, with oil activities slumping by 47.3% and non-oil activities plunging by 19.0%. Oil exports, which in late 2002 attained a level of about 3 million barrels per day, came in at 0.6 MBD in January, 0.9 in February and 1.93 in March. These export volumes mean that Venezuela largely failed to benefit from the high oil prices prevailing in the first quarter of the year.

To encourage normalization of productive activities, the Government announced the adoption of policies to protect domestic production. The effect of these policies in the short run is constrained by weaknesses in the infrastructure of production for domestic markets that have developed over several years. Investment would therefore need a major boost, having been clearly neglected since 1999. In the short term, the recovery of oil production and progressive normalization that followed the strike herald significant improvements from the very depressed first quarter of this year. Nonetheless, it is too late to prevent a negative rate of activity growth for the year as a whole compared to 2002, probably at a two-digit level.

b) Prices, wages and employment

The consumer price index rose by 31.2%, in 2002, bringing the curtain down on a six-year period during which inflation fell steadily from 100% in 1996 to 12% in 2001. The behaviour of prices in 2002 reflected the impact of the bolívar depreciation during the year, compounded by the rise in the VAT rate and elimination of a number of exemptions. The wholesale price index jumped by 51.3%, following a rise of just 10.2% in the previous year.

The sharp downturn in economic activity pushed the unemployment rate up to 15.8% in late 2002 –its highest level since 1967; official figures for 2003 show unemployment at 19.1% in April. In addition, real wages dropped by 13.5% during the year.

c) The external sector

In 2002, the trade surplus widened to nearly US$ 14 billion, thanks largely to a 29.4% drop in imports associated with the economic slowdown, while exports declined by 6.4% in the wake of production cutbacks agreed with OPEC and the oil-industry standstill during the strike. The current account balance was also positive, to the tune of US$ 7.7 billion, but a capital outflow of some US$ 12 billion resulted in an overall balance-of-payments deficit of US$ 4.3 billion.

The financial and capital account has been in deficit since 1999; and this, together with the heavy outflows recorded as errors and omissions, reveals an exceptional and growing haemorrhage of capital from the domestic economy: US$ 26 billion between 2000 and 2002. In the latter year, foreign direct investment (FDI) dwindled to just US$ 475 million (down from US$ 4.4 billion in 2000), a level that could do little to offset the outflow of capital from the private sector. The financial and capital account posted a net deficit of US$ 8.905 billion, which, together with errors and omissions (a further US$ 3.145 billion), resulted in a total capital outflow in excess of US$ 12.050 billion. Total international reserves ended 2002 at US$ 14.755 billion, which was US$ 4.342 billion lower than previous year's level, largely (78%) corresponding to FIEM drawings.

The country's international reserves continued to decline in January 2003, reflecting the lack of oil income and further capital outflows. By the end of that month, reserves had fallen to US$ 13.669 billion, their lowest level in the last four years. This situation, compounded by fiscal needs, made it necessary to draw further on FIEM resources. Subsequently, following the closure of the foreign-currency market, introduction of currency controls and suspension or reduction of foreign-currency sales to the private sector, total reserves recovered to US$ 18 billion by early July 2003.

During the first quarter of 2003, exports fell by 24.6%, while imports plummeted by 43.8%. This is a temporary situation, however, since oil sales can be expected to regain normal volumes during the rest of the year. In terms of capital movements, suspension of the supply of foreign currency by the Central Bank and the use of accumulated funds by certain productive sectors have helped to staunch the capital haemorrhage.

Part three

The Caribbean subregion, 2002-2003

General trends

1. States members of the Organisation of Eastern Caribbean States (OECS)[1]

In 2002 the OECS economies registered negative growth (-0.3%) as key productive sectors stagnated. The tourism sector languished, reflecting significant structural weaknesses. The manufacturing sector remained uncompetitive by international standards and construction suffered from a reduction in the rate of implementation of investment projects. Agriculture proved to be the exception to this trend, but its development potential remains constrained by internal difficulties and by the effects that the gradual withdrawal of preferential market access will have on the industry.

In terms of individual member States, Antigua and Barbuda, Montserrat, Saint Kitts and Nevis and Saint Vincent and the Grenadines recorded positive growth rates (1.4%, 6.0%, 0.4% and 1.1%, respectively), while all the others saw their economies contract (-4.2% and -1.2%, for Anguilla and Grenada, respectively) or stagnate (Saint Lucia). Dominica witnessed by far the deepest trough (-6.7%) as a result of an impending economic crisis that severely curtailed the functions of the government.

Dominica's situation drew the attention of regional organizations and national institutions to the fiscal vulnerability and general macroeconomic situation in the OECS economies. The OECS countries have recorded steadily declining rates of growth since the 1970s and, at the same time, have accumulated significant fiscal and external gaps, creating debt sustainability problems and making the countries more dependent on foreign financing, which in some cases

1 The States members of OECS include Anguilla, Antigua and Barbuda, the British Virgin Islands, Dominica, Grenada, Montserrat, Saint Kitts and Nevis, Saint Lucia and Saint Vincent and the Grenadines. The analysis here presented covers all member States with the exception of the British Virgin Islands. These States form a currency union and fall under the monetary authority of the Eastern Caribbean Central Bank (ECCB). These economies have three different fiscal years. Dominica's fiscal year starts in July and ends in June. The fiscal year in Anguilla, Saint Kitts and Nevis and Montserrat coincides with the calendar year. The rest of the economies have a fiscal year spanning from April to March. ECCB reports the fiscal accounts on a calendar-year basis to make them comparable.

has tended to decline. In 2002, public debt outstanding rose by 14.7%. The Caribbean governments decided to create a stabilization fund to deal with this situation and enable the countries of the sub region to meet the institutional and economic challenges posed by the current international trends towards globalization and market liberalization.

The downturn in growth translated into a decline in productive sectors, demand for credit and rising levels of liquidity in the financial system. However, commercial banks did not systematically lower the cost of borrowing, opting instead to bear the opportunity costs of holding funds idle and thereby reinforcing a declining trend in their profitability.

At the same time, tax revenues were unable, in the majority of cases, to compensate for the expansion of current expenditure, forcing most member States to balance their fiscal accounts by constraining capital expenditures.

These imbalances were reflected in member States' external accounts, which at the aggregate level reveal the importance of portfolio investment as a source of financing and show a reduction in foreign direct investment flows.

The outlook for 2003 remains bleak. The development of member States' productive sectors is hampered by technical difficulties and the lack of profitable outlets. Most States are thus relying on an increase in the implementation rate of public sector programmes and on external stimuli to revive their economic activity. Member States project a recovery of the tourism and construction sectors, while agriculture is expected to maintain its current overall performance.

2. Other Caribbean countries

The economic performance of the other Caribbean countries was varied. Nonetheless, with the exception of Trinidad and Tobago and Belize (3.2% and 3.7%), these countries share some of the features characterizing the economic performance of OECS. Growth in Barbados, Bahamas, Guyana, Jamaica and Suriname stagnated. Barbados registered a decline (-0.4%), and Guyana, Jamaica and Suriname recorded similar rates of expansion (1.1%, 1.0% and 1.2%, respectively).[2]

The slowdown in growth, which is explained by the contraction in the main economic sectors (agriculture, mining and tourism), led the banking system to increase liquidity margins, forcing the authorities in Jamaica, Trinidad and Tobago and Suriname to intervene in those countries' flexible exchange rate systems in an effort to prevent depreciation of the exchange rate and stave off the threat of higher inflation. In Jamaica, in spite of concerted efforts to keep the exchange rate stable, the nominal rate followed an unstable path that turned into a free fall in the early months of 2003 before it finally stabilized. In Suriname, direct intervention by the authorities, including an increase in the reserve requirement ratio and the establishment of a trading band, did not stop the currency from depreciating. In Trinidad and Tobago, phases of foreign exchange shortage alternated with phases of relative abundance.

In the case of the fixed exchange rate systems, the authorities' response depended on the specifics of each case. In Barbados and Bahamas the authorities sought to engineer a decline in interest rates, in part to alleviate the domestic debt burden. Meanwhile, Belize was also exposed to devaluation pressures, forcing the authorities to adopt a strict monetary stance.

2 Bahamas does not report current GDP figures.

The fiscal accounts improved in Belize and Guyana and worsened in the rest of the Caribbean countries. The reasons for the deterioration of the fiscal accounts do not have a common denominator and can only be analysed on a case-by-case basis.

Given the countries' low growth, inflation was not a priority for most of them. The rate of inflation rose in Guyana and settled at the two-digit level in Suriname.

The external account out-turn was mixed. Trinidad and Tobago registered a surplus, and Bahamas and Guyana improved their current-account position, while the rest of the countries widened their imbalances.

For 2003 most of the countries except Jamaica expect improved growth prospects. Trinidad and Tobago is expecting higher foreign exchange flows as a result of its large endowment of oil resources. Bahamas and Barbados are expecting a recovery led by tourism. After changing its tourism legislation and approving the construction of a hotel by a major chain, Barbados is likely to record positive growth in 2003. Belize plans to stabilize its economy as its fiscal deficit narrows and becomes sustainable over time. Guyana is counting on the government's efforts to rationalize and improve the productivity of its agricultural sector. Suriname will benefit from a number of investments by foreign companies in the agricultural and mining sectors.

On the external front, the Caribbean Community (CARICOM) countries signed a free trade agreement with Costa Rica in March 2003 as part of their broader regional integration efforts. The smaller CARICOM countries are also beginning to outline a strategy for negotiations with Europe in the wake of the Cotonou Agreement, while others, such as Jamaica, are shifting their trade strategies from market access to export promotion and diversification.

Organisation of Eastern Caribbean States (OECS)

1. Economic policy

(a) Fiscal policy

At the aggregate level the OECS economies improved their fiscal position with respect to the previous year, owing mainly to an improvement in the capital account. This resulted, in turn, from an increase in capital revenue (from EC$ 11 million in 2001 to EC$ 42 million in 2002) and, most importantly, a contraction in capital expenditure (-14%). The reduction in capital expenditure reflected the completion of investment projects and also, in some countries, low rates of implementation of public-sector investment programmes.

The current account balance deteriorated (from a deficit of EC$ 127 million in 2001 to EC$ 160 million in 2002) because of the expansion of current expenditure (6.6%), which amply offset the increase in current revenue (5.3%). Current revenue was driven by the taxes collected on international trade and transactions (7.2%), and current expenditure, by all of its components. The deficit was financed from external sources.

In terms of individual member countries, Anguilla and Montserrat registered surpluses on their overall fiscal balance. Antigua and Barbuda, Dominica and Saint Lucia narrowed their fiscal shortfalls, but Grenada, Saint Kitts and Nevis and Saint Vincent and the Grenadines saw their fiscal accounts deteriorate.

Anguilla's performance is explained by the containment of current expenditure despite the settlement of wage arrears that took place in the second quarter of the year and the contraction in capital outlays due to the completion of public-sector investment projects.

In Antigua and Barbuda, current revenues rose thanks to an increase in the customs service charge (from 5% to 10%) and the widening of the base of the environmental levy. However, rising current expenditure led to deterioration in the current account deficit owing to an increase in the wage bill and maintenance outlays. The contraction in capital expenditure was due mainly to the completion of projects as the government undertook the task of rehabilitating road infrastructure and health facilities and expanding the Heritage Quay.

In July 2002 Dominica implemented an IMF standby arrangement which contemplated measures to increase fiscal revenues, including a stabilization levy and a broadened sales tax incorporating telecommunications services. In practice, fiscal revenues remained at the previous year's level and the required adjustment was brought about through the containment of current expenditure and a drop-off in the rate of capital project implementation.

Grenada witnessed a decline in its current account surplus as revenue failed to keep pace with expenditure. While tax revenues reflected the slow pace of economic activity, the potential of non-tax revenues was constrained by a reduction in the number of offshore financial companies. Current expenditure reflected interest payments on the external debt and transfers and subsidies. Capital expenditure rose significantly as public works were undertaken on a major hospital.

Montserrat's current account deficit widened owing to an increase in transfers and subsidies, which is explained by the operational and maintenance costs of the helicopter and ferry services transferred to the government at the beginning of 2002. Meanwhile, capital expenditure shrank as public-sector projects entered their completion phase.

In Saint Lucia saw its current account surplus rise in relation to the previous year because of a marginal increase in tax revenue and the successful containment of expenditure. The government thus found itself with greater leverage to carry out capital expenditure projects to revitalize the economy. Ongoing projects included road and water infrastructure, the improvement of security services and a fish-landing complex. Fiscal management was facilitated by a rise in capital grants due to a fisheries project.

Saint Kitts and Nevis managed to reduce its current account deficit despite an increase in its external debt burden due to a bond issue, higher transfers in the first half of the year and lower receipts of international trade and transaction taxes, as a result of the removal of the accommodation tax to help shore up the tourism sector's competitiveness in the light of lower visitor expenditure. The capital account balance reflected a 50% increase in expenditure due to the construction of a fisheries complex and a hospitality center, hospital rehabilitation and the enhancement of road and building infrastructure.

In Saint Vincent and the Grenadines, the fiscal accounts showed a bigger current account surplus as a result of an increase in the rate of the consumption tax, a widening of the tax base of the interest levy and the introduction of licences. At the same time, capital expenditure more than offset the revenue effects of these tax measures, and included equity investment in the Caribbean airline LIAT, the Grenadines Multi-Project Phase and outlays on human capital development and physical infrastructure.

In 2003 most of the countries are expected to resume their normal rates of public project implementation, although their fiscal situation is likely to remain unchanged unless growth prospects improve.

(b) Monetary and exchange-rate policy

The OECS economies have formed a currency union since 1983. Its monetary unit, the Eastern Caribbean dollar, is pegged to the United States dollar at EC$ 2.70 per US$ 1. The union's monetary authority, the Eastern Caribbean Central Bank, acts as a quasi-currency board and is required by statute to back up 60% of its monetary liabilities. Since the formation of the union, the Central Bank has maintained a neutral monetary stance and has hardly changed its reference rate of interest. Two important features of the currency union explain this neutral stance. On the one hand, the monetary authority's management of its foreign assets and liabilities has guaranteed a backing ratio that greatly exceeds the statutory levels. On the other hand, the commercial banking system forms a closed circuit that follows the banking principle, namely the maintenance of equality between assets and liabilities.

In 2002, the expansion of the broad money supply (7%) resulted from the accumulation of net foreign assets by commercial banks (23%). This is explained by the slowdown in economic growth, which negatively affected the demand for credit (1.2%), leading the commercial banking system to accumulate liquidity (the deposit-loan ratio rose from 1.24 to 1.30) and to channel that liquidity into the acquisition of external assets. The prime lending rate moved from 9% to 8.5% in September 2002, but did not decrease sufficiently to offset the effect of falling inflation.

As has been usual in the past, personal loans represent close to half of total lending (46%). Agriculture, tourism and manufacturing registered the largest increases in credit (12%, 9% and 8%, respectively). Professional services, financial institutions, entertainment and transport reduced their demand for credit (-3%, -8%, -9% and -10%).

Monetary trends in the individual countries mirrored those of the ECCB area in the aggregate. In all the countries, the banking system accumulated net foreign assets, with the biggest increases being registered in Dominica and Grenada (2% and 11.2%, representing 3.3% and 7.8% of the financial system's total net assets). At the same time, except in Saint Vincent and the Grenadines (14%), the growth of demand for credit was sluggish (5%, 0.3%, 11.2%, -4.1%, -2.3% and 3.6% for Anguilla, Antigua and Barbuda, Dominica, Grenada, Saint Kitts and Nevis and Saint Lucia, respectively). The respective commercial banking systems increased their levels of liquidity, but this was scarcely reflected in their lending policy, as interest rates remained constant (in Anguilla, Montserrat, Saint Lucia and Saint Vincent and the Grenadines) or decreased by one percentage point in nominal terms (in Antigua and Barbuda, Dominica, Grenada and Saint Kitts and Nevis). Again with the exception of Saint Vincent and the Grenadines, the deposit-loan ratio increased in all cases (1.41, 1.19, 1.20, 1.27, 1.23, 1.08 and 1.45 in January 2002 and 1.56, 1.22, 1.39, 1.39, 1.27, 1.11 and 1.39 in January 2003 for Anguilla, Antigua and Barbuda, Dominica, Grenada, Saint Kitts and Nevis, Saint Lucia and Saint Vincent and the Grenadines, respectively).

In 2003 the situation has not changed, and the factor that will ultimately determine the behaviour of the demand for credit is GDP growth.

2. The main variables

(a) Economic activity

The OECS economies registered negative growth (-0.3%) as a result of the contraction in construction (-2.2%), tourism (-0.9%) and manufacturing (-0.8%). Agriculture proved to be the exception to this trend, making a robust recovery from the previous year's underperformance (from -9.2% in 2001 to 6.6% in 2002).

Agriculture rebounded mainly because of a 19% increase in the volume of banana production, as Saint Lucia's output, representing 73% of the total, rose by 16%, while that of Saint Vincent and the Grenadines was up by 10.9%. This was due to favourable weather conditions, improved irrigation and, in the specific case of Saint Lucia, the effects of an emergency recovery programme. In the other Windward Islands, banana output contracted (-3.4% and -9.4% in Dominica and Grenada, respectively) as a result of drought conditions and a decrease in total acreage. The production of other crops (cocoa, nutmeg and mace), which rose by 27%, 41% and 10%, respectively, benefited from greater productivity, improved supply prices, extensive cultivation and more efficient pest control.

Construction reflected the contraction in government capital expenditure due to the completion of public and private investment projects and also to a reduction in their implementation rate. Exceptions to this pattern included Grenada, Montserrat and Antigua and Barbuda. In Grenada construction expanded in response to an increase in public capital expenditure. In Montserrat public and private investment rose, and in Antigua and Barbuda the increase in construction was led by the expansion of hotel capacity.

Manufacturing reflected the slow growth of external demand and local industries' lack of competitiveness. Soap, toothpaste, flour and rice retreated (0.2%, -16%, -30% and 0.9%, respectively).

The languishing tourism sector did not fully recover from the effects of the 11 September attacks and was also hurt by the discontinuation of weekly cruise-ship routes to some of the OECS countries. The number of stay-over arrivals and yacht passengers increased marginally (by 1% and 0.4%), while that of cruise-ship passengers and cruise-ship calls declined (by 24% in both cases). The net result for OECS as a whole and also at the individual country level was a contraction in the number of total visitor arrivals (-14%) and in visitor expenditure (-1%).

(b) Prices, wages and employment

The price level decreased in most OECS member States, reflecting continued stagnant growth and stable international and agricultural prices. On average, the growth in the consumer price index decreased from 0.27% to -0.40%. At the country level, Anguilla registered the most pronounced drop-off (-1.75%) owing to lower prices for accommodations, which, in turn, reflected an incentive policy designed to maintain the competitiveness of the tourism industry. Saint Lucia was the only country in which prices trended upward in the last quarter of the year with respect to the same period of the previous year (0.29% and 0.35% in 2001 and 2002) because of increases in fuel and electricity (1.06%), transport and communications (1.13%) and medical care and expenses (2.71%). In 2003 inflation will remain subdued, in the vicinity of 0.5%-1.3%.

A comparative examination of the components of the price index by member State reveals that food prices (which have the highest weight in the price index of all the economies) declined on average from 0.12% to -0.60% between the last quarter of 2001 and the same period of 2002. Housing, which is second in importance for most economies, exhibited a trend (-0.06% and -1.38% on average in 2001 and 2002) similar to that of most of the other components of the consumer price index, with one or two minor exceptions.

Labour market information on the OECS economies indicates that Antigua and Barbuda and Saint Vincent and the Grenadines registered increases in employment among civil servants and nurses. In addition, Montserrat implemented a 10% wage increase for civil servants.

(c) The external sector

The overall balance-of-payments outcome was positive, as the current account deficit (US$ -481 million, or 16% of GDP) was amply financed by the surplus on the capital and financial account.

The current account out-turn is explained by the mixed performance reflected in the merchandise trade balance (US$ -1.016 billion) and the fall-off in tourism earnings (-1% in gross visitor expenditure), which reduced the service account surplus from US$ 658 million to US$ 627 million. At the country level, the merchandise trade deficit narrowed in Dominica, Anguilla and Saint Lucia (-17%, -12% and -7%, respectively) and widened significantly in Montserrat and Saint Vincent and the Grenadines (47% and 10% respectively). Dominica and Grenada registered reductions in their merchandise exports (-4% and -2%, respectively) that were more than offset by the decline in imports (-12% and -3%, respectively). Saint Lucia benefited from a rise in banana exports (44%) and a negligible expansion of total imports (less than 1%). For its part, Saint Vincent and the Grenadines recorded a drop in exports (-13%) and an increase in imports (3.5%). Lastly, in Montserrat imports are bound to outpace exports merely by virtue of the economy's small size. The country's total merchandise import bill amounts to 17 times its export earnings.

The capital and financial account surplus (US$ 566 million), reflected official transfers to the OECS economies. The financial surplus (US$ 450 million) reflected an upsurge in portfolio investment, since foreign direct investment, which went mainly to the tourism sectors, declined (-6%).

Table 1
ANTIGUA AND BARBUDA: MAIN ECONOMIC INDICATORS

	1994	1995	1996	1997	1998	1999	2000	2001	2002[a]
	Annual growth rates [b]								
Gross domestic product	…	…	…	5.6	4.9	4.9	2.5	1.1	1.4
Gross domestic product by economic activity									
Agriculture	…	…	…	5.1	4.3	3.4	3.4	4.4	1.0
Mining and quarrying	…	…	…	5.3	8.7	4.2	4.2	6.5	2.0
Manufacturing	…	…	…	6.4	5.8	4.7	3.1	6.5	2.7
Electricity, gas and water	…	…	…	6.6	1.1	14.3	11.2	20.2	4.1
Construction	…	…	…	8.7	11.1	8.7	7.0	12.1	3.5
Wholesale and retail	…	…	…	4.2	4.7	4.7	4.5	7.7	-2.0
Transport	…	…	…	9.4	1.1	2.1	4.8	3.8	-3.3
Communications	…	…	…	11.1	11.1	25.7	-6.4	-2.4	0.1
Banks and insurance	…	…	…	31.4	15.3	0.0	1.4	2.6	12.0
Real estate and housing	…	…	…	4.2	5.3	4.7	4.2	8.3	3.0
Other services	…	…	…	4.7	3.4	4.2	4.2	7.1	2.7
Tourism	…	…	…	6.1	-2.2	2.8	-0.9	-7.3	2.1
	Millions of dollars								
Balance of payments									
Balance on current account	-6	-1	-59	-47	-47	-63	-62	-47	-87
Goods balance	-242	-238	-271	-275	-283	-316	-300	-283	-297
Exports fob	45	53	39	39	37	37	42	39	…
Imports fob	-288	-291	-310	-314	-321	-353	-342	-321	…
Services balance	257	201	206	240	259	262	262	249	240
Income account balance	-27	-27	-26	-22	-21	-28	-33	-20	-36
Current transfers balance	6	64	32	10	-2	20	9	6	6
Capital and financial account balance [c]	14	14	48	50	56	73	56	64	95
Net foreign direct investment	25	31	19	23	23	31	33	39	34
Financial capital [d]	-10	-17	29	27	33	42	23	24	61
Global balance	8	14	-11	3	9	10	-6	16	8
Variation in reserve assets [e]	-8	-14	11	-3	-9	-10	6	-16	-8
Other external sector indicators									
Gross external debt (% of GDP)	…	…	…	60.0	62.3	60.2	60.6	57.3	66.0
Prices									
Consumer prices (rates of change)	…	…	…	-1.1	4.7	1.0	0.5	1.7	…
Nominal exchange rate (Eastern Caribbean dollars per dollar)	2.7	2.7	2.7	2.7	2.7	2.7	2.7	2.7	2.7
	Percentages of GDP								
Non-financial public sector									
Current revenue	…	…	…	20.9	20.4	19.7	18.3	19.3	20.0
Current expenditure	…	…	…	20.7	21.4	21.3	21.5	24.7	26.7
Capital account balance	…	…	…	-3.5	-3.7	-2.5	-2.3	-5.4	-6.7
Fiscal balance [f]	…	…	…	-3.2	-3.7	-3.7	-5.4	-7.7	-7.3
Money and credit									
Domestic credit	…	…	…	71.8	74.9	80.1	86.9	71.6	…
Public sector	…	…	…	10.3	12.4	16.5	17.9	4.1	…
Private sector	…	…	…	65.5	65.9	68.0	73.2	72.8	…
Broad money (M3)	…	…	…	65.7	70.9	74.6	77.6	78.4	…
Local-currency liquidity (M2)	…	…	…	62.3	67.2	70.6	72.2	74.1	…
Foreign-currency deposits	…	…	…	3.4	3.7	4.0	5.4	4.3	…
	Annual percentages								
Real interest rates									
Weighted average deposit rate	…	…	…	5.7	-0.2	3.2	4.5	2.7	…
Weighted average lending rate	…	…	…	13.4	7.3	11.0	11.6	9.6	…

Source: ECLAC, on the basis of official information.
[a] Preliminary figures. [b] On the basis of constant 1980 prices. [c] Includes errors and omissions. [d] Refers to the capital and financial accounts, minus net foreign direct investment, plus errors and omissions. [e] The sign (-) indicates a reserve increase. [f] Includes grants.

Table 1
DOMINICA: MAIN ECONOMIC INDICATORS

	1994	1995	1996	1997	1998	1999	2000	2001	2002[a]
				Annual growth rates [b]					
Gross domestic product	…	…	…	5.1	4.8	4.4	2.3	-6.1	-6.7
Gross domestic product by economic activity									
Agriculture	…	…	…	-3.3	-3.9	-3.1	-11.0	-11.0	-0.6
Mining and quarrying	…	…	…	-5.6	-5.6	6.3	-2.8	-2.8	-0.3
Manufacturing	…	…	…	24.6	-3.3	-9.3	-7.0	-7.0	-22.7
Electricity, gas and water	…	…	…	21.2	17.6	8.5	5.6	5.6	0.6
Wholesale and retail	…	…	…	5.4	5.4	5.3	-0.6	-0.6	-5.2
Transport	…	…	…	3.4	5.2	-0.7	-7.8	-7.8	-14.1
Communications	…	…	…	33.8	33.2	8.3	-10.5	-10.5	-9.5
Banks and insurance	…	…	…	3.6	18.1	7.6	2.6	2.6	2.4
Real estate and housing	…	…	…	3.1	4.1	3.1	2.0	2.0	0.9
Other services	…	…	…	9.3	6.1	4.9	10.0	10.0	1.6
Tourism	…	…	…	-2.0	0.1	-1.5	-8.7	-8.7	-5.5
				Millions of dollars					
Balance of payments									
Balance on current account	-38	-41	-51	-42	-23	-36	-54	-49	-41
Goods balance	-47	-53	-64	-65	-53	-66	-76	-71	-59
Exports fob	48	50	53	54	63	56	55	44	…
Imports fob	-96	-103	-117	-119	-116	-122	-130	-115	…
Services balance	14	18	22	29	33	42	37	24	26
Income account balance	-11	-13	-19	-17	-16	-26	-33	-20	-20
Current transfers balance	7	8	10	10	13	14	18	17	12
Capital and financial account balance [c]	34	49	53	43	27	47	54	53	54
Net foreign direct investment	23	54	18	21	7	18	11	12	25
Financial capital [d]	12	-5	36	22	20	29	43	42	29
Global balance	-3	8	2	1	4	11	0	5	13
Variation in reserve assets [e]	3	-8	-2	-1	-4	-11	0	-5	-13
Other external sector indicators									
Gross external debt (% of GDP)	29.2	25.6	23.2	19.4	19.1	19.8	23.4	21.2	19.3
Prices									
Consumer prices (rates of change, end-of-period)	…	…	…	2.3	1.4	0.0	1.1	1.1	0.5
Nominal exchange rate (Eastern Caribbean dollars per dollar)	2.7	2.7	2.7	2.7	2.7	2.7	2.7	2.7	2.7
				Percentages of GDP					
Non-financial public sector									
Current revenue	…	…	…	…	29.3	27.8	29.4	28.4	29.6
Current expenditure	…	…	…	…	27.8	28.6	30.9	33.0	34.7
Capital account balance	…	…	…	…	-1.9	-6.6	-4.1	-4.6	-0.1
Fiscal balance [f]	…	…	…	…	-0.7	-9.8	-5.4	-9.3	-5.1
Money and credit									
Net domestic credit	…	…	…	56.0	57.4	58.2	67.5	70.9	…
Public sector	…	…	…	7.2	5.3	6.8	10.3	14.1	…
Private sector	…	…	…	58.4	58.5	58.1	62.4	61.9	…
Broad money (M3)	…	…	…	57.6	60.6	64.8	64.7	71.2	…
Local-currency liquidity (M2)	…	…	…	56.5	59.1	63.0	63.3	69.0	…
Foreign-currency deposits	…	…	…	1.1	1.4	1.8	1.4	2.2	…
				Annual percentages					
Real interest rates									
Weighted average deposit rate	…	…	…	1.9	2.6	3.8	2.6	2.9	2.6
Weighted average lending rate	…	…	…	8.5	9.6	11.8	9.4	9.8	9.2

Source: ECLAC, on the basis of official information.
[a] Preliminary figures. [b] On the basis of constant 1980 prices. [c] Includes errors and omissions. [d] Refers to the capital and financial accounts, minus net foreign direct investment, plus errors and omissions. [e] The sign (-) indicates a reserve increase. [f] Includes grants.

Table 1
GRENADA: MAIN ECONOMIC INDICATORS

	1994	1995	1996	1997	1998	1999	2000	2001	2002[a]
	Annual growth rates [b]								
Gross domestic product	…	…	…	7.2	7.3	7.5	6.6	-5.1	-1.2
Gross domestic product by economic activity									
Agriculture	…	…	…	-1.2	11.1	-2.1	-3.2	-3.2	19.0
Mining and quarrying	…	…	…	12.3	8.0	33.2	96.4	96.4	-4.0
Manufacturing	…	…	…	16.5	13.7	16.0	-7.1	-7.1	-1.6
Electricity, gas and water	…	…	…	6.9	6.7	14.2	7.6	7.6	3.2
Construction	…	…	…	20.3	10.3	18.8	-12.8	-12.8	0.9
Wholesale and retail	…	…	…	5.9	5.8	4.2	-3.1	-3.1	-1.1
Transport	…	…	…	5.9	5.0	-0.5	-2.0	-2.0	1.7
Communications	…	…	…	33.2	13.0	26.4	-10.3	-10.3	-19.5
Banks and insurance	…	…	…	11.1	13.0	11.3	6.5	6.5	5.6
Real estate and housing	…	…	…	3.6	3.6	2.0	1.3	1.3	1.5
Other services	…	…	…	4.6	3.7	-2.6	4.5	4.5	-14.2
Tourism	…	…	…	2.1	12.6	2.9	-4.1	-4.1	5.7
	Millions of dollars								
Balance of payments									
Balance on current account	-27	-41	-56	-68	-80	-52	-82	-85	-110
Goods balance	-94	-105	-122	-122	-137	-110	-138	-133	-147
Exports fob	25	25	25	33	46	74	83	64	…
Imports fob	-119	-130	-147	-155	-183	-185	-221	-197	…
Services balance	60	61	61	50	51	65	70	62	58
Income account balance	-9	-13	-15	-17	-23	-27	-34	-36	-43
Current transfers balance	16	17	21	22	29	19	20	22	22
Capital and financial account balance [c]	32	47	56	75	84	57	92	91	141
Net foreign direct investment	19	20	17	34	49	42	37	49	109
Financial capital [d]	12	27	39	41	36	16	54	42	32
Global balance	-5	-6	0	-7	-4	-5	-10	-6	-31
Variation in reserve assets [e]	-5	-6	0	-7	-4	-5	-10	-6	31
Other external sector indicators									
Gross external debt (% of GDP)	…	…	…	29.3	26.7	27.6	32.8	31.2	45.6
Prices									
Consumer price index (rates of change, end-of-period)	…	…	…	0.8	1.2	1.0	3.5	2.5	0.7
Nominal exchange rate (Eastern Caribbean dollars per dollar)	2.7	2.7	2.7	2.7	2.7	2.7	2.7	2.7	2.7
	Percentages of GDP								
Non-financial public sector									
Current revenue	…	…	…	…	24.3	26.6	27.1	26.5	27.3
Current expenditure	…	…	…	…	23.3	22.5	21.0	24.0	27.2
Capital account balance	…	…	…	…	-6.8	-10.1	-12.2	-15.1	-22.0
Fiscal balance [f]	…	…	…	…	-3.0	-2.8	-3.2	-8.4	-19.6
Money and credit									
Domestic credit	…	…	…	72.7	74.8	74.7	83.0	90.0	…
Public sector	…	…	…	6.5	4.9	0.9	3.6	8.3	…
Private sector	…	…	…	69.2	72.3	75.3	80.0	82.4	…
Broad money (M3)	…	…	…	79.0	79.3	83.8	89.8	101.4	…
Local-currency liquidity (M2)	…	…	…	75.1	76.1	79.6	83.5	94.5	…
Foreign-currency deposits	…	…	…	3.9	3.1	4.2	6.3	7.0	…
	Annual percentages								
Real interest rates									
Weighted average deposit rate	…	…	…	3.2	3.0	3.3	0.7	1.7	2.5
Weighted average lending rate	…	…	…	10.6	10.4	10.6	7.7	7.4	8.4

Source: ECLAC, on the basis of official information.
[a] Preliminary figures. [b] On the basis of constant 1980 prices. [c] Includes errors and omissions. [d] Refers to the capital and financial accounts, minus net foreign direct investment, plus errors and omissions. [e] The sign (-) indicates a reserve increase. [f] Includes grants.

Table 1
SAINT KITTS AND NEVIS: MAIN ECONOMIC INDICATORS

	1994	1995	1996	1997	1998	1999	2000	2001	2002[a]
	Annual growth rates [b]								
Gross domestic product	…	…	…	7.3	1.0	3.7	5.5	2.3	0.4
Gross domestic product by economic activity									
Agriculture	…	…	…	-10.4	-8.3	-7.8	12.5	12.5	13.3
Mining and quarrying	…	…	…	10.3	8.8	50.0	-16.3	-16.3	-4.0
Manufacturing	…	…	…	-0.9	8.7	12.8	-8.2	-8.2	3.3
Electricity, gas and water	…	…	…	6.7	-1.1	12.4	4.1	4.1	9.8
Construction	…	…	…	7.5	14.5	41.3	4.5	4.5	-4.5
Wholesale and retail	…	…	…	4.4	3.9	-3.1	2.1	2.1	4.5
Transport	…	…	…	-0.5	1.8	8.6	4.3	4.3	4.6
Communications	…	…	…	0.9	11.2	0.7	4.9	4.9	2.0
Banks and insurance	…	…	…	-0.1	3.5	13.1	-0.9	-0.9	2.8
Real estate and housing	…	…	…	-13.0	8.7	6.4	4.7	4.7	1.0
Other services	…	…	…	4.9	2.8	2.6	2.7	2.7	2.5
Tourism	…	…	…	2.3	-11.2	-19.0	4.1	4.1	-9.9
	Millions of dollars								
Balance of payments									
Balance on current account	-24	-45	-65	-62	-41	-84	-64	-97	-113
Goods balance	-70	-81	-93	-85	-87	-90	-121	-112	-114
Exports fob	29	37	39	45	44	45	51	55	…
Imports fob	-98	-117	-132	-131	-131	-135	-173	-167	…
Services balance	48	27	27	30	43	14	24	34	24
Income account balance	-13	-11	-16	-21	-25	-28	-29	-37	-42
Current transfers balance	11	19	16	15	27	20	63	18	19
Capital and financial account balance [c]	24	48	64	65	52	87	60	108	122
Net foreign direct investment	15	20	35	20	32	58	96	88	118
Financial capital [d]	8	27	29	46	23	29	-37	20	4
Global balance	-1	2	-1	4	11	3	-4	11	9
Variation in reserve assets [e]	1	-2	1	-4	-11	-3	4	-11	-9
Other external sector indicators									
Gross external debt (% of GDP)	…	…	…	39.2	43.4	50.2	49.1	59.0	65.0
Prices									
Consumer prices (rates of change, end-of-period)	…	…	…	11.3	0.9	2.2	3.1	1.8	1.8
Nominal exchange rate (Eastern Caribbean dollars per dollar)	2.7	2.7	2.7	2.7	2.7	2.7	2.7	2.7	2.7
	Percentages of GDP								
Non-financial public sector									
Current revenue	…	…	…	…	30.5	30.4	28.4	28.3	30.3
Current expenditure	…	…	…	…	30.2	32.4	33.7	33.1	33.2
Capital account balance	…	…	…	…	-6.7	-10.7	-10.4	-8.3	-13.3
Fiscal balance [f]	…	…	…	…	-6.3	-11.8	-14.8	-12.6	-13.0
Money and credit									
Domestic credit	…	…	…	68.5	69.2	80.5	90.1	86.9	…
Public sector	…	…	…	-1.7	-3.5	6.3	13.7	14.1	…
Private sector	…	…	…	70.2	72.7	74.2	76.4	72.8	…
Broad money (M3)	…	…	…	70.7	70.4	73.8	87.2	85.6	…
Local-currency liquidity (M2)	…	…	…	54.5	57.0	59.4	59.2	60.3	…
Foreign-currency deposits	…	…	…	16.3	13.4	14.5	28.0	25.3	…
	Annual percentages								
Real interest rates									
Weighted average deposit rate	…	…	…	-6.5	3.3	2.1	1.2	2.3	1.4
Weighted average lending rate	…	…	…	-0.1	10.3	8.9	7.8	9.1	8.1

Source: ECLAC, on the basis of official information.
[a] Preliminary figures. [b] On the basis of constant 1980 prices. [c] Includes errors and omissions. [d] Refers to the capital and financial accounts, minus net foreign direct investment, plus errors and omissions. [e] The sign (-) indicates a reserve increase. [f] Includes grants.

Table 1
SAINT LUCIA: MAIN ECONOMIC INDICATORS

	1994	1995	1996	1997	1998	1999	2000	2001	2002[a]
	Annual growth rates [b]								
Gross domestic product [c]	1.8	1.7	1.4	0.6	3.1	3.1	0.2	-5.4	1.0
Gross domestic product [d] by economic activity									
Agriculture	-19.4	4.9	.8	-17.9	3.1	-17.6	2.6	-24.4	-1.0
Mining and quarrying	-20.6	30.6	-0.4	11.3	1.7	15.3	14.0	-27.9	5.0
Manufacturing	-4.9	5.9	-6.8	-0.3	-1.2	4.2	-2.6	-4.2	1.9
Electricity, gas and water	6.1	9.2	1.2	7.5	8.2	7.1	7.2	3.6	-0.2
Construction	4.9	2.4	-4.0	0.4	10.5	12.8	-4.6	-5.0	-4.8
Wholesale and retail	3.8	-2.4	3.6	6.7	1.7	3.6	-1.9	-13.8	-3.2
Transport and Communications	14.7	0.5	4.2	0.6	2.8	5.6	1.7	2.1	-3.8
Banks and insurance	5.5	2.8	4.4	4.9	4.8	6.7	2.8	2.4	-10.8
Other services	3.6	2.7	1.4	1.2	1.9	1.8	1.9	-1.3	1.8
	Millions of dollars								
Balance of payments									
Balance on current account	-48	-33	-58	-78	-66	-82	-63	-50	-45
Goods balance	-166	-155	-181	-222	-225	-251	-249	-218	-202
Exports fob	100	115	86	70	70	61	63	…	…
Imports fob	-266	-269	-267	-292	-295	-312	-312	…	…
Services balance	134	141	144	167	182	185	213	…	186
Income account balance	-33	-39	-34	-36	-43	-38	-43	-42	-43
Current transfers balance	17	19	13	13	20	22	17	14	14
Capital and financial account balance [e]	45	39	52	83	81	90	71	60	71
Net foreign direct investment	33	33	18	48	83	83	55	22	67
Financial capital [f]	12	6	33	35	-2	7	16	38	4
Global balance	-3	6	-6	5	15	8	8	10	26
Variation in reserve assets [g]	3	-6	6	-5	-15	-8	-8	-10	-26
Other external sector indicators									
Gross external debt (% of GDP)	…	…	…	24.0	23.1	24.1	25.9	33.2	34.0
Prices									
Consumer prices (rates of change, end-of-period)	…	…	…	0.7	3.6	6.1	0.3	2.1	-0.6
Nominal exchange rate (Eastern Caribbean dollars per dollar)	2.7	2.7	2.7	2.7	2.7	2.7	2.7	2.7	2.7
	Percentages of GDP								
Non-financial public sector									
Current revenue	…	…	…	…	24.9	26.9	26.8	25.1	25.1
Current expenditure	…	…	…	…	19.2	20.1	20.2	23.1	22.3
Capital account balance[h]	…	…	…	…	-1.9	-3.8	-8.0	-5.9	-4.8
Fiscal balance	…	…	…	…	3.8	2.9	-1.4	-3.9	-2.1
Money and credit									
Domestic credit	…	…	…	…	59.2	61.1	63.3	...	…
Public sector	…	…	…	…	-16.0	-15.3	-15.1	...	…
Private sector	…	…	…	…	75.2	76.5	78.4	...	…
Broad money (M2)	…	…	…	…	59.2	58.8	62.0	...	…
Local-currency liquidity (M3)	…	…	…	…	59.6	60.0	62.4	...	…
Foreign-currency deposits	…	…	…	…	0.4	1.1	0.4	...	…
	Annual percentages								
Real interest rates									
Weighted average deposit rate	…	…	…	3.9	1.1	-1.3	4.6	2.6	5.5
Weighted average lending rate	…	…	…	11.9	7.4	6.5	12.7	10.5	13.5

Source: ECLAC on the basis of official information.
[a] Preliminary figures. [b] On the basis of constant 1990 prices. [c] Market prices. [d] Factor cost [e] Includes errors and omissions. [f] Refers to the capital and financial accounts, minus net foreign direct investment, plus errors and omissions. [g] The sign (-) indicates a reserve increase. [h] Includes grants.

Table 1
SAINT VINCENT AND THE GRENADINES: MAIN ECONOMIC INDICATORS

	1994	1995	1996	1997	1998	1999	2000	2001	2002[a]
	Annual growth rates [b]								
Gross domestic product	…	…	…	3.1	5.7	3.6	2.0	-0.5	1.1
Gross domestic product by economic activity									
Agriculture	…	…	…	9.1	-3.6	7.1	-1.1	-1.1	11.8
Mining and quarrying	…	…	…	-3.0	-1.0	-14.9	-10.5	-10.5	-2.9
Manufacturing	…	…	…	-5.3	-0.9	-8.6	-9.9	-9.9	-3.0
Electricity, gas and water	…	…	…	8.2	9.6	6.5	22.0	22.0	2.6
Construction	…	…	…	16.0	-3.9	-11.9	-6.8	-6.8	-2.9
Wholesale and retail	…	…	…	11.1	8.7	8.3	13.5	13.5	3.2
Transport	…	…	…	3.8	4.3	1.3	1.7	1.7	2.7
Communications	…	…	…	13.1	24.4	10.1	-4.1	-4.1	-10.2
Banks and insurance	…	…	…	3.8	12.4	5.7	11.3	11.3	4.4
Real estate and housing	…	…	…	3.1	2.0	1.5	3.1	3.1	1.5
Other services	…	…	…	2.4	-0.2	2.2	5.1	5.1	4.7
Tourism	…	…	…	-4.0	10.0	6.8	3.2	3.2	-8.0
	Millions of dollars								
Balance of payments									
Balance on current account	-57	-41	-36	-84	-95	-72	-28	-38	-47
Goods balance	-67	-57	-75	-105	-120	-127	-93	-106	-117
Exports fob	49	62	53	47	50	50	52	46	…
Imports fob	-115	-119	-128	-153	-170	-177	-144	-152	…
Services balance	9	19	38	23	28	59	65	72	72
Income account balance	-12	-12	-9	-13	-14	-19	-19	-19	-17
Current transfers balance	12	9	10	11	11	15	19	15	15
Capital and financial account balance [c]	58	39	36	85	101	76	42	47	41
Net foreign direct investment	47	31	43	92	89	56	29	21	25
Financial capital [d]	11	9	-7	-7	12	20	13	26	16
Global balance	0	-1	0	1	6	4	14	9	-6
Variation in reserve assets [e]	0	1	0	-1	-6	-4	-14	-9	6
Other external sector indicators									
Gross external debt (% of GDP)	…	…	…	30.2	31.7	48.1	47.5	46.3	48.0
Prices									
Consumer prices (rates of change, end-of-period)	…	…	…	0.5	3.3	-1.8	1.4	0.8	-0.1
Nominal exchange rate (Eastern Caribbean dollars per dollar)	2.7	2.7	2.7	2.7	2.7	2.7	2.7	2.7	2.7
	Percentages of GDP								
Non-financial public sector									
Current revenue	…	…	…	…	28.2	28.5	28.8	28.9	32.2
Current expenditure	…	…	…	…	24.0	25.1	26.6	27.5	29.0
Capital account balance	…	…	…	…	-11.3	-6.5	-3.7	-4.9	-6.0
Fiscal balance [f]	…	…	…	…	-3.3	-1.7	-0.4	-1.6	-2.0
Money and credit									
Domestic credit	…	…	…	47.3	45.0	59.8	56.7	56.2	…
Public sector	…	…	…	-9.1	-11.8	-10.0	-8.7	-8.2	…
Private sector	…	…	…	56.4	56.8	60.8	65.4	64.4	…
Broad money (M3)	…	…	…	56.1	60.2	64.7	70.2	69.6	…
Local-currency liquidity (M2)	…	…	…	55.0	58.8	62.8	69.2	68.8	…
Foreign-currency deposits	…	…	…	1.0	1.4	1.8	1.0	0.8	…
	Annual percentages								
Real interest rates									
Weighted average deposit rate	…	…	…	3.7	1.0	6.5	3.1	3.6	4.7
Weighted average lending rate	…	…	…	10.8	7.8	13.6	10.0	10.9	12.0

Source: ECLAC, on the basis of official information.
[a] Preliminary figures. [b] On the basis of constant 1980 prices. [c] Includes errors and omissions. [d] Refers to the capital and financial accounts, minus net foreign direct investment, plus errors and omissions. [e] The sign (-) indicates a reserve increase. [f] Includes grants.

Bahamas

1. Economic policy

(a) Fiscal policy

The central government's deficit widened significantly between fiscal years 2000/2001 and 2001/2002, then narrowed in fiscal year 2002/2003 (B$ 16, B$ 95 and B$ 147 million). The 2001/2002 outcome resulted from a decline in tax revenues. These revenues were negatively affected by the events of 11 September, which translated into lower receipts from international trade and transactions taxes. Import taxes, which account for 46% of total tax revenues, declined by 12%. In the same vein, tax receipts from tourism-related gaming and hotel occupancy were also affected (-10%). Finally, lower-than-expected non-tax revenues from fines, forfeits and administrative fees aggravated the problem. Meanwhile, expenditure was determined by transfer payments to public corporations (29%), as emoluments remained within the authorities' target range and capital expenditure fell short (5%) of the amount budgeted. The deficit was financed from domestic and external sources (52% and 48% of the total). This included 80% of the total supplementary borrowing approved by the legislature in June to pay accumulated arrears due to the negative effects of the 11 September events on government revenues.

In fiscal year 2002/2003 tax revenues are reflecting a recovery in the tourism and trade sectors. In the first six months of the fiscal year, tax receipts increased by 5% as a result of the improved performance of import duties and stamp taxes on imports and of departure taxes (6% and 13%, respectively). The gaming and hotel occupancy taxes are also expected to rise, but their tax contribution has remained stable in the first six months of the fiscal year. Other taxes (property and motor vehicle taxes and business and professional licence fees) also increased (by 21%, 26% and 47%, respectively) despite the recent measures focusing on tax incentives and exemptions. These measures include the creation of duty-free economic enterprise zones to revive activity in depressed areas. They also contemplate higher levels of exemptions, lower property tax rates and the waiver of the stamp tax for first homebuyers to boost the construction sector.

Expenditure reflected salary adjustments (7%), outlays for the promotion of tourism and property rental agreements (9%) and subsidies to improve health and education (6%). Capital expenditure (7% of total expenditure) contracted as a result of the reduction in government capital investment.

The deficit for fiscal year 2002/2003 was financed mostly by domestic borrowing, which, together with an increase in public transfers to the national airline and to education, increased the national debt by 11%. The government's domestic debt is held by public corporations (37% of the total) and commercial banks and private institutions (25% of the total for each). The foreign-currency debt rose by 32% owing to the domestic operations of the government and public corporations (25% and 14% of the total, respectively), increasing the debt-service ratio from 3.1% in 2001 to 4.1% in 2002. However, the external debt declined (-10%).

(b) Monetary and exchange-rate policy

Pressure on international reserves, which intensified following the 11 September events, forced the Central Bank of the Bahamas into a restrictive monetary stance that took the form of quantitative limits. The monetary institution kept the discount rate at 6% and, at the same time, imposed a credit ceiling on the commercial banking system in September 2001 that remained in place throughout 2002. The monetary policy stance constrained the growth of credit in the commercial banking system and limited the Central Bank's freedom to carry out foreign exchange operations. Net foreign exchange purchases helped to build a prudent stock of foreign currency.

As a result, the overall growth of the money supply (M3) declined with respect to the previous year (from 4.6% in 2001 to 3.4% in 2002). Likewise, domestic credit to private productive activities contracted (-4%) except in the tourism sector (4.5%). Conversely, personal loans and credit to the public sector expanded (by 6% and 49%, respectively). The growth in personal loans is explained by that of home mortgages (15.2%). The increase in credit to the public sector financed the greater part of its budget deficit.

Table 1
BAHAMAS: MAIN ECONOMIC INDICATORS

	1994	1995	1996	1997	1998	1999	2000	2001	2002[a]
	Annual growth rates								
Real sector indicators									
Tourist arrivals	-6.2	-6.0	5.6	0.6	-2.6	8.9	15.3	-0.5	5.2
Value of construction starts	44.8	-32.0	51.3	154.4	-64.3	-0.7	19.1	-8.0	18.6
Value of construction completions	43.5	-40.9	42.5	9.2	187.9	-7.4	-34.2	8.0	-2.7
Electricity generation (mwh)	5.1	2.2	2.9	5.7	8.6	5.1	6.9	3.9	5.6
	Millions of dollars								
Balance of payments									
Balance on current account	-42	-146	-263	-472	-995	-672	-471	-348	-188
Goods balance	-815	-931	-1 014	-1 116	-1 374	-1 428	-1 371	-1 151	-1 036
Exports fob	199	225	273	295	363	380	805	614	740
Imports fob	-1 014	-1 157	-1 287	-1 411	-1 737	-1 808	-2 176	-1 765	-1 776
Services balance	883	903	862	757	542	857	1.029	951	1.018
Income account balance	-138	-136	-149	-153	-198	-138	-173	-190	-213
Current transfers balance	27	18	37	39	34	37	43	42	42
Capital and financial account balance[b]	51	143	256	529	1.115	737	410	318	249
Net foreign direct investment	23	107	88	210	147	145	250	101	169
Financial capital[c]	28	36	168	319	969	593	161	217	79
Global balance	9	-3	-8	57	119	65	-61	-30	60
Variation in reserve assets[d]	-9	3	8	-57	-119	-65	61	30	-61
Other external sector indicators									
Gross external debt	410	392	357	385	395	390	392	389	513
Prices									
Retail price index (average annual variation)	-27.8	2.2	1.4	0.5	1.4	1.3	1.7	2.0	2.0
Nominal exchange rate (Bahamanian dollars per dollar)	1.0	1.0	1.0	1.0	1.0	1.0	1.0	1.0	1.0
	Millions of Bahamanian dollars								
Non-financial public sector									
Current revenue	642	658	687	763	804	918	957	864	960
Current expenditure	570	611	678	714	747	817	846	836	954
Capital account balance	-64	-62	-112	-90	-95	-106	-85	-97	-124
Primary balance	27	57	41	-46	23	28	56	74	6
Financial balance[e]	-23	-43	-140	-73	-70	-38	-16	-169	-147
Public debt									
Internal	78	89	73	66	55	37	25	43	203
External	332	303	284	319	339	353	368	346	311
Money and credit									
Domestic credit	2 066	2 267	2 458	2 993	3 353	3 736	4 159	4 677	4 940
Public sector	475	490	491	505	586	664	647	775	871
Private sector	1 592	1 777	1 967	2 488	2 767	3 071	3 511	3 902	4 070
Broad money (M3)	1 731	1 879	1 986	2 466	2 859	3 178	3 465	3 623	3 748
Local-currency liquidity (M2)	1 705	1 845	1 958	2 424	2 798	3 125	3 378	3 532	3 656
Foreign-currency deposits	26	34	29	42	61	53	86	92	92
	Annual percentages								
Real interest rates									
Weighted average deposit rate	44.6	2.0	3.6	4.8	4.1	3.2	2.2	2.2	2.1
Weighted average lending rate	58.2	10.9	11.0	12.2	10.8	10.4	9.9	9.3	9.1

Source: ECLAC on the basis of official information.
[a] Preliminary figures. [b] Includes errors and omissions. [c] Refers to the capital and financial accounts, minus net foreign direct investment, plus errors and omissions. [d] The sign (-) indicates a reserve increase. [e] Included interest

2. The main variables

(a) Economic activity

The tourism sector manifested a clear recovery from the negative effects of 11 September as increases were recorded in total arrivals (from -0.5% in 2001 to 5.2% in 2002) and in the level of hotel occupancy (from -3.7% in 2001 to 0.7% in 2002). The disaggregation of total arrivals into air and sea arrivals shows that the latter was the more dynamic component (1.8% and 8.9%, respectively). Nassau/Paradise Island recorded the biggest market share of tourist arrivals, followed by the rest of the Family Islands (59% and 27%, respectively). The tourism industry is expected to continue to recover in 2003. Among the domestic factors that will help to generate a positive outcome for this sector are the expansion of hotel room capacity in the Family Islands, airlift support for Grand Bahamas and improved port infrastructure.

Construction remained at the previous year's level and showed mixed signals, making the outcome for 2003 uncertain. On the one hand, the number of building permits declined (-3.6%) and their value fell by half (from B$ 317 per permit in 2001 to B$ 167 in 2002). On the other hand, the number of building starts increased (by 12%), mainly reflecting residential projects facilitated an increase in housing loans from financial institutions and, to a lesser extent, commercial starts, which reflected the completion of hotel projects in Grand Bahamas. The public sector also implemented two projects involving building starts.

Fisheries registered increases in volume (17%) and price (30%), mostly attributable to crayfish tails.

(b) Prices, wages and employment

The inflation rate remained stable (2%) and mostly reflected increases in education (from 7.7% in 2001 to 12.9% in 2002) and furniture and household operation (from 2.6% in 2001 to 4.9% in 2002). With the exception of food and beverages, which showed the same rate of inflation as in the previous year (0.5%), all the categories registered declines in their rates of price variation.

(c) The external sector

The overall balance-of-payments outcome was positive (US$ 60 million) as the current account deficit (US$ 188.3 million) was amply offset by the capital and financial account surplus (US$ 249 million net of errors and omissions).

The current account deficit narrowed from the previous year as a result of lower import growth and the recovery of the tourism sector. Merchandise import behaviour followed the contractionary stance of the monetary authorities and reflected moderate economic activity, especially in the construction sector. Export earnings reflected the improved catch of crayfish, which boosted external sales of this product by 39%. The net negative balance of the merchandise account was partly offset by the performance of services (4.8%), particularly travel (3.8%). However, this result was moderated by the increased risk premium for casualty coverage, as reflected by the increase in payments to foreign insurance services (4.3%). The net income gap is largely explained by profit remittances from the banking system. Lastly, current net transfers remained at the previous year's level (US$ 42 million) on account of the government's receipts (US$ 49 million).

The capital and financial account surplus reflected a combination of factors. These included the foreign-currency borrowing operations of public corporations (US$ 53 million), which offset the central government's net external debt outflows (US$ 51 million); foreign private investment directed in part to the tourism sector (US$ 169 million); the government's fiscal operations, which resulted in an increase in foreign-currency financial transactions (US$ 205.4 million); and foreign loans received by the private sector (US$ 65 million).

Barbados

1. Economic policy

(a) Fiscal policy

The fiscal result for 2002/2003 was a deficit bigger than the one recorded in the previous fiscal year (12.0% of GDP, as opposed to 11.0% in 2001/2002; excluding amortization and net enterprises, the percentages were 5.6% and 3.8%). This resulted from an increase in expenditure (from 42% to 44% of GDP between the two periods), since the tax/GDP ratio remained constant at 32%. In an effort to avoid increasing in its external debt stock (19% of GDP at the end of 2002), the government financed its deficit from domestic sources, particularly through the ways and means accounts and by drawing on government deposits held at the Central Bank.

The behaviour of fiscal revenues partly reflected the decline in the corporate tax rate from 40% to 38%; the reduction of the basic income tax from 25% to 22.5% and of the top rate applicable to taxable income from 40% to 37.5% in 2003; the contraction in economic growth, which had a negative impact on income and profits; and goods and services tax receipts. At the same time, the imposition of a 60% tariff on selected agricultural products boosted revenues from the international trade tax.

The increase in total expenditure resulted mainly from the increase in wages and the payment of arrears in September and October 2002. Capital expenditure rose in 2002 in response to the government's countercyclical policy strategy, reflected in ongoing public works such as airport, highway and sewerage infrastructure. In 2003, partly as a result of the completion of these projects and partly owing to a conscious policy decision to reduce the debt-to-GDP ratio, which reached 19% in 2002, the government scaled back its capital expenditure. Thus, overall capital expenditure registered a decline in 2002/2003. In order to reduce the future impact of its investment programme on the fiscal accounts, the government plans to rely on public-private partnerships.

For the fiscal year 2003/2004, the government plans to increase revenues and expenditure by 4.7% and 5.5%, respectively, yielding a fiscal deficit of 10.5% of nominal GDP, or 4.4% when corrected for amortization and net enterprises. This will result from a combination of lower planned capital expenditure and new tax measures. The measures are conceived, in part, as a step towards structuring the tax system in order to accommodate the eventual tariff phase-out required in the framework of the Free Trade Area of the Americas (FTAA) in 2005. They are also meant to enhance the country's competitiveness within the Common Single Market and Economy, which is expected to enter into force in 2004.

Specifically, these measures include the widening of the reverse tax credit base, which replaces tax concessions in the low-income bracket. The package also seeks to stimulate growth by eliminating the tax differential between domestic and foreign companies and reducing the small business tax (from 25% to 20%), property taxes and the property transfer tax. Finally, the package envisages the extension of tax concessions to selected geographical areas.

(b) Monetary and exchange-rate policy

The monetary authority grappled with the excess liquidity caused initially by the domestic financing of the fiscal deficit, the meagre growth of demand for bank loans to the private sector as a result of the contraction in economic activity, and the injection of liquidity caused by share transactions. The commercial banking system's total reserves increased from BDS$ 348 million to BDS$ 645 million between January 2002 and October 2002. Over this period, the share of excess reserves rose from 44% to 67%. The monetary aggregates reflected the excess liquidity. The monetary base and the money supply increased by 40% between December 2001 and the same month of 2002.

In line with the fiscal stance that prevailed in 2002, the monetary authority modified its policy and, in October 2002, reduced the minimum interest rate payable on deposits by half a percentage point (from 3% to 2.5% per annum). In the same vein, the Central Bank's weighted average lending rate of interest on loans declined from 8.5% to 8% and total reserve requirements for commercial bank deposits and government securities were reduced by a full percentage point.

The aim of these measures was to reduce the operating costs of the banking system in the expectation

Table 1
BARBADOS: MAIN ECONOMIC INDICATORS

	1994	1995	1996	1997	1998	1999	2000	2001	2002[a]
	Annual growth rates [b]								
Gross domestic product	4.5	2.5	3.1	3.3	4.4	3.3	3.4	-2.8	-0.4
Gross domestic product by economic activity									
Sugar	7.7	-26.0	53.9	9.4	-25.9	11.2	9.6	-14.7	-9.8
Non-sugar agriculture and fishing	-5.5	18.0	1.4	-7.5	-3.2	8.4	0.0	-5.8	-0.6
Manufacturing	6.8	8.4	-0.9	3.8	3.4	-2.4	-0.5	-8.2	0.2
Construction	3.9	12.1	4.0	14.2	16.9	10.0	2.6	-4.4	3.1
Basic services [c]	3.4	3.5	3.1	3.2	5.4	4.5	1.4	2.7	-0.7
Other services [d]	4.9	1.1	2.3	2.9	4.6	2.6	4.5	-2.2	-0.4
	Millions of dollars								
Balance of payments									
Balance on current account	134	43	70	-50	-63	-148	-145	-94	-143
Goods balance	-355	-446	-456	-599	-651	-714	-744	-681	-696
Exports fob	190	245	287	289	270	275	286	271	251
Imports fob	-545	-691	-743	-888	-921	-989	-1.030	-952	-947
Services balance	495	503	540	550	591	571	603	587	554
Income account balance	-41	-48	-52	-48	-56	-71	-82	-93	-97
Current transfers balance	34	33	38	47	52	66	78	94	96
Capital and financial account balance [e]	-96	0	17	67	57	185	346	321	159
Net foreign direct investment	13	12	13	15	16	17	…	…	…
Financial capital [f]	-108	-9	7	54	42	169	…	…	…
Global balance	38	42	86	17	-6	36	201	227	16
Variation in reserve assets[g]	-38	-42	-86	-17	6	-36	-201	-227	-16
Other external sector indicators									
Gross external debt (millions of dollars)	509	479	463	428	453	492	605	539	489
Gross external debt (% of GDP)	29.2	25.6	23.2	19.4	19.1	19.8	23.4	21.2	19.3
Employment and wages									
Participation rate [h]	67.3	68.2	68.1	67.8	67.8	67.8	68.6	69.5	68.5
Unemployment rate [i]	21.8	19.6	15.8	14.5	12.3	10.4	9.2	9.9	10.5
Prices									
Consumer price index (annual average variation)	0.7	1.9	2.4	7.7	-1.2	1.6	2.4	2.8	0.2
Nominal exchange rate (Barbados dollars per dollar)	2.0	2.0	2.0	2.0	2.0	2.0	2.0	2.0	2.0
	Percentages of GDP								
Non-financial public sector									
Revenue	27.4	26.8	26.2	33.7	34.4	33.1	33.9	31.0	32.0
Expenditure	28.2	27.5	29.4	34.9	35.2	34.5	35.8	42.0	44.0
Fiscal balance	-0.8	-0.7	-3.2	-1.2	-0.8	-1.4	-1.9	-3.8	-5.6
Public debt	71.4	66.3	67.5	62.0	59.6	58.3	62.1	59.3	59.0
Internal	51.0	47.1	49.2	46.2	45.2	42.5	42.5	41.7	42.8
External	20.4	19.2	18.3	15.9	14.4	15.8	19.6	17.7	16.2
Money and credit									
Domestic credit	52.6	50.1	49.9	52.1	54.8	57.6	54.6	50.0	61.7
Public sector	11.1	9.7	10.0	7.9	7.1	6.1	3.6	-1.5	7.2
Private sector	36.7	39.3	38.8	41.9	45.2	49.6	48.3	49.3	51.2
Broad money (M3)	…	…	…	…	…	…	…	…	…
Local-currency liquidity (M2)	54.8	54.3	58.8	56.7	58.3	61.8	64.3	69.4	76.7
Foreign-currency deposits	…	…	…	…	…	…	…	…	…
	Annual percentages								
Real interest rates									
Weighted average deposit rate	4.3	3.2	2.7	-3.2	5.5	3.1	2.4	0.3	6.5
Weighted average lending rate	11.1	9.7	9.3	3.9	13.0	9.9	9.3	8.1	10.1

Source: ECLAC, on the basis of official information.
[a] Preliminary figures. [b] On the basis of constant 1979 prices. [c] Includes electricity, gas, water and transport, storage and communication. [d] Includes retail trade, restaurants and hotels, financial establishments, insurance, real estate, social and personal services. [e] Includes errors and omissions. [f] Refers to the capital and financial accounts, minus net foreign direct investment, plus errors and omissions. [g] The sign (-) indicates a reserve increase. [h] Economically active population as a percentage of the working age population. [i] Unemployed as a percentage of the economically active population. Includes hidden unemployment.

that this would benefit the final consumer. Most importantly, they sought to reduce the debt burden of entrepreneurs at a time when growth was faltering. The measures were not completely successful, however, as nominal interest rates barely declined, and actually increased in real terms. The nominal prime lending rate remained at 8.5% throughout the year and the weighted average rate dipped slightly from 10.97% in January to 10.35% in December, which translated into a decrease of 0.7% in real terms. The demand for loans expanded by 6% overall between December 2001 and December 2002.

The sectoral distribution of credit shows that only distribution and tourism increased their demand for credit (by 15% and 14%, respectively, between December 2001 and December 2002). The sluggish demand for loans helped to channel the excess liquidity of banks to the government's treasury bills (banks account for 96% of the total). In turn, the greater demand for treasury bills translated into lower interest rates on government issuances (1.09% in January 2003, as compared to 2.86% in May 2002), which eased the government's debt burden.

In 2003, credit demand is expected to recover and expand by 11%, while liabilities to the private sector will increase by around 5%. Also, the Central Bank will remove restrictions on interest rates as a step towards the gradual liberalization of the money market.

2. The main variables

(a) Economic activity

In 2002 Barbados partially recovered from the economic contraction it had suffered the previous year (-2.8%), and it registered positive growth in 2003. GDP growth was -0.4% in 2002 and is expected to be 1.5% in 2003.

Agriculture (-0.6%) reflected a decline in sugar production (-10%), which is explained by the late start in the sugar crop and adverse weather conditions that impeded the fulfilment of the European Union sugar quota (9,000 tons short of the quota). In addition, the acreage planted decreased from 8,500 to 7,052 hectares. Concomitantly, and also because of lower international sugar prices and higher domestic costs, sugar exports fell from 48,900 to 39,500 tons. In 2003, non-sugar agriculture is forecasted to register negative growth.

Manufacturing improved its performance in relation to the previous year (-8% and 0.2% in 2001 and 2002). Some branches benefited from the imposition of a 60% tariff on selected imports, and a "buy local" campaign. For 2003, the government plans to maintain that tariff and expand the "buy local" campaign to cover the full range of goods and services. In the initial months of 2003, growth in the manufacturing sector stalled, and most of its subsectors contracted. However, the food and beverages and tobacco subsectors expanded by 2.3% and 11.5%, respectively. In 2003, manufacturing is expected to expand by 1.3%.

The construction sector (3%) was boosted by the start of public-sector projects and the construction of a new hotel belonging to a leading chain, despite the decline in residential building activity. Public-sector projects included those corresponding to the national housing corporation, the home mortgage scheme and road works. The construction sector is expected to maintain its dynamism in 2003 and to expand by 4%, reflecting the recovery of the tourism sector.

Mining and quarrying fell by 6.5% as a result of the natural depletion of oil wells. Consequently, crude oil and gas production decreased by 15.8% and 16.1%, respectively.

Tourism contracted for the second year in a row (-5.9% and -2.3%). The number of tourist arrivals, and within this group, the number of long-stay visitors and cruise-ship arrivals declined (-1.8% and -0.8%, respectively). The average length of stay, hotel room occupancy rates and tourist expenditure followed accordingly (-7%, -5.6% and -20%, respectively). During the year the government announced measures to revitalize and strengthen the tourism sector. Key to this effort is the Tourism Development Act (2002), which went to effect in 2003 and replaces the Hotel Aids Act promulgated more than 40 years ago. The main underlying rationale for the Act is to take into account the entire life cycle of tourism activities and to improve the standard of the tourism industry in general by considering that Barbados is a mature tourist destination and that product development should be its highest priority.

The Act provides concessions for restaurants, villas, recreational facilities and time-share properties that include the tax-free payment of dividends, tax concessions on loans, tax write-offs for selected activities related to the development and promotion of tourism and tax credits for investment to improve wastewater disposal systems. In addition, the new package of tourism incentives includes the duty-free import of materials and supplies for hotel construction and of inputs for hotel operations. Tax concessions of up to 150% are also granted for interest paid on loans for the purpose of refurbishment, with a 15-year period to write off capital expenditures. In 2003, tourism should increase by 4.2% and visitor arrivals, by 4%.

(b) Prices, wages and employment

In consonance with the decline in economic activity, lower import prices and stagnant credit growth, inflation reached one of its lowest levels of the past 10 years (0.2%). In terms of the components of the price index, medical and personal care showed the biggest average increase (0.35%), followed by food (0.22%), which has the highest weight in the index, and housing and household operations (0.08% and -0.21%, respectively). In 2003 prices are projected to rise by 3%.

The unemployment rate rose from 9.9% to 10.3%. The rate was higher for women than for men (11.8% and 10.2%, respectively, in the last quarter of 2002), who account for equal shares of the labour force. Employment increased in wholesale and retail trade, government services, agriculture, fisheries and construction, and declined in manufacturing, in transport, storage and communications and in the general service sector. The wage bill rose owing to wage increases and the payment of arrears in the third quarter of 2002.

(c) The external sector

The current account deficit widened (from 3.7% of GDP in 2001 to 5.6% in 2002) because of the underperformance of exports, while imports also declined. The overall balance was positive (US$ 16 million), owing to the outcome of the financial and capital account (US$ 159 million), but significantly smaller than it had been the previous year (US$ 321 million).

Merchandise exports reflected the general stagnation of the main sectors of the economy. Sugar, electrical components, chemicals and food and beverages, which account for 61% of total external merchandise sales, recorded declines of 14.4%, 22.7%, 2.7% and 3.5%, respectively. On the debit side of the external accounts, merchandise imports (-0.9%) reflected the contraction in income and, at the level of their components, a fall-off in capital goods imports (-1.8%).

The services balance was positive (US$ 586.7 million and US$ 554.1 million in 2001 and 2002), but indicated a clear lack of recovery in the tourism sector owing to adverse external conditions. Declines in long stays, in cruise-ship passengers and in tourist expenditure contributed to the negative outcome of the net travel account with respect to the previous year (-2.5% and -3.9% in 2001 and 2002).

The capital and financial account was affected by the completion of several projects, which resulted in lower levels of private and public long-term foreign direct investment (US$ 280 million and US$ 48.5 million in 2001 and 2002).

In the first quarter of 2003, the current account worsened with respect to the previous quarter (3.7% and -0.3% of GDP in 2002 and 2003) because of the increase in imports (11%) that offset the positive performance of merchandise and service exports (2.9% and 3.1%, respectively). Imports reflected a rise in foreign capital goods purchases (21.4%). The capital and financial account surplus fell in comparison to the previous year (from US$ 26.5 million in 2002 to US$ 1.4 million in 2003). In the remaining months of 2003, import growth is projected to moderate and conform to the trend of the economy, while the expected partial recovery of the tourism sector may offset the poor performance of merchandise exports. For 2003 the current account deficit is expected to narrow to an amount representing 4.5% to 5% of GDP as the services balance improves. Official estimates also indicate that the financial account is likely to worsen and that, as a result, the net international reserve position will deteriorate.

Belize

1. Economic policy

(a) Fiscal policy

The government reduced its fiscal imbalance (from -6% of GDP in 2001 to -5% in 2002) through improved revenue performance (21% and 25% of GDP in 2001 and 2002) and by restraining the growth of current and capital expenditure (0.3% and 0.7% for 2001 and 2002, respectively). The deficit was financed from external sources. As a result, the external debt increased from 43% to 54% of GDP.

The behaviour of revenue partly reflected the expansion of indirect taxes, particularly the one on international trade and transactions (8.9% and 9.6% of GDP in 2001 and 2002), and the contribution of the revenue replacement duty on oil. Receipts from this tax resulted from the difference between international ex-refinery oil prices (which declined in the first half of the calendar year) and the domestic prices charged to the consumer at the pump (which were not adjusted to reflect current conditions in the petroleum market). Total revenue also reflected the one-time repayment of old loans (0.7% and 1.9% of GDP in 2001 and 2002, respectively).

Current expenditure (21% and 20% of GDP in 2001 and 2002) reflected the containment of public-sector wages. The capital expenditure out-turn corresponded to an increase in locally-financed capital expenditure that was partly offset by a decline in foreign-financed capital expenditure.

For 2003 the government plans to reduce the fiscal deficit further and is targeting deficit levels of about 2% of GDP. Two major stumbling blocks stand in its way: the recent wage increase, which will boost recurrent expenditure, and the ballooning debt. Capital expenditure adjustment will provide part of the required adjustment leverage, but additional fiscal measures may be needed to stabilize public finances.

(b) Monetary and exchange-rate policy

In 2002 the authorities implemented a series of measures in response to the devaluation pressures felt in the foreign exchange market. These included direct intervention in the money market through sterilization operations facilitated by the increase in the legal limit on the issuance of treasury bills. The Central Bank also constrained the credit creation potential of the commercial banking system by raising the cash reserve requirement for all deposits by two percentage points. Finally, the government proceeded to legalize the existing parallel foreign exchange market in an effort to provide an outlet for foreign currency trading.

As a result, the financial system's overall liquidity position plummeted. The growth of the money supply slackened (from 7.8% in 2001 to 2.2% in 2002). In the same vein, commercial banks' ratio of approved liquid assets to required liquid assets decreased from 52% to 25% in the same period. Banks attempted to increase their liquidity by raising deposit rates, which narrowed the interest rate spread (from 11% in 2001 to 10% in 2002).

In 2003, the authorities are not expected to alter their domestic policy stance, as inflation and exchange-rate pressures remain subdued and as the fiscal deficit narrows to sustainable levels.

2. The main variables

(a) Economic activity

GDP growth moderated (from 4.6% in 2001 to 3.7% in 2002) as the agricultural and manufacturing sectors registered a mixed performance and tourism rebounded from the effects of the 11 September attacks.

In the agricultural sector, the increase in sugar cane production, as measured by sugar cane deliveries (12.4%), was offset by a contraction in citrus fruit output (-26%). Meanwhile, bananas recovered from the effects of adverse external conditions and their production volume expanded, although banana producers faced

Table 1
BELIZE: MAIN ECONOMIC INDICATORS

	1994	1995	1996	1997	1998	1999	2000	2001	2002[a]
	Annual growth rates [b]								
Gross domestic product	1.4	3.8	3.6	4.5	1.8	6.5	10.8	4.6	3.7
Gross domestic product by economic activity									
Agriculture	2.9	6.3	6.5	11.8	-1.6	12.5	4.2	12.3	…
Forestry and logging	13.4	-13.6	-13.0	-2.7	-2.8	-0.7	-30.9	16.0	…
Mining	-9.1	7.5	-3.2	-4.1	-4.1	17.0	23.6	2.9	…
Manufacturing	4.8	4.4	0.3	2.7	-2.9	3.9	19.5	1.9	…
Construction	-20.5	1.1	-9.5	1.0	-1.7	20.5	14.8	9.1	…
Trade, restaurants and hotels	4.4	2.5	-1.4	8.2	6.6	3.1	24.1	-0.5	…
Transport and communications	1.2	4.4	5.5	-2.9	2.4	8.2	3.1	4.3	…
	Millions of dollars								
Balance of payments									
Balance on current account	-40	-17	-7	-32	-60	-78	-153	-185	-163
Goods balance	-75	-66	-58	-90	-105	-124	-192	-214	-190
Exports fob	156	165	171	193	186	213	295	275	310
Imports fob	-232	-231	-230	-283	-291	-337	-487	-489	-500
Services balance	33	38	47	46	41	53	35	53	53
Income account balance	-25	-22	-26	-23	-32	-44	-55	-72	-72
Current transfers balance	27	33	31	35	36	37	59	48	46
Capital and financial account balance [c]	36	21	27	33	46	90	205	181	158
Foreign direct investment	15	21	17	12	18	47	23	60	25
Other capital [d]	21	0	16	25	33	43	181	122	133
Global balance	-4	4	21	1	-14	13	52	-4	-5
Variation in reserve assets [e]	4	-4	-21	-1	14	-13	-52	4	5
Prices									
Consumer prices (rates of change)	2.6	2.9	6.4	1.0	-0.8	-1.2	0.6	1.1	2.3
Nominal exchange rate (Belize dollars per dollar)	2.0	2.0	2.0	2.0	2.0	2.0	2.0	2.0	2.0
	Percentages of GDP								
Central government (fiscal years)									
Current revenue	22.6	22.4	21.4	22.9	22.9	22.0	21.8	21.0	25.2
Current expenditure	19.9	20.4	19.2	19.6	20.1	19.3	18.8	18.5	19.6
Current balance	2.8	2.0	2.2	3.3	2.8	2.7	3.0	2.6	5.4
Capital balance	-9.2	-8.0	-5.2	-4.2	-4.1	-4.4	-6.3	-8.5	-10.2
Overall balance[f]	-6.4	-6.0	-3.1	-0.8	-1.3	-1.7	-3.3	-5.9	-4.9
	Percentages of GDP								
Money and credit									
Net domestic credit	46.2	49.7	48.0	52.6	59.6	56.3	53.2	61.4	56.3
Public sector	10.0	12.1	8.2	8.4	11.2	9.1	8.8	13.0	3.6
Private sector	36.3	37.6	39.7	44.2	48.4	47.2	44.4	48.4	52.7
Broad money (M3)	…	…	…	…	…	…	…	…	…
Local-currency liquidity (M2)	45.0	50.2	51.6	57.5	60.9	61.1	62.5	64.6	62.9
Foreign-currency deposits	…	…	…	…	…	…	…	…	…
	Annual percentages								
Real interest rates									
Weighted average deposit rate	3.4	4.2	-0.2	5.6	6.9	7.0	4.4	3.2	2.2
Weighted average lending rate	12.1	13.0	9.2	15.4	17.2	17.7	15.1	14.1	11.9

Source: ECLAC, on the basis of official information.
[a] Preliminary figures. [b] On the basis of constant 1979 prices. [c] Does not include errors and omissions. [d] Refers to the capital and financial accounts, minus net foreign direct investment, plus errors and omissions. [e] The sign (-) indicates a reserve increase. [f] Included interest.

declining prices in the international market. The fisheries subsector made a notable recovery from the effects of hurricane Iris.

Manufacturing was boosted by the growth of sugar and molasses production (7% and 19%) as a result of improved efficiency and favourable trends in international prices. An additional contributing factor was the increase in factory efficiency from 88.6% to 93.3%. The sector's performance was marred, however, by the downturn in citrus juices and pulp (-29%) and the lack of competitiveness of the apparel sector.

Tourism recorded a marginal increase in total stay-over visitors (1%) and an unprecedented rise in total cruise-ship visitors (from 40,898 in 2001 to 271,737 in 2002).

(b) Prices, wages and employment

Inflation, as measured by the consumer price index, increased from 1.1% in 2001 to 2.3% in 2002, reflecting higher fuel costs for the consumer and a rate adjustment in January for basic telephone services.

At the component level, the biggest increase was registered by transport and communications (9%, representing a 17% share of the consumer price index), followed by medical care (3%, representing a 2% share). These increases were partly offset by small movements in their opposite direction by other components of the price index, particularly clothing and footwear; rent and water; and household foods and household goods and maintenance (-0.9%, -0.5%, and -0.4%, representing 9%, 16%, and 8.5% of the consumer price index).

The unemployment rate rose marginally from 9.5% to 10.6%, reflecting declines in the labour force in agriculture and manufacturing (-10% and -19%, respectively). Public-sector wages increased in 2003 as part of a labour agreement to increase wages for civil servants, nurses, police officers and teachers by 8% in three successive steps between 2003 and 2005.

(c) The external sector

The overall balance-of-payments out-turn was negative (US$ -4 million in 2001 and US$ -5 million in 2002) reflecting a reduction in the current account deficit (-23% and -19% of GDP in 2001 and 2002) and a lower-than-expected surplus in the financial account (22% and 18% of GDP in 2001 and 2002).

The current account result reflected the improved performance of traditional exports (13%), particularly sugar and bananas. Imports responded mainly to the authorities' restrictive policy stance and the slowdown in economic growth. Services and current transfers showed surpluses. Conversely, the factor income sub-account recorded a deficit due to the repatriation of profits.

The capital account balance (US$ 1 million in 2001 and US$ 10 million in 2002) reflected governmental loan disbursements. The financial account result is explained by the drop-off in foreign direct investment (from 8% of GDP in 2001 to 3% in 2002), which, after peaking the previous year, returned to its recent historical levels.

Guyana

1. Economic policy

(a) Fiscal policy

The central government reduced its fiscal deficit in relation to the previous year (-9.2% of GDP in 2001 and -7.5% in 2002) as current fiscal revenues (37% and 38% of GDP in 2001 and 2002, respectively) increased and current expenditures stagnated (41% and 42% of GDP in 2001 and 2002). Capital expenditures and revenues did not experience any substantial changes. The deficit was financed by external borrowing and net domestic credit (44% and 56% of the total).

The levels of current revenues reflected the performance of personal and corporate income tax revenues (14.8% and 15.8% of GDP in 2001 and 2002, respectively). These results were attributable to government efforts to improve the administrative capacity of the Guyana Revenue Authority, the public wage hike (which was implemented in the last quarter of 2001 and thus made its effects felt in 2002), and the increase in the travel voucher tax and purchase tax on motor vehicles. Revenues from production, consumption and international trade taxes maintained their share of GDP.

Personal emoluments (35% of total current expenditure), which reflected the payment of wage increases, drove current expenditures. The other major component of expenditure, debt charges, contracted (10.4% and 9% of GDP in 2001 and 2002, respectively) due to the decline in domestic and external interest payments. The former reflected decreases in the discount rate and in the volume of treasury bill redemption. The latter corresponded to debt relief.

Guyana's non-financial enterprises saw their balance sheet position deteriorate as their overall positive balance shrank from G$ 3.456 billion to G$ 665 million. This was caused by an unexpected decrease in the operating balance with respect to the previous year. In turn, the operating out-turn was due to the higher employment costs registered by a major public corporation and larger-than-planned outlays on freight, repairs and maintenance.

Guyana's public domestic debt stock (3%) reflected the sterilization operations of the central bank. The outstanding debt increased from 169% to 172% of GDP as a result of the disbursement of existing loans from multilateral organizations (67% of the total).

In 2003 the fiscal deficit is expected to widen to 13% of GDP. Revenues are projected to remain at 32% of GDP while expenditures will increase from 46% to 50% of GDP. This increase reflects the expansion of capital expenditures (11% and 16% of GDP in 2002 and 2003, respectively) due to a loan transfer to Guysuco. Grants under the HIPC scheme will also decline significantly (-58%) due to a change in the debt relief accounting methodology. The government has announced the implementation of a series of measures to broaden the tax base, whose full impact was to begin to be felt in April 2003. These measures include a consumption tax on local telephone calls and an increase in the withholding tax on interest income from 15% to 20%. The government also plans to introduce a value added tax in 2006 and has announced additional measures to improve tax administration and collection. These measures entail amendments to the customs act, financial administration and auditing procedures, and the tax act.

The revenue effect of these measures will be partly offset by the decision to increase wages over the next three years and raise the income tax threshold from G$ 216,000 to G$ 240,000 as of 2003.

(b) Monetary and exchange-rate policy

Monetary policy in Guyana was geared to maintaining price stability. Narrow and broad money expanded by 6% (December 2001-2002), reflecting the combination of an increase in foreign net assets (7%) and a contraction in domestic credit (8%).

The performance of credit is mainly attributable to a decrease in net public-sector deposits, since demand for credit to the private sector remained stagnant throughout the year. In turn, the government's higher financing needs reflected the deficit of public firms, which was incurred because of higher employment and input costs and lower-than-expected sales of some of the country's main export products. In addition, domestic receipts slumped in response to lower economic growth, which hurt debtors' financial positions and investment earnings.

Table 1
GUYANA: MAIN ECONOMIC INDICATORS

	1994	1995	1996	1997	1998	1999	2000	2001	2002[a]
	Annual growth rates [b]								
Gross domestic product	8.4	5.1	7.1	7.1	-1.7	3.0	-1.4	2.3	1.1
Gross domestic product by economic activity									
Agriculture, forestry and fishing	12.2	8.4	5.1	24.0	-6.4	14.6	-10.2	3.7	6.0
Manufacturing	5.3	9.4	3.9	-39.4	-10.6	6.7	-11.7	0.0	2.3
Construction	20.0	9.7	14.0	13.1	4.7	-10.0	6.6	2.0	-3.9
Basic services [c]	7.9	9.6	10.9	8.9	-3.1	2.1	7.1	5.4	4.5
Other services [d]	5.4	5.4	6.1	5.3	1.3	-0.8	5.1	0.9	0.4
	Millions of dollars								
Balance of payments									
Balance on current account	-101	-95	-54	-91	-99	-75	-109	-129	-107
Goods balance	-41	-41	-20	-34	-54	-25	-80	-94	-68
Exports fob	463	496	575	593	547	525	505	490	495
Imports fob	-504	-537	-595	-628	-601	-550	-585	-584	-563
Services balance	-9	-7	-22	-23	-32	-31	-24	-20	-24
Income account balance	-83	-86	-52	-74	-56	-58	-52	-59	-55
Current transfers balance	32	39	41	40	44	39	47	44	40
Capital and financial account balance [e]	37	26	52	95	76	71	152	117	82
Global balance	-64	-69	-1	4	-23	-4	43	-12	-25
Variation in reserve assets [f]	64	69	1	-4	23	4	-43	12	25
Other external sector indicators									
Real effective exchange rate (1999=100) [g]	…	…	108.0	113.8	114.5	103.8	109.4	110.5	…
Gross external debt (millions of dollars)	2 000	2 058	1 537	1 513	1 516	1 210	1 195	1 193	1 238
Gross external debt (% of GDP)	377.8	330.9	218.0	203.7	229.8	176.5	169.7	169.3	171.3
Prices									
Consumer prices (rates of change, December-December)	…	8.1	4.5	4.1	4.8	8.7	5.8	1.9	6.1
Nominal exchange rate (average, Guyana dollars per dollar)	138.2	141.9	140.4	13.7	150.4	177.7	184.8	189.5	191.8
	Percentages of GDP								
Non-financial public sector									
Current revenue	31.4	33.4	35.5	31.9	30.7	29.8	31.8	29.9	33.4
Current expenditure	31.2	26.9	24.2	26.3	28.0	25.7	31.3	31.2	33.5
Capital account balance	-6.9	-9.8	-12.9	-12.8	-9.5	-6.0	-7.9	-6.4	-3.1
Primary balance	-6.8	-3.3	-1.6	-7.2	-6.8	-2.0	-7.4	0.3	2.1
Financial balance	-6.8	-3.3	-1.6	-7.2	-6.8	-2.0	-7.4	-9.2	-7.5
Public debt	…	…	…	…	…	…	…	8.8	7.7
Internal	…	…	…	…	…	…	…	5.1	4.6
External	…	…	…	…	…	…	…	3.6	3.1
	Percentajes of GDP								
Money and Credit									
Domestic credit	3.4	11.4	17.3	25.9	34.9	23.5	25.3	26.3	26.9
Public sector	-15.0	-12.5	-19.4	-16.2	-13.1	-21.6	-19.9	-18.1	-15.9
Private sector	18.4	23.9	36.7	42.1	48.0	45.1	45.2	44.4	42.8
Broad money (M3)	…	…	…	…	…	…	…	…	…
Local-currency liquidity (M2)	51.9	55.9	58.1	60.3	63.6	62.3	65.7	69.7	70.9
Foreign-currency deposits	…	…	…	…	…	…	…	…	…
	Annual percentages								
Real interest rates									
Small savings rate	…	2.2	3.1	3.2	2.1	-0.7	1.4	4.7	-1.7
Weighted lending rate	…	20.4	18.5	18.3	18.3	17.9	17.7	17.6	16.8

Source: ECLAC on the basis of official information.
[a] Preliminary figures. [b] On the basis of constant 1988 prices. [c] Includes electricity, gas, water and transport, storage and communications. [d] Includes retail trade, restaurants and hotels, financial establishments, insurance, real estate, social and personal services. [e] Includes errors and omissions. [f] The sign (-) indicates a reserve increase. [g] Included interest.

Slack demand for credit by the private sector reflected the conservative lending policies adopted by the banking system and the slowdown in economic growth with respect to the previous year. The largest decline was registered in agriculture (-16%), followed by manufacturing (-9%). The services sector, which is the largest credit recipient (34% of the total), recorded the smallest drop (-5%). The decrease in nominal and real rates of interest did nothing to reverse this trend. The bank rate declined in nominal terms from 8.75% in December 2001 to 6.25% in December 2002. The commercial banks' weighted average lending rate followed suit, decreasing from 17.6% to 16.8% in the same period (15% and 10%, respectively, in real terms). As a result, the commercial banks' excess reserves rose, peaking in August 2002 (33% of the total). In response, the banks increased their demand for Treasury bills, at the same time as they shifted the composition of their portfolios, substituting foreign for domestic assets.

This provided an outlet for bank funds and helped to relieve the government's debt burden by pushing down interest rates on government securities. Also, to a lesser extent, it increased the pressure on the foreign-exchange market, which forced the central bank to engage in moderate interventions without altering the international reserve position of the financial system or the behaviour of the exchange rate (G$ 189.6 and G$ 191.8 in January and December 2002, respectively).

2. The main variables

(a) Economic activity

GDP (1.1%) dropped below its target level (2%), as most sectors, with the exception of agriculture, experienced low levels of growth. In 2003 GDP is expected to expand by 1.2%.

The performance of agriculture (6%) was driven by the sugar industry (16%), which benefited from the restructuring and modernization efforts undertaken in the framework of the Agriculture Improvement Plan, good weather conditions and higher levels of productivity. Rice production contracted (-11.1%) due, in part, to financial and technical setbacks. Livestock gained (5%) thanks to an expansion in capacity and domestic protection measures. Lastly, forestry contracted (-7.7%). In 2003 agriculture will expand by 2.9% as different crops continue to benefit from the Agricultural Improvement Plan. Rice output will increase by 2%, while the poultry meat and livestock sector is set to expand by 5%.

The performance of the mining and quarrying sector (-7%) reflected trends in the bauxite industry. Bauxite was hit by adverse weather conditions (flooding), declining international prices, a credit squeeze, rising production costs and consequently lower levels of profitability. By contrast, diamond and gold production rose, thanks to technology improvements and larger flows of foreign direct investment. The overall output of the mining sector will contract (-7.1%) due to lower-than-expected gold production and continued stagnation in the bauxite industry.

The rate of growth of the manufacturing sector (2.3%) was in keeping with its historical average and reflected the mixed performance of its components. Agro-based manufacturing was up in the sugar segment but shrank in the rice segment. Clothing and textiles and food processing declined, while pharmaceuticals trended upward.

Within the services sector (0.4%), transport and communications showed the strongest growth (4.5%), which was attributable to a greater volume of inbound communication and cellular traffic. Construction (-4%) failed to reap the full benefits of ongoing public-sector investment programmes due to a sluggish performance by the private sector.

(b) Prices, wages and employment

The rate of inflation increased from 1.9% to 6.1%, which was mainly a reflection of domestic factors, since international prices remained stable and exchange-rate movements were minimal throughout the year. Increases were recorded in the cost of utilities, petroleum, housing accessories and food. Housing accessories and food prices rose by 9% and 2%, respectively. Inflation is projected to reach 5%.

The public-sector minimum wage was increased by 5%. Members of the police force, fire service and prison department also received additional income rises. Teachers were awarded pay hikes ranging from 5% to 16%. Lastly, certain unskilled workers in the private sector also received wage increases.

(c) The external sector

The balance-of-payments current account deficit narrowed (from 22% of GDP in 2001 to 17% in 2002) thanks to a decline in imports, which was attributable in turn to lower domestic growth. The capital account surplus was not sufficient to offset the current account imbalance, which led to a deficitary balance-of-payments position (2% and 4% of GDP in 2001 and 2002). This deficit was financed with Highly Indebted Poor Country (HIPC) debt relief funds.

Total external sales, mainly merchandise exports, grew only marginally (1%), although sales of most commodities rose. Sugar exports (9.4%) rose in volume (12%) even though international prices fell (2%), thanks to the government's Agriculture Improvement Plan and good weather conditions. Gold and timber exports were also up by 7.3% and 9%, respectively. These gains were undermined, however, by a significant drop in bauxite exports (-42%) and a smaller downturn in rice (-9.5%) caused by the low levels of profitability prevailing in the two industries.

The fall-off in imports took place across all the categories. Imports of consumer goods, intermediate goods and capital goods recorded contractions of 4.4%, 3.35% and 1.6%, respectively.

The capital account (US$ 95 and US$ 63 million in 2001 and 2002, respectively) reflected a delay in the disbursement of HIPC assistance. Private foreign direct investment inflows shrank (from US$ 56 million in 2001 to US$ 43.6 million in 2002) as a result of the economic slowdown, but expanded in the telecommunications and fisheries industries.

In 2003, the current account deficit will widen to 20% of GDP, mainly as a result of a higher import bill following the oil price hike. With the exception of gold and timber, traditional exports will record strong growth underpinned by a series of measures geared towards developing and modernizing the product on sectors. Higher disbursements for public-sector projects and the increase in private foreign direct investment which is expected to result from better growth prospects will offset only part of the current account deficit. The overall imbalance in external accounts will rise from 4% to 8.5% of GDP and will be financed through debt relief assistance.

Jamaica

1. Economic policy

(a) Fiscal policy

The budget deficit increased from 3.8% of GDP in fiscal year 2001-2002 to 7.7% in fiscal year 2002-2003 as a result of lower-than-budgeted fiscal revenues and a lax fiscal stance. The poor performance of fiscal revenues was mainly attributable to shortfalls in earnings from taxes on interest and, to a lesser extent, on dividends, the self-employment tax, corporate taxes, the bauxite/alumina tax and international trade taxes.

The out-turn of interest and international trade taxes reflected a delay in the implementation of fiscal measures to improve the tax system by widening its base and by closing loopholes. Among the most important of these measures was the removal of the withholding tax exemption for public firms, an increase in fees and fines, amendments to the General Consumption Tax Act and the Customs Act, and the tightening of the link between tax compliance and the granting of licences and professional certification. Despite the fact that production levels were higher than the previous fiscal year, revenues from the bauxite/alumina tax were hurt by the decline in the international price of alumina and the slow growth of the United States economy. By contrast, and despite the delay in implementation of the reforms, the yield on production and consumption taxes exceeded expectations thanks to increased compliance efforts and higher levels of activity at the PETROJAM (Petroleum Company of Jamaica) public refinery.

Government expenditures reflected an increase in the wage bill, larger interest payments and recurrent public programmes (up 21%, 22% and 37%, respectively, with respect to fiscal year 2002-2003). Wage settlements, the adjustment of public pay packages and a rise in the minimum wage accounted for the increase in wages and salaries. Interest payments on domestic debt (up by 16% with respect to fiscal year 2001-2002), which represent 75% of total interest payments, were driven by the depreciation of the exchange rate. This, in turn, raised the cost of servicing domestic debt denominated in United States dollars (which accounts for 20% of the total). In addition, stringent monetary measures geared to avoiding exchange-rate depreciation –including interest rate hikes– increased the burden of debt denominated in the local currency. Lastly, recurrent programmes included the provision of basic services and utilities, pensions and spending on relief in the wake of flood damage.

For fiscal year 2003-2004 the authorities plan to reduce the deficit from 7.7% to 5.8% of GDP by constraining expenditure and, even more importantly, increasing revenue by means of a set of measures intended to broaden the tax base. The main tax measures, which were announced in April 2003, include a levy on imports and the expansion of the general consumption tax base. These two measures alone will account for 90% of the revenues expected from the entire package. The first imposes a levy of 4% on all imports, including capital goods and raw materials. The second widens the tax base by eliminating exempt and zero-rated goods and services and increasing the rate on telephone calls to 20%. It also proposes to do away with the refund granted to manufacturers supplying tax-exempt goods and to include sporting goods in the tax base.

Following these measures, tax revenues are projected to increase by 37%. The biggest increases are expected in production and consumption (34%) and international trade (39%). Revenues from income and profit taxes are projected to expand by 23%. The results for the first quarter of 2003-2004 show that the revenue out-turn was 15% higher than budgeted. Also, actual expenditure was 12% under budget. As a result, the difference between the budgeted and actual fiscal result was about J$ 2.953 billion.

Spending constraints will be reflected in a decline in real wages (7%), since capital expenditures and interest payments are expected to rise with respect to fiscal year 2001-2002 (by 28% and 27%, respectively). Debt management strategy will be key to the achievement of fiscal policy goals during the current fiscal year.

At the start of the present fiscal year, the domestic debt stock represented 92% of GDP. This was an increase of 22% with respect to the previous year, which may be attributed to the financing needs of the government and the Bank of Jamaica (to cover its quasi-fiscal deficit),

Table 1
JAMAICA: MAIN ECONOMIC INDICATORS

	1994	1995	1996	1997	1998	1999	2000	2001	2002[a]
	Annual growth rates [b]								
Gross domestic product	0.9	1.0	1.0	-1.7	-0.3	-0.4	0.7	1.7	1.0
Gross domestic product by economic activity									
Agriculture, forestry and fishing	6.6	2.6	4.2	-13.7	-1.5	1.4	-10.9	5.2	-8.3
Mining and quarrying	6.9	-6.8	7.5	3.3	3.3	-1.2	-1.7	3.8	3.3
Manufacturing	-0.1	-0.8	-3.3	-2.5	-4.4	-0.7	0.9	0.6	-0.1
Construction	-6.3	7.2	-5.4	-3.9	-5.8	-1.5	0.2	2.0	2.2
Basic services [c]	3.5	8.1	8.0	5.7	5.8	7.6	6.8	5.0	5.4
Other services [d]	10.2	3.1	2.2	-4.2	-0.6	3.7	3.8	0.1	1.1
	Millions of dollars								
Balance of payments									
Balance on current account	82	-99	-143	-332	-328	-216	-387	-788	-942
Goods balance	-551	-829	-994	-1,132	-1,131	-1,187	-1,442	-1,618	-1,795
Exports fob	1,548	1,796	1,721	1,700	1,613	1,499	1,563	1,454	1,345
Imports fob	-2,099	-2,625	-2,715	-2,833	-2,744	-2,686	-3,004	-3,073	-3,139
Services balance	525	494	453	467	477	655	584	382	295
Income account balance	-352	-371	-225	-292	-308	-333	-350	-438	-471
Current transfers balance	460	607	624	625	634	647	821	886	1 028
Capital and financial account balance [e]	276	126	414	162	372	80	905	1 653	704
Net foreign direct investment	130	147	184	203	369	524	468	614	…
Financial capital [f]	199	45	324	15	85	-349	511	1 128	-23
Global balance	358	27	271	-170	44	-136	518	865	…
Variation in reserve assets [g]	-358	-27	-271	170	-44	136	-518	-865	…
Other indicators of the external sector									
Gross external debt (millions of dollars)	…	…	…	3 278	3 306	3 024	3 375	4 146	4 348
Gross external debt (% of GDP)	90.1	71.3	58.4	51.8	51.0	46.3	50.3	53.4	57.6
Employment									
Participation rate [h]	…	…	…	…	65.6	64.5	63.3	63.0	63.6
Unemployment rate [i]	15.4	16.2	16.0	16.5	15.5	15.7	15.5	15.0	15.1
Prices									
Consumer prices (rates of change, December-December)	26.8	25.6	15.8	9.2	7.9	6.8	6.1	8.8	7.3
Nominal exchange rate (Jamaican dollars per dollar)	33.4	35.3	37.0	35.6	36.6	39.3	43.3	46.1	48.7
	Percentages of GDP								
Central government									
Revenue	30.6	32.0	29.1	27.6	29.2	32.9	35.3	18.4	29.8
Expenditure	27.3	29.9	36.0	35.9	36.7	37.5	34.0	22.2	37.5
Financial result	3.3	2.1	-6.9	-8.3	-7.5	-4.6	1.4	-3.8	-7.7
Primary balance	13.6	11.9	5.7	1.9	6.1	10.6	15.3	5.3	7.9
Interest	10.3	9.8	12.6	10.2	13.6	15.2	14.0	9.1	15.6
External	…	…	…	…	…	12.8	11.2	7.2	11.8
Internal	…	…	…	…	…	2.5	2.8	1.9	3.8
Money and Credit									
Domestic credit	10.1	17.7	26.3	33.9	43.0	46.7	43.3	44.5	14.5
Public sector	-5.8	-2.7	4.2	17.2	35.0	39.3	36.2	36.7	3.4
Private sector	18.0	21.8	23.1	17.5	13.4	9.7	9.5	10.4	12.8
Broad money (M3)	…	…	…	…	…	…	…	…	…
Local-currency liquidity (M2)	36.4	40.2	39.1	39.7	40.4	43.8	43.3	43.6	45.2
Foreign-currency deposits	…	…	…	…	…	…	…	…	…
	Annual percentages								
Real interest rates									
Weighted average deposit rate	27.9	26.2	20.8	14.1	15.5	13.3	12.2	10.1	8.9
Weighted average lending rate	45.8	48.6	37.8	31.9	30.1	24.6	22.1	19.5	18.3

Source: ECLAC, on the basis of official information.
[a] Preliminary figures. [b] On the basis of constant 1996 prices. [c] Includes electricity, gas, water and transport, storage and communications, [d] Includes retail trade, restaurants and hotels, financial establishments, insurance, real estate, social and personal services. [e] Includes errors and omissions. [f] Refers to the capital and financial accounts, minus net foreign direct investment, plus errors and omissions. [g] The sign (-) indicates a reserve increase. [h] Economically active population as a percentage of the working age population. [i] Unemployed as a percentage of the economically active population. Includes hidden unemployment.

increased external financing constraints and the depreciation of the exchange rate.

The stock of external debt increased by only 1% in foreign currency but 19% in the local currency, due to exchange-rate depreciation, to stand at 59% of GDP at the end of March 2003.

Since fiscal year 1998-1999 the authorities' debt management strategy has been based on keeping borrowing costs to a minimum. For 2003-2004, this strategy has been widened to include risk management. The main elements of the strategy have a twofold purpose: to isolate the debt stock from movements in interest and exchange rates and to develop a domestic securities market to facilitate the use of market-based instruments to trade debt issues. The first will be achieved by means of an increase in the proportion of fixed-rate instruments (which accounted for 48% of outstanding domestic debt in March 2003, with a target of 60% for fiscal year 2003-2004), restrictions on dollar-denominated and dollar-indexed bonds (which represented 20% of domestic debt in March 2003) and the extension of debt maturities. The second goal will be achieved by maintaining the government's leeway to issue its securities on the domestic market and by anchoring traded securities to benchmark securities with higher liquidity premiums and lower carrying costs. Ultimately, the government's success in trimming the deficit will depend on growth, stability in the foreign-exchange market and monetary strategy.

(b) Monetary and exchange-rate policy

In Jamaica the management of monetary policy has had to deal with a changing environment. Early in the year, the monetary authorities maintained the policy begun in 1998, which consisted of reducing the costs paid to financial intermediaries, and lowered the cash reserve ratio from 10% to 9% (March 2003). At the same time, the central bank lowered the rate of interest on its open-market instruments in order to transfer this reduced cost to consumers.

From June on, however, as the foreign-exchange market came under devaluation pressures, the authorities focused their policy goals on keeping Jamaica's exchange rate stable. The average depreciation of the nominal exchange rate was 0.4% between January and June, increasing to 1% in August. It peaked at 2% in December 2002, which coincided with the government's admission that the fiscal deficit target of 4% of GDP could not be met and that the deficit would, in fact, be double that figure. The nominal exchange rate continued to depreciate in 2003, declining by 13%.

The monetary authorities used three tools to reduce the instability in the foreign-exchange market in 2003: international reserves, open-market operations and temporary direct controls. The decline in international reserves (-14% between December and January and -12% between January and March 2003) and the open-market operations absorbed liquidity, thereby reducing agents' scope for switching to United States dollar-denominated assets, and helped to keep the money base within the targeted range. In addition, these measures reduced the supply of foreign exchange and, by widening the interest-rate spread, made the domestic economy more attractive to investors.

The limited success of these measures prompted the authorities to introduce temporary direct controls at the beginning of 2003. These controls included a special deposit requirement of 5% on financial institutions' liabilities with the Bank of Jamaica and a 120-day reverse repurchase instrument which carried a 30% interest rate. By the end of the quarter, however, the short-lived effect of these new measures forced the authorities to revert to open-market operations and interest-rate hikes (on both short- and long-term instruments) and intervention in the foreign-exchange market.

The exchange rate finally stabilized at the end of May 2003, when the government announced that the Bank of Jamaica would intervene heavily in the market and that it would issue an indexed bond denominated in United States dollars to mop up liquidity. In addition, it announced measures to reduce the fiscal deficit by cutting expenditure and, even more importantly, increasing the tax base.

The official interpretation of the exchange rate's behaviour lies in the disequilibrium of fiscal accounts. Starting from an investment/savings balance macroeconomic accounting framework, an increase in the fiscal deficit implies that either external savings must rise or the current account must be in deficit.

In the absence of any counteracting fiscal measures on the expenditure or revenue side, financing the deficit increases the government's debt. In the financial systems' balances, government debt (assets) can be matched by greater money creation (a liability). In the absence of restrictions on foreign-exchange transactions and given a favourable interest-rate spread (enhanced by the fact that the exchange-rate depreciation risk is low), as in the case of Jamaica, the increase in liquidity can find an outlet in domestic and/ or foreign goods and services and domestic assets. Independently of time and liquidity preferences, the most likely outcome is an increase in prices, which can translate into exchange-rate appreciation and an increase in imports.

Both these results can widen the current account deficit and erode international reserves. In turn, a decline in international reserves and expectations of a persistent fiscal deficit can lead agents to anticipate currency depreciation and to act accordingly. The consequent exchange-rate depreciation feeds back into prices through a cost mechanism and puts further pressure on the current account and international reserves. As mentioned above, the authorities can intervene to defend the local currency using international reserves or interest rate-hikes. This will only exacerbate the situation, however, until the root of the problem –the fiscal deficit– is tackled.

2. The main variables

(a) Economic activity

In 2002, GDP grew by 1% (1.7% in 2001). This reflected an expansion in the services sector (2%), since the goods-producing sector contracted by 0.4%. In 2003 GDP will increase by 2%.

The agricultural sector's underperformance (-8.3%) is explained largely by climatic factors, including the droughts that affected some parishes in the first quarter of 2002 and flood damage in May and September 2002. Domestic crop production was down by 12%, with fruits, condiments and legumes experiencing the largest declines (-36%, -34% and -26%, respectively). Export crop production decreased by 5.3%. Within this group, citrus fruits, cocoa and bananas recorded the largest contractions in external sales (-27%, -25% and -7%, respectively). In 2003 the agricultural sector is expected to reverse this trend, as production recovers from the effects of the floods, and turn in positive rates of growth. In the first quarter of 2003, the agricultural sector grew by close to 5%, with domestic and export crop production rising by 6.5% and 6.3%, respectively.

Mining output (3%) reflected the interruptions in production caused by flood rains and by technical and industrial difficulties, the expansion of capacity in bauxite plants and the growth of the construction sector. The notable surge in bauxite and alumina production (34% and 28%, respectively) in the final quarter was mainly attributable to the fact that JAMALCO (Jamaica Alumina Company) plant, which had been closed for the greater part of the year, began to operate at full capacity. Domestic bauxite and alumina production expanded by 12% and 13%, respectively, while exports of both minerals expanded at only 2% and 6%, due to lower international prices. Mining performance in 2003 will capitalize on the expansion of capacity and turn in a solid growth rate of 6%. In the first quarter of 2003 the growth of the mining sector was 5%.

Manufacturing stagnated (-0.1%) due to the flood rains, which had a negative impact on food, beverage and tobacco production and on sugar-cane output. In addition, the clothing sector maintained the downward trend that has been evident since at least 1997. In 2003, the manufacturing sector is expected to continue to record zero growth, as petroleum refining (which is one of the sector's most dynamic activities) is interrupted for maintenance purposes. During the first quarter, manufacturing dropped by 0.4%.

Construction (2.2%) performed better than in 2001 (-0.2%) thanks to residential and non-residential private construction and public-sector projects. Public-sector activity included housing completions by the national housing trust, public infrastructure projects such as the Northern Coastal Highway and Highway 2000, and installations by the light and power company. Construction is expected to maintain its present rate of growth in 2003, after expanding by 2.2% in the first quarter.

The tourism sector posted a decline (-0.4%), as it strained to recover in the wake of the events of 11 September. The number of stopover passengers fell by 1% and tourism earnings were down by 4.0%. The number of cruise-ship passengers increased (3%), however, and is expected to continue to rise, leading to positive growth for the whole sector in 2003. During the first quarter of 2003, stopover and cruise arrivals increased by 7% and 47%, respectively. Tourist expenditure rose by 12% and the GDP of the sector as a whole rose by 7%.

(b) Prices, wages and employment

The rate of inflation declined from 8.8% in 2001 to 7.3% in 2002. The main factors underlying the behaviour of inflation were the tight policy pursued by the monetary authorities, the disruption in the supply of agricultural products caused by flooding, the increase in the price of crude oil and, to a lesser extent, exchange-rate depreciation. In 2003, the depreciation of the exchange rate is expected to be the single most important factor determining inflation trends. Depreciation did not affect prices during the first three months of 2003, since inflation was negative (-0.4%) but kicked in with full force in April as the monthly inflation rate reached 1.6%, which may push the annual rate of inflation up to 11%.

An examination of the major categories of the price index shows that vegetables and fruit were the main contributors to the overall increase in prices, followed by other household expenses and meat, poultry and fish, baked products, cereals and breakfast drinks (23.1%, 14.2%, 10.3% and 10.5% of the total, respectively).

Following a proposal from the National Minimum Wage Advisory Commission, the House of Representatives approved a 50% rise in the minimum wage in November 2001 which became effective in January 2002. A survey of employment and earnings in large establishments also revealed that the average weekly earnings of all employees and of wage earners increased by 7.6% and 10%, respectively, for all major industrial sectors with the exception of construction. Employment increased by 1.6% and the rate of unemployment remained stable at 15%. The rate of female unemployment, which is twice as high as the male unemployment rate (21% and 11%, respectively), represented 61% of the unemployed labour force.

(c) The external sector

The current account deficit, which deteriorated in the course of the year (10.2% and 11.8% of GDP in 2001 and 2002, respectively), was not fully offset by the surplus in the capital and financial account. As a consequence, the stock of net international reserves declined from US$ 1,839,400,000 in 2001 to US$ 1,601,200,000 in 2002.

The trade deficit widened due to a contraction in the major categories of commodity exports, including alumina (-6%), sugar (-6%) and bananas (-2.7%). Bauxite (13%) was the exception to the rule, thanks to restored production capacity following the re-opening of a major refinery.

Alumina accounts for 76% of all major traditional exports. Its export volume increased below potential due to adverse weather conditions and labour stoppages, and was thus not enough to offset a decline in international prices (-12.6%). Market access obstacles and declines in productivity hampered external sugar sales. As in the case of alumina and sugar, banana production felt the impact of the May and September flooding. The performance of non-traditional exports (-17%) reflected the clothing industry's lack of competitiveness.

Goods imports were up by 2%, thanks mainly to the results for food products (5%), consumer durables (16%) and, within this group, imports of automobiles and other machinery and equipment (36%), including telephones and gas generators.

The services balance reflected a fall-off in the travel account and particularly in gross estimated visitor expenditure (-4.4%) as a result of the price reductions granted by the industry in order to maintain its competitive edge. The deficits on the income account and current transfers (-US$ 471 million and -US$ 1,028,400,000, respectively) are associated with higher levels of profit repatriation and debt payments, in the first case, and a rise in the level of private remittances (18%), in the second.

The surplus on the capital and financial account (US$ 704 million) is attributable partly to lower government borrowing in international capital markets and larger outflows of official payments and partly to a slump in private foreign direct investment (from US$ 1,022,600,000 to US$ 650.9 million) in response to a general climate of economic uncertainty.

Suriname

1. Economic policy

(a) Fiscal policy

In 2002 the fiscal balance deteriorated from -1.4% of GDP in 2001 to -10.9% in 2002 as a result of an increase in expenditure (from 34% of GDP in 2001 to 43% in 2002) and a marginal decline in tax revenues (33% and 31% of GDP in 2001 and 2002, respectively). The deficit was partly covered by financial development assistance and funds from the central bank, though central bank financing of the fiscal deficit is limited to 10% of government revenues.

Expenditure performance largely reflected a rise in public sector wages (which represented 46% of the total in 2002) that came into effect in March and was compounded by a one-time bonus payment in July (73%). The other spending categories displayed a mixed out-turn. Transfers and capital expenditures dipped, the first from 8.1% of GDP in 2001 to 7.3% in 2002 and the second from 2% of GDP in 2001 to 1.5% in 2002. Interest payments expanded from 2% of GDP in 2001 to 3% in 2002, and spending on goods and services, from 8% of GDP in 2001 to 10% in 2002.

Trends in tax revenues mainly reflected a drop-off in bauxite earnings (from 5% of GDP in 2001 to 2% in 2002). Indirect taxes held steady as a proportion of GDP despite the stagnation of economic activity (at 14.5% and 14% of GDP in 2001 and 2002, respectively).

Between December 2002 and January 2003 the authorities passed a series of tax measures to deal with the fiscal imbalance and the negative effects of the implementation of the third and fourth phases of the CARICOM common external tariff, which went into effect in January 2003. The measures implemented in 2003 included an increase in the threshold of the wealth tax and the introduction of a threshold in the rental value tax and a casino tax consisting of the payment of a set amount per table and per machine. Changes were also made to the threshold income brackets, and the rates of income and sales taxes (effective in December 2002) went up. Sales taxes rose from 5% to 8% for services and from 7% to 10% for goods. These measures geared to narrowing the budget deficit are expected to raise 100 billion guilders in tax revenues. The revenue-enhancing effects were felt in the first three months of 2003 as direct and indirect tax receipts expanded by 81% and 16%, respectively.

Estimated revenues (including grants) for 2003 are equivalent to 34% of GDP (with current revenue standing at 32% of GDP). Current and capital expenditure are projected to reach 31% and 4% of GDP, respectively.

(b) Monetary and exchange-rate policy

In an attempt to curb inflation, which started to trend upward in February, the monetary authorities used direct controls to limit the creation of credit by the commercial banking system and to moderate the depreciation of the nominal exchange rate. In May 2002 the central bank upped the reserve ratio from 27.5% to 35%. After the exchange rate peaked at 3,000 guilders to the dollar in August (which represented a depreciation of 27% since January), in September a band system was introduced for foreign-exchange sales and purchases (2,540-2,800 guilders for the sale of United States dollars and 2,490-2,750 guilders for purchases).

These stabilization efforts were partly offset by a significant increase in net credit to the government (from -55% in 2001 to 147% in 2002) to finance its fiscal gap, which boosted the expansion of the narrow and broad money supply (43% and 41% for M1 and M2, respectively).

Credit to the private sector was also up (by 27%), in response to a decline in real rates of interest brought about by the rise in prices and by decreases in the nominal lending rate (from 23.4% in December 2001 to 21.3% in December 2002) as economic activity stalled.

In 2003 the exchange-rate band became practically inoperative. Also, some non-official sources indicate that currency traders are increasingly avoiding government regulation of the foreign-exchange market as foreign exchange has become more scarce. The authorities are expecting the growth of the money supply to decline to 20%.

Table 1
SURINAME: MAIN ECONOMIC INDICATORS

	1994	1995	1996	1997	1998	1999	2000	2001	2002[a]
	Annual growth rates [b]								
Gross domestic product	-0.1	0.0	5.3	3.3	2.9	-3.5	-1.2	1.3	1.2
	Millions of dollars								
Balance of payments									
Balance on current account	…	…	…	…	-183	-90	-9	-84	-60
Exports of goods and services	…	…	475	494	422	421	490	496	314
Imports of goods and services	…	…	568	559	574	476	452	472	350
Income account balance	…	…	…	…	-29	-34	-45	-108	-21
Current transfers balance	…	…	…	…	-2	-2	-2	-1	-3
Capital and financial account balance [c]	…	…	…	…	61	19	-81	105	-39
Global balance	…	…	-4	-9	-46	-84	-51	77	-99
Variation in reserve assets [d]	…	…	-36	-22	-36	-22	1	78	-23
Prices									
Inflation (rates of change, December-December)	…	…	1.2	17.4	22.9	112.8	76.2	4.9	28.3
Official nominal exchange rate (guilders per dollar)	…	…	396	396	396	980	2,157	2,157	2,500
Average free nominal exchange rate (guilders per dollar)	…	…	414	435	556	1,251	1,914	2,243	2,639
	Percentages of GDP								
Non-financial public sector									
Revenue	…	…	46.7	35.8	36.0	24.0	28.0	32.7	32.5
Expenditure	…	…	44.3	39.7	49.9	34.3	40.7	34.1	43.4
Fiscal balance	…	…	2.5	-4.0	-13.8	-10.3	-12.7	-1.4	-10.9
Public debt	…	…	…	58.0	61.9	51.3	65.9	37.0	33.6
Internal	…	…	…	7.9	11.9	17.0	38.2	14.0	13.9
External	…	…	…	50.1	50.0	34.3	27.8	23.0	19.6
	Rates of change (December to December)								
Money and credit									
Credit to the private sector	…	…	…	41.7	24.5	33.5	-14.6	58.3	26.7
Credit to the government (net)	…	…	…	-500.0	254.3	28.2	541.9	-55.1	147.9
Narrow money supply	…	…	…	21.7	34.1	47.9	97.3	42.8	42.7
Broad money supply	…	…	…	16.3	28.7	37.0	91.5	38.7	40.7
	Annual percentages								
Real interest rates									
Weighted average deposit rate	…	…	15.1	-0.7	-5.9	-45.5	-34.5	5.9	-15.5
Weighted average lending rate	…	…	33.3	9.7	2.3	-39.6	-26.8	17.7	-5.1

Source: ECLAC, on the basis of official information.
[a] Preliminary figures. [b] On the basis of constant 1990 prices. [c] Includes errors and omissions. [d] The sign (-) indicates a reverse increase.

2. The main variables

(a) Economic activity

GDP growth stagnated (with rates of 1.3% in 2001 and 1.2% in 2002) owing to the poor performance of the agricultural and mining sectors. In 2003 the economy is expected to remain stagnant.

Agricultural output faced cash constraints, adverse weather conditions and lower international prices for some of its major export products. Banana output was curtailed as one of the major State companies suspended production, unable to finance variable costs. The company, which is undergoing a rehabilitation and privatization process, is expected to resume production and exports in 2004. Rice production was also constrained by debt, lack of irrigation due to dry weather conditions and technical difficulties. Fisheries suffered as a result of lower prices for shrimp, caused by an increase in supply due to illegal fishing.

Mining performance reflected a decline in bauxite and oil production. Export volumes of bauxite fell by 1.2%, while oil export volumes were down by 73%. The contraction in bauxite production reflected lower international prices (11%) and low levels of government capital investment. In October 2002 the government agreed to a joint venture development with an international bauxite company, which is expected to increase the industry's capacity and production. In the first three months of 2003 the volume of alumina increased (2.5%), responding to a recovery of international prices. Gold production is expected to expand owing to investments by a foreign company in an open pit mine.

(b) Prices, wages and employment

The rate of inflation rose from 4.9% to 28.3% on a point-to-point basis for December 2001-December 2002, as a result of the steady depreciation of the exchange rate, which increased costs and led to price adjustments, wage increases and higher liquidity in the economy.

The official exchange rate, which was anchored at 2,200 guilders to the dollar at the beginning of 2002, was adjusted several times and ended the year at 2,545.79 guilders to the dollar (an increase of 16%). In the parallel free market the exchange rate rose above the 3,000-guilder barrier in September and reached an average of 2,638 guilders for the year, thereby exceeding the quantitative limits which the monetary authorities had imposed on the purchase and sale of foreign exchange. Public-sector wages were readjusted in March. In 2003 inflation continued its upward trend to reach 36% in April, reflecting price hikes in the gasoline (40%) and food segments. Inflation is likely to remain in the double digits in 2003.

A breakdown of the consumer price index shows that at the component level, food and non-alcoholic beverages, alcoholic beverages and tobacco displayed the largest increases, followed by household furnishings and utilities (35%, 34% and 33%, respectively).

The unemployment rate remained at 16%, reflecting the sluggishness of the economy.

(c) The external sector

The overall balance of payments turned negative in 2002 as both the current account and the capital account ran deficits (the first recording US$ -84 million and US$ -60 million in 2001 and 2002, respectively, and the second recording US$ 105 million and US$ -40 million in 2001 and 2002, respectively). As a result, the authorities' net international reserve position deteriorated from US$ 108 million to US$ 92 million.

The current-account deficit reflected the underperformance of exports. All the major traditional exports saw marked declines, which were mainly attributable to volume considerations. Banana and rice exports recorded contractions averaging 11%. Alumina exports fell by 13% and external oil sales were down by 73%. Imports remained stable as a result of stagnant income growth.

The capital-account balance reflects inter-company balances (US$ -64 million in 2002) and loan disbursements by the government (US$ -27 million in 2002).

In 2003 export volumes saw an upswing. In the first quarter of the year alumina export volumes were up by 27%, while crude petroleum exports and refinery products rose by 66%. If exports maintain this trend and imports respond to the recovery in economic activity, the current account deficit will widen to US$ 107 million. The capital account will offset this imbalance, however, as different investment projects in key sectors of the economy (bananas, bauxite and gold) come on stream. As a result, the authorities are likely to increase the import coverage ratio. The coverage ratio stood at 3.1%, in January 2003, rose to 3.7% in May 2003 and will probably remain at 3.5% in December 2003.

Trinidad and Tobago

1. Economic policy

(a) Fiscal policy

The central government reduced its surplus from the figure recorded in fiscal year 2000/2001 and registered a virtual balance on its fiscal accounts for fiscal year 2001/2002 (1.8% and -0.3% of GDP, respectively) as a result of tax buoyancy from non-energy sources (8% and 5% of GDP for the two fiscal years, respectively), which partly offset the underperformance of the petroleum sector's earnings (8% and 5% of GDP in the same period). This result notwithstanding, the tax-to-GDP ratio declined from 24.5% to 22.7%.

The oil sector's tax potential was undermined by the fall in the price of crude oil during the fiscal year (-15%). The price slump affected profits and, therefore, corporate tax revenues (4.9% and 3.1% of GDP in fiscal years 2000/2001 and 2001/2002, respectively), which are the largest contributor of oil-sector taxes (56% of the total). An upturn in the price of oil towards the end of the year had a positive effect on the country's public finances as the corporation tax intake (measured on a calendar-year basis) increased.

Tax receipts from the non-oil sector were boosted by the performance of the value added tax (13%) and, to a lesser extent, international trade taxes (5%). In turn, the value added tax flows reflected an increase in efficiency and a lower level of tax refunds. International trade tax receipts benefited from an increase in vehicle imports. Income tax recorded a marginal drop (from 8% of GDP in 2001 to 7.5% in 2002) as a downturn in the corporation tax intake was not fully offset by the performance of personal income taxes, owing in part to the payment of public-sector wage arrears. Lastly, non-tax revenues were boosted by the higher profits of public firms and administrative fees.

Expenditure patterns (21% of GDP in 2002 and 22% in 2002) reflected the settlement of public-sector wage arrears, as mentioned above (12%), and transfers and subsidies to households (24%), including pension outlays.

The deficit was financed from domestic sources and external borrowing was avoided, which enabled the authorities to reduce the external debt-to-GDP ratio from 21% in 2000 to 17% in 2002. As the government used existing lines of credit from contracted external loans to develop the country's infrastructure, however, the service-to-debt ratio rose from 3.7% to 4.3%.

The budget for the new fiscal year 2002/2003, which was submitted and adopted in October, is estimated to yield a deficit of 1% of GDP due to payments to settle wage arrears. On the revenue side, the main features of the budget include a reduction in the top marginal rate of income and corporation tax (from 35% to 30%), the elimination of taxes on medication and export allowances to comply with WTO agreements. On the expenditure side, the government is planning to increase spending on health care and education by 10% and 12%, respectively. The out-turn for the first half of fiscal year 2002/2003 shows the accounts in balance. This resulted in part from the delay in the implementation of the capital expenditure programme.

(b) Monetary and exchange-rate policy

Monetary policy went through three phases in the course of the year. In the first, which lasted for the first three quarters, the financial system was marked by excess liquidity caused in part by a climate of uncertainty surrounding the political stalemate prevailing throughout the year, the continued slowdown in the United States economy and, most importantly, the government's fiscal operations. Net credit to the government rose from 16% to 33% between 2001 and 2002. The monetary authorities responded with sterilization operations, which were facilitated by the extension of the limit on central bank note issues in March 2002 (125%).

The central bank also intervened in the foreign-exchange market to offset the excess demand for United States dollars in the first part of the year (the bilateral exchange rate was quoted at 6.23553 in January and at 6.27260 in April), which helped to further dampen the excess liquidity in the financial system. The upward pressure placed on interest rates by sterilization operations, the liquidity constraints imposed by budgetary operations and the slow growth of the economy prompted the authorities to adopt a looser monetary stance.

Table 1
TRINIDAD AND TOBAGO: MAIN ECONOMIC INDICATORS

	1994	1995	1996	1997	1998	1999	2000	2001	2002[a]
	Annual growth rates [b]								
Gross domestic product	8,4	3,2	2,9	3,0	4,6	5,8	5,7	4,0	3,2
Gross domestic product by economic activity									
Agriculture	…	…	…	2.7	-10.7	12	9.5	-2.8	2.5
Petroleum	…	…	…	-2	5.4	8.1	1.1	0.7	10.7
Manufacturing	…	…	…	3.5	4.1	3.4	6.7	3.1	-2.9
Construction	…	…	…	15	13.9	7.9	8	4.9	5
Distributive trade	…	…	…	17.7	13.6	9.8	21.5	6.5	1.2
Other services [c]	…	…	…	2.0	3.3	1.8	3.4	6.5	-0.6
	Millions of dollars								
Balance of payments									
Balance on current account	218	294	105	-614	-644	31	544	416	96
Goods balance	741	588	382	-529	-741	64	969	718	193
Exports fob	1,778	2,456	2,354	2,448	2,258	2,816	4,290	4,304	3,875
Imports fob	-1,037	-1,868	-1,972	-2,977	-2,999	-2,752	-3,322	-3,586	-3,682
Services balance	-112	101	244	292	416	329	166	204	222
Income account balance	-412	-390	-514	-381	-341	-400	-629	-539	-365
Current transfers balance	0	-4	-7	4	22	38	38	33	47
Capital and financial account balance [d]	-32	-210	133	807	724	132	-103	55	-48
Net foreign direct investment	516	299	355	999	730	379	654	685	587
Financial capital [e]	-548	-509	-222	-192	-6	-248	-758	-630	-634
Global balance	186	84	238	194	80	162	441	471	49
Variation in reserve assets [f]	-186	-84	-238	-194	-80	-162	-441	-471	-49
Other external sector indicators									
Gross external debt (millions of dollars)	…	…	…	1 565	1 471	1 585	1 680	1 638	1 596
Gross external debt (% of GDP)	…	…	…	26.9	24.3	23.3	20.6	18.0	17.3
Employment									
Participation rate [g]	…	…	…	…	…	60.8	61.2	60.7	60.9
Unemployment rate [h]	…	17.2	16.2	15.0	14.2	13.2	12.2	10.8	10.4
Prices									
Consumer price index (rates of change, December-December)	…	5.3	3.3	3.6	5.6	3.4	3.6	5.5	4.2
Nominal exchange rate (Trinidad dollars per dollar)	…	5.9	6.0	6.3	6.3	6.3	6.3	6.2	6.3
	Percentages of GDP								
Non-financial public sector									
Current revenue	…	…	…	…	…	…	23.2	24.6	22.7
Current expenditure	…	…	…	…	…	…	21.1	21.1	21.9
Capital account balance	…	…	…	…	…	…	2.1	3.4	0.9
Primary balance	…	…	…	…	…	…	4.8	5.9	3.4
Financial balance	…	…	…	…	…	…	-0.2	1.8	-0.3
External debt	…	…	…	…	…	…	17.1	14.2	15.0
Money and Credit									
Bank credit	…	…	…	36.7	34.6	36.8	32.5	33.2	33.9
Public sector	…	…	…	5.8	4.9	4.4	3.0	5.3	4.9
Private sector	…	…	…	31.0	29.6	32.4	29.5	27.9	29.0
Broad money (M3)	…	…	…	…	55.3	56.6	48.7	51.2	49.0
Local-currency liquidity (M2)	…	…	…	40.8	44.2	41.9	37.8	39.8	39.6
Foreign-currency liquidity	…	…	…	…	11.1	14.6	10.9	11.4	9.4
	Annual percentages								
Real interest rates									
Weighted average deposit rate	…	…	…	…	…	…	4.3	6.2	2.1
Weighted average lending rate	…	…	…	…	…	…	6.0	7.8	5.2

Source: ECLAC, on the basis of official information.
[a] Preliminary figures. [b] On the basis of constant 1985 prices. [c] Includes retail trade, restaurants and hotels, financial establishments, insurance, real estate, social and personal services. [d] Includes errors and omissions. [e] The sign (-) indicates a reserve increase. [f] Refers to the capital and financial accounts, minus net foreign direct investment, plus errors and omissions. [g] Economically active population as a percentage of the working age population. [h] Unemployed as a percentage of the economically active population. [i] Includes hidden unemployment.

In August, the combination of low growth, excess liquidity and a stable exchange rate prompted the authorities to lower the benchmark repo rate from 5.75% to 5.25%. The repo rate was introduced in May 2002 and refers to the overnight borrowing rate charged by the central bank to commercial banks. This financial option comes with the possibility of repurchase by the central bank at a rate of interest known as the reverse repo rate. Funds are repurchased by the central bank at a 50-basis-point discount over the repo rate. The repo rate was set at 5.75% and the reverse rate, at 5.25%. The repo rate also constitutes the reference point for other rates such as the discount rate (charged on borrowing from the central bank to cover temporary liquidity shortages) and the special deposit rate (the rate at which excess reserves are remunerated when held at the central bank).

The structure of interest rates followed a downward trend over the period. The weighted average interbank lending rate decreased from 5.25% to 3.8% in September and settled at 4.47% at the end of the year. The treasury bill rate was reduced from 6.3% to 4.6%. Lastly, the basic prime lending rate slipped from 14.5% to 11.5%. The effect of the reduction of lending rates on banks' profitability was mitigated by a similar and (in some instances) greater decline in deposit rates. The median ordinary deposit rate fell from 3% to 2.35% and the rate on 3- and 6-month time deposits, from 7.15% and 6% to 3.38% and 4.25%, respectively.

Towards the last two months of the year, the monetary authorities moved to prevent a spending surge aggravated by seasonal factors, reverting to a restrictive stance on liquidity through open-market operations. At the same time, they intervened again in the foreign-exchange market to stave off devaluation pressures. The exchange rate ended the year at 6.29965 Trinidad and Tobago dollars to the United States dollar, which represented a depreciation of 6% since the beginning of the year.

Demand for credit stalled (7.2% and 6.4%), reflecting the general sluggishness of the economy and the change in monetary policy objectives. Manufacturing, finance, insurance and communications and consumer loans, which account for 60% of commercial banks' loan portfolio, grew by a mere 0.5%.

The behaviour of money-supply aggregates reflected the interest rate and exchange rate objectives. Narrow money and broad money expanded by 10% and 4%, respectively, in 2002 (3.7% and 16% in 2001).

2. The main variables

(a) Economic activity

GDP growth decreased for the third consecutive year (5.7%, 4.0% and 3.2% for 2000, 2001 and 2002, respectively), reflecting a significant drop in the performance of the non-energy sector (4.9% and 1% in 2001 and 2002, respectively), particularly manufacturing. By contrast, the energy sector surged from a paltry 0.7% growth rate in 2001 to a robust 10.7% in 2002. In 2003 GDP is expected to increase by 4%.

The performance of the energy sector was accounted for by an increase in crude oil production (15% in thousands of barrels per day) and an expansion of production capacity in ammonia and liquefied natural gas. The production of crude oil rose, thanks to the positive effects of natural gas on condensate output. Exploration declined (-17%), refining operations stagnated (-2%) and natural gas output expanded by 230 cubic feet per day. Natural gas liquids (14%) responded to the start-up of operations by the Atlantic LNG Company's Train 2. Atlantic LNG Train 3 is expected to be operational in 2003 and output is thus forecast to grow by an extra 3.3 million tons. Natural gas liquids also benefited from higher international prices. In 2003 the energy sector will continue to post strong growth as the different projects come on stream.

Petrochemicals posted a mixed outcome. Methanol expanded by a mere 1.4% in spite of favourable international prices, but this performance is expected to improve with the construction of two new plants. The fertilizer subsector (11%) was positively affected by the arrival of a new company.

The recovery of the agricultural sector (up by 2.5% in 2002, after having declined by 2.8% in 2001) was associated with upturns in sugar, cocoa and citrus (30% and 8.5% for cane and raw sugar, respectively, and 75% and 92% for cocoa and citrus, respectively), which are the major agricultural commodities. The performance of sugar masked the financial difficulties of the government's sugar company and poor weather conditions that undermined its productivity, however.

Manufacturing contracted by 2.9% in response to unfavourable external conditions, including the weakness of the region's economies, which constitute the industry's main export market. Additional explanatory factors include a shifting policy environment, an uncertain political future and the lack of a definite strategy to deal with the future challenges posed by Trinidad and Tobago's full integration into the regional and multilateral trading regimes.

(b) Prices, wages and employment

The rate of inflation (5.5% in 2001 and 4.2% in 2002) reflected the slowdown in growth and the concomitantly low spending levels in the economy, together with policy interventions to absorb liquidity and maintain a stable exchange rate. A breakdown of the price index shows that all the components recorded lower growth rates relative to the previous year. It also indicates that food posted the biggest price increase (10%) and clothing, the biggest drop (-2.5%).

The unemployment rate remained virtually unchanged from the previous year (10.8% in 2001 and 10.4% in 2002). The distribution of employment among economic sectors reveals that the services sector (representing 40% of the total) created 14,000 jobs. Manufacturing also generated positive job growth. By contrast, agriculture and construction recorded job losses.

Average weekly earnings decreased for industry as a whole (-19%). Textiles and clothing saw the largest downturn (-21%) and the water sector, the biggest rise (27%). The minimum wage increased in January 2003 from 7.00 Trinidad and Tobago dollars to 8.00.

(c) The external sector

Trinidad and Tobago narrowed both its current-account surplus, which it has been able to maintain since 1999 (US$ 416 million in 2001 and US$ 96 million in 2002), and its capital account surplus (US$ 542.4 million in 2001 and US$ 231 million in 2002),[3] but nonetheless remained in a surplus position for the fourth year in a row.

The performance of the current account (1% of GDP) was largely influenced by lower-than-expected export earnings from mineral fuels and lubricants (-28%), which represent 60% of total merchandise exports, notwithstanding the upward trend in the international price of petroleum. Chemicals and manufacturing also recorded declines (-39% and -17%, respectively, accounting for 28% of the total). Demand for imports (2.6%) was driven by machinery and transport equipment and, to a lesser extent, capital goods.

The services balance (US$ 204 million in 2001 and US$ 222 million in 2002) was largely attributable to the transport and insurance components (US$ 84.5 million and US$ 99.6 million, respectively), while the income account reflected profit repatriation.

The reduction in the capital account surplus was due to lower foreign direct investment (US$ 684.9 million in 2001 and US$ 586.5 million in 2002) following the completion of infrastructure projects, Trinidad and Tobago intraregional investment and foreign currency outflows from domestic banks.

In 2003 the current-account surplus will expand as a result of higher volumes of energy-sector exports (3.6% of GDP). This result will be partly offset by a decline in the capital account as energy projects reach completion.

3 The capital account figures refer to net capital movements.

Statistical appendix

Table A - 1
LATIN AMERICA AND THE CARIBBEAN: MAIN ECONOMIC INDICATORS

	1994	1995	1996	1997	1998	1999	2000	2001	2002[a]	2003[b]
	Annual growth rates									
Gross domestic product [c]	5.2	1.1	3.8	5.1	2.2	0.5	3.8	0.4	-0.6	1.5
Per capita gross domestic product [c]	3.4	-0.6	2.1	3.4	0.6	-1.0	2.2	-1.1	-2.1	0.0
Consumer prices [d]	324.3	25.4	18.2	10.5	9.8	9.4	8.7	6.0	12.1	8.6
	Percentages									
Urban open unemployment	6.6	7.5	7.9	7.5	8.1	8.8	8.4	8.3	8.9	…
Total gross external debt/ GDP [e]	35.4	36.7	35.0	33.3	37.8	42.6	37.2	37.7	43.3	...
Total gross external debt/ exports of goods and services	248.9	228.9	214.2	201.5	229.3	218.1	177.5	181.3	180.5	...
Balance of payments	**Billions of dollars**									
Current account	-51.6	-38.0	-38.9	-64.9	-87.3	-53.8	-45.3	-51.2	-13.4	-3.7
Goods	-12.7	3.3	5.3	-11.9	-33.4	-5.7	4.4	-1.6	24.3	37.2
Exports FOB	188.5	229.5	257.3	286.4	283.2	299.1	358.3	343.5	346.4	361.7
Imports FOB	-201.2	-226.2	-252.1	-298.4	-316.6	-304.8	-353.9	-345.1	-322.1	-324.5
Services	-15.6	-15.6	-15.5	-19.8	-20.7	-15.9	-16.9	-19.3	-14.0	-14.6
Income	-36.1	-40.8	-43.2	-48.3	-49.9	-51.5	-53.2	-54.5	-50.7	-54.8
Current transfers	12.8	15.1	14.5	15.1	16.7	19.2	20.4	24.2	26.9	28.5
Capital and financial account [f]	41.7	29.8	67.7	83.6	68.9	47.8	60.0	32.9	-14.2	...
Net foreign direct investment	24.4	25.8	40.3	57.0	60.6	79.6	67.8	68.7	39.0	...
Financial capital [g]	17.3	4.0	27.4	26.7	8.3	-31.7	-7.7	-35.8	-53.2	...
Overall balance	-9.9	-8.2	28.7	18.7	-18.5	-6.0	14.7	-18.4	-27.6	...
Change in reserve assets [h]	4.5	-23.1	-26.1	-15.8	9.6	6.3	-7.0	1.2	3.2	...
Other financing [i]	5.5	31.3	-2.6	-2.9	8.9	-0.3	-7.7	17.2	24.5	...

Source: ECLAC, on the basis of official figures.
[a] Preliminary figures.
[b] Projections.
[c] Based on official figures converted into dollars at 1995 prices.
[d] December-to-December variation.
[e] Estimates based on figures expressed in dollars at current prices.
[f] Includes errors and omissions.
[g] Refers to the capital and financial accounts, minus net foreign direct investment, plus errors and omissions.
[h] A minus sign (-) indicates an increase in reserve assets.
[i] Includes the use of IMF credit and loans and exceptional financing.

Table A - 2
LATIN AMERICA AND THE CARIBBEAN: GROSS DOMESTIC PRODUCT
(Annual growth rates)

	1994	1995	1996	1997	1998	1999	2000	2001	2002[a]	2003[b]
Latin America and the Caribbean	**5.2**	**1.1**	**3.8**	**5.1**	**2.2**	**0.5**	**3.8**	**0.4**	**-0.6**	**1.5** [c]
Subtotal (20 countries)	**5.2**	**1.1**	**3.8**	**5.2**	**2.2**	**0.5**	**3.7**	**0.4**	**-0.6**	**1.5** [c]
Argentina	5.8	-2.9	5.5	8.0	3.8	-3.4	-0.8	-4.4	-10.9	5.5
Bolivia	4.8	4.7	4.5	4.9	5.0	0.3	2.3	1.6	2.7	2.0
Brazil	6.2	4.2	2.5	3.1	0.1	1.0	4.0	1.5	1.4	1.5
Chile	5.0	9.0	6.9	6.8	3.3	-0.5	4.2	3.2	2.1	3.5
Colombia	5.9	4.9	1.9	3.3	0.8	-3.8	2.5	1.5	1.5	2.5
Costa Rica	4.6	3.9	0.8	5.4	8.3	8.0	1.8	1.2	2.6	4.5
Cuba	0.6	2.7	9.1	2.7	0.0	5.7	6.3	2.9	1.1	...
Ecuador	3.7	2.1	3.0	5.2	2.2	-5.7	0.9	5.5	3.8	1.5
El Salvador	6.0	6.2	1.8	4.2	3.8	3.4	2.1	1.9	2.2	2.0
Guatemala	4.1	5.0	3.0	4.4	5.1	3.9	3.4	2.6	2.2	2.0
Haiti	-17.6	9.5	5.6	3.2	2.9	2.9	2.0	-0.6	-0.5	0.0
Honduras	-1.9	3.7	3.7	4.9	3.3	-1.5	5.6	2.7	2.4	2.5
Mexico	4.5	-6.2	5.4	6.8	5.0	3.7	6.8	-0.5	0.8	1.5
Nicaragua	4.0	4.4	5.1	5.4	4.1	7.5	6.5	3.2	0.7	1.5
Panama	3.1	1.9	2.7	4.7	4.6	3.5	2.6	0.4	0.8	2.0
Paraguay	3.0	4.5	1.1	2.4	-0.6	-0.1	-0.6	2.4	-2.3	1.5
Peru	12.7	8.6	2.5	6.9	-0.5	0.9	2.5	-0.1	5.3	3.5
Dominican Republic	4.7	4.3	7.2	8.2	7.4	8.0	7.3	3.0	4.3	-1.0
Uruguay	7.0	-2.3	5.0	5.4	4.4	-3.4	-1.9	-3.5	-10.7	-2.5
Venezuela	-3.0	4.8	0.0	6.9	0.6	-5.5	3.8	3.5	-9.0	-13.0
Subtotal - Caribbean	**3.1**	**2.7**	**2.6**	**2.0**	**2.7**	**4.1**	**4.7**	**2.2**	**1.7**	**2.5**
Antigua and Barbuda	6.2	-4.8	6.0	5.5	5.0	4.9	2.6	4.3	1.5	...
Barbados	4.4	1.9	2.5	2.6	4.0	3.0	3.1	-2.2	-0.4	...
Belize	1.5	3.7	1.3	4.4	2.0	6.0	10.5	4.7	3.7	...
Dominica	1.9	1.2	2.9	2.2	3.1	1.3	1.3	-5.4	-6.0	...
Grenada	3.4	3.1	3.0	4.3	7.6	7.5	6.7	-3.4	-1.5	...
Guyana	9.4	3.8	7.4	6.8	-2.2	5.0	-2.3	2.3	1.5	...
Jamaica	1.6	2.2	-0.1	-1.8	-0.8	0.6	1.0	1.8	0.9	...
Saint Kitts and Nevis	5.5	3.2	5.8	7.2	1.1	3.5	5.0	2.0	0.5	...
Saint Lucia	4.6	2.1	0.8	-0.3	3.0	2.8	0.3	-5.0	1.0	...
Saint Vincent and the Grenadines	-2.3	7.8	1.2	3.5	5.8	3.6	1.8	0.3	1.0	...
Suriname	-0.1	0.0	5.3	3.3	2.9	-3.5	-1.2	1.3	1.2	...
Trinidad and Tobago	4.2	4.2	4.4	4.0	5.3	7.8	9.2	4.3	3.0	...

Source: ECLAC, based on official figures converted into dollars at constant 1995 prices.
[a] Preliminary figures.
[b] Projections.
[c] Refers only to those countries that provide data.

Table A - 3
LATIN AMERICA AND THE CARIBBEAN: PER CAPITA GROSS DOMESTIC PRODUCT
(Annual growth rates)

	1994	1995	1996	1997	1998	1999	2000	2001	2002[a]	2003[b]
Latin America and the Caribbean	**3.4**	**-0.6**	**2.1**	**3.4**	**0.6**	**-1.0**	**2.2**	**-1.1**	**-2.1**	**0.0**[c]
Subtotal (20 countries)	**3.4**	**-0.6**	**2.1**	**3.5**	**0.6**	**-1.1**	**2.2**	**-1.2**	**-2.1**	**0.0**[c]
Argentina	4.4	-4.1	4.1	6.6	2.5	-4.6	-2.0	-5.6	-11.9	4.2
Bolivia	2.4	2.3	2.0	2.4	2.5	-2.1	-0.1	-0.7	0.4	-0.3
Brazil	4.7	2.7	1.1	1.7	-1.2	-0.3	2.6	0.2	0.1	0.2
Chile	3.3	7.3	5.4	5.3	1.9	-1.8	2.9	1.9	0.8	2.3
Colombia	3.8	2.9	0.0	1.4	-1.1	-5.6	0.7	-0.3	-0.2	0.8
Costa Rica	2.1	1.4	-1.7	2.8	5.6	5.4	-0.5	-0.9	0.6	2.5
Cuba	0.0	2.2	8.6	2.2	-0.4	5.3	5.9	2.5	0.8	...
Ecuador	1.5	0.0	0.9	3.1	0.2	-7.5	-1.0	3.5	2.0	-0.3
El Salvador	3.7	4.0	-0.3	2.1	1.6	1.3	0.1	0.0	0.3	0.2
Guatemala	1.4	2.2	0.3	1.7	2.4	1.1	0.7	0.0	-0.5	-0.6
Haiti	-19.0	7.5	3.7	1.3	1.0	1.1	0.2	-2.4	-2.3	-1.8
Honduras	-4.7	0.7	0.8	2.1	0.5	-4.1	2.8	0.1	-0.2	0.0
Mexico	2.6	-7.8	3.7	5.1	3.3	2.1	5.2	-1.9	-0.6	0.1
Nicaragua	0.9	1.5	2.2	2.6	1.4	4.7	3.7	0.5	-1.9	-1.1
Panama	1.0	-0.1	0.6	2.6	2.6	1.5	0.7	-1.5	-1.1	0.2
Paraguay	0.4	1.7	-1.6	-0.2	-3.2	-2.6	-3.1	-0.1	-4.7	-1.0
Peru	10.8	6.7	0.7	5.0	-2.2	-0.8	0.8	-1.7	3.8	2.0
Dominican Republic	2.9	2.5	5.3	6.3	5.6	6.2	5.5	1.3	2.6	-2.6
Uruguay	6.2	-3.0	4.2	4.6	3.6	-4.1	-2.6	-4.2	-11.4	-3.2
Venezuela	-5.1	2.6	-2.1	4.7	-1.4	-7.3	1.8	1.5	-10.7	-14.6
Subtotal - Caribbean	**2.3**	**1.9**	**1.8**	**1.2**	**1.9**	**3.4**	**4.0**	**1.5**	**1.0**	**1.8**
Antigua and Barbuda	4.5	-6.3	4.5	4.1	3.7	3.7	1.6	3.5	0.9	...
Barbados	4.0	1.5	2.1	2.2	3.7	2.6	2.8	-2.6	-0.7	...
Belize	-1.3	1.0	-1.2	1.9	-0.3	3.6	8.0	2.5	1.5	...
Dominica	0.9	0.3	2.0	1.4	2.3	0.6	0.8	-5.8	-6.3	...
Grenada	3.9	3.7	3.6	4.9	8.2	8.1	7.2	-3.0	-1.3	...
Guyana	8.9	3.3	6.9	6.2	-2.7	4.5	-2.7	1.9	1.2	...
Jamaica	0.6	1.3	-1.0	-2.6	-1.6	-0.3	0.1	0.9	0.0	...
Saint Kitts and Nevis	4.0	2.3	5.8	7.8	2.0	4.5	5.8	2.5	0.8	...
Saint Lucia	3.4	1.0	-0.1	-1.1	2.3	2.1	-0.4	-5.8	0.2	...
Saint Vincent and the Grenadines	-3.0	7.1	0.5	2.9	5.2	3.0	1.2	-0.2	0.4	...
Suriname	-0.5	-0.5	4.7	2.6	2.1	-4.4	-2.1	0.5	0.4	...
Trinidad and Tobago	3.4	3.5	3.8	3.5	4.9	7.4	8.8	3.9	2.6	...

Source: ECLAC, based on official figures converted into dollars at constant 1995 prices.
[a] Preliminary figures.
[b] Projections.
[c] Refers only to those countries that provide data.

Table A - 4

LATIN AMERICA AND THE CARIBBEAN: GROSS FIXED CAPITAL FORMATION

(Percentages of GDP)

	1994	1995	1996	1997	1998	1999	2000	2001	2002[a]
Latin America and the Caribbean	**20.2**	**19.1**	**19.3**	**20.8**	**21.1**	**20.2**	**19.7**	**19.1**	**18.1**
Argentina	20.0	17.9	18.5	20.1	20.7	18.7	17.6	15.5	11.1
Bolivia	14.3	15.5	16.6	20.2	24.7	20.9	18.6	14.7	15.9
Brazil	20.0	20.5	20.3	21.5	21.4	21.3	19.8	19.7	18.6
Chile	22.2	25.2	25.6	26.6	26.2	21.5	22.3	22.1	21.9
Colombia	23.3	22.4	21.7	20.5	19.1	12.7	13.9	15.0	15.5
Costa Rica	19.2	19.0	17.3	18.8	21.7	19.3	18.9	19.0	19.9
Cuba	7.8	8.1	10.1	10.4	10.9	10.9	11.2	10.6	9.9
Ecuador	19.6	18.8	17.5	17.0	17.3	13.3	14.8	15.7	17.8
El Salvador	17.6	18.7	16.3	16.9	17.9	17.1	17.5	17.2	16.9
Guatemala	14.1	14.5	13.7	16.2	18.5	18.8	16.9	16.5	17.0
Haiti	12.8	26.1	27.6	28.8	27.1	32.6	37.8	37.4	38.0
Honduras	29.0	24.0	24.6	27.1	29.0	31.3	27.4	24.5	22.6
Mexico	21.6	16.2	17.9	20.5	21.5	22.3	23.1	21.9	21.5
Nicaragua	22.1	23.9	24.7	28.0	30.1	39.0	32.7	30.5	32.5
Panama	24.6	26.0	24.6	24.7	27.3	32.2	29.0	25.7	24.5
Paraguay	22.4	23.1	22.8	22.0	21.1	20.3	20.3	15.9	14.3
Peru	21.5	24.1	22.8	24.6	24.4	21.5	20.0	18.3	17.1
Dominican Republic	18.2	17.9	17.9	19.8	23.8	24.7	24.7	24.6	24.1
Uruguay	14.0	13.5	14.0	14.5	15.0	14.6	13.0	12.2	9.5
Venezuela	17.0	16.6	15.3	18.1	17.4	15.4	15.0	16.5	14.1

Source: ECLAC, based on official figures converted into dollars at constant 1995 prices.

[a] Preliminary figures.

Table A - 5

LATIN AMERICA AND THE CARIBBEAN: FINANCING OF GROSS DOMESTIC INVESTMENT [a]

(Percentages of GDP)

	1994	1995	1996	1997	1998	1999	2000	2001	2002[b]
1. Domestic saving	19.3	20.3	20.3	20.4	19.0	18.8	19.9	18.2	18.9
2. Net factor income	-2.3	-2.5	-2.3	-2.3	-2.4	-2.8	-2.5	-2.7	-3.1
3. Net transfers	0.8	0.9	0.8	0.8	0.8	1.1	1.0	1.2	1.5
4. Gross national saving (1+2+3)	17.8	18.8	18.8	18.8	17.4	17.1	18.4	16.8	17.4
5. External saving [c]	3.6	2.5	2.3	3.6	4.6	3.1	2.4	2.9	1.2
6. Gross domestic investment (4+5)	21.4	21.3	21.2	22.4	22.0	20.2	20.8	19.7	18.6

Source: ECLAC, on the basis of official figures.

[a] Based on coefficient for 20 countries, calculated in local currency and converted into dollars at current prices.

[b] Preliminary figures.

[c] These percentages differ from the figures (with opposite sign) for the current-account as a percentage of GDP given in table A-7. External saving is calculated on the basis of the countries' national accounts, using adjusted balance-of-payments information. It is also affected by the fact that external saving is the sum (with the opposite sign) of the current account and the capital account, as defined in the fifth editon of the International Monetary Fund's *Balance of Payments Manual.*

Table A - 6
LATIN AMERICA AND THE CARIBBEAN: BALANCE OF PAYMENTS
(Millions of dollars)

	Exports of goods (FOB)			Imports of goods (FOB)			Balance on goods			Balance on services		
	2000	2001	2002[d]	2000	2001	2002[d]	2000	2001	2002[d]	2000	2001	2002[d]
Latin America and the Caribbean	**358 330**	**343 467**	**346 353**	**-353 893**	**-345 077**	**-322 058**	**4 437**	**-1 611**	**24 295**	**-16 920**	**-19 300**	**-14 024**
Argentina	26 410	26 655	25 709	-23 852	-19 148	-8 470	2 558	7 507	17 239	-4 288	-4 021	-1 607
Bolivia	1 246	1 285	1 310	-1 610	-1 477	-1 532	- 364	- 193	- 222	- 245	- 267	- 281
Brazil	55 086	58 223	60 362	-55 783	-55 572	-47 219	- 697	2 651	13 143	-7 162	-7 759	-5 038
Chile	19 210	18 466	18 340	-17 091	-16 411	-15 827	2 119	2 054	2 513	- 648	- 918	- 957
Colombia	13 620	12 787	12 304	-11 090	-12 267	-12 076	2 531	520	228	-1 273	-1 419	-1 453
Costa Rica	5 813	4 923	5 277	-6 025	-5 744	-6 825	- 211	- 821	-1 547	665	729	709
Ecuador	5 057	4 781	5 192	-3 657	-5 179	-6 196	1 399	- 397	-1 004	- 420	- 523	- 566
El Salvador	2 963	2 891	3 017	-4 703	-4 796	-4 922	-1 740	-1 905	-1 906	- 235	- 303	- 194
Guatemala	3 082	2 864	2 629	-4 742	-5 142	-5 578	-1 660	-2 278	-2 950	- 48	133	125
Haiti	328	305	274	-1 087	-1 055	-980	- 758	- 750	- 706	- 90	- 106	- 105
Honduras	2 012	1 943	1 930	-2 670	-2 807	-2 804	- 658	- 865	- 874	- 182	- 210	- 160
Mexico	166 455	158 443	160 682	-174 458	-168 396	-168 679	-8 003	-9 954	-7 997	-2 323	-3 558	-4 048
Nicaragua	728	699	702	-1 648	-1 620	-1 636	- 920	- 921	- 935	- 115	- 120	- 126
Panama	5 839	5 996	5 284	-6 981	-6 672	-6 460	-1 143	- 675	-1 176	864	868	1 027
Paraguay	2 329	1 952	2 319	-2 866	-2 507	-2 391	- 537	- 555	- 71	175	157	215
Peru	7 034	7 108	7 688	-7 351	-7 198	-7 426	- 317	- 90	261	- 793	- 800	- 821
Dominican Republic	5 737	5 276	5 183	-9 479	-8 779	-8 883	-3 742	-3 503	-3 699	1 854	1 826	1 771
Uruguay	2 384	2 144	1 931	-3 311	-2 915	-1 873	- 927	- 771	59	394	324	136
Venezuela	32 998	26 726	26 219	-15 491	-17 391	-12 280	17 507	9 335	13 939	-3 051	-3 334	-2 652

Table A - 6 (continued)

	Trade balance			Income balance			Current transfers			Current account		
	2000	2001	2002[d]	2000	2001	2002[d]	2000	2001	2002[d]	2000	2001	2002[d]
Latin America and the Caribbean	**-12 483**	**-20 911**	**10 271**	**-53 228**	**-54 487**	**-50 664**	**20 367**	**24 174**	**26 949**	**-45 344**	**-51 223**	**-13 445**
Argentina	-1 730	3 486	15 633	-7 370	-8 095	-6 457	235	180	414	-8 864	-4 429	9 590
Bolivia	- 609	- 459	- 503	- 225	- 211	- 202	387	396	369	- 447	- 274	- 335
Brazil	-7 859	-5 108	8 105	-17 887	-19 743	-18 190	1 521	1 638	2 390	-24 225	-23 213	-7 695
Chile	1 471	1 136	1 556	-2 795	-2 757	-2 536	558	428	426	- 766	-1 192	- 553
Colombia	1 258	- 900	-1 226	-2 286	-2 607	-2 729	1 669	2 292	2 377	641	-1 215	-1 579
Costa Rica	453	- 92	- 839	-1 252	- 793	- 253	92	148	155	- 707	- 737	- 937
Ecuador	979	- 920	-1 570	-1 411	-1 269	-1 262	1 352	1 639	1 654	921	- 550	-1 178
El Salvador	-1 975	-2 208	-2 099	- 253	- 266	- 287	1 797	2 284	2 003	- 431	- 190	- 384
Guatemala	-1 708	-2 145	-2 825	- 209	- 90	- 291	868	997	1 942	-1 049	-1 238	-1 173
Haiti	- 848	- 856	- 811	- 9	- 9	- 14	772	769	776	- 86	- 97	- 49
Honduras	- 840	-1 075	-1 034	- 153	- 148	- 166	747	929	957	- 246	- 293	- 243
Mexico	-10 326	-13 511	-12 045	-14 827	-13 829	-12 282	6 994	9 338	10 268	-18 160	-18 002	-14 058
Nicaragua	-1 035	-1 041	-1 061	- 202	- 240	- 203	320	336	377	- 917	- 946	- 888
Panama	- 279	193	- 149	- 614	- 545	- 217	177	198	213	- 715	- 154	- 154
Paraguay	- 362	- 398	144	22	- 13	34	177	167	116	- 163	- 245	294
Peru	-1 109	- 890	- 560	-1 452	-1 203	-1 474	993	999	906	-1 568	-1 094	-1 128
Dominican Republic	-1 888	-1 677	-1 928	-1 041	-1 092	-1 135	1 902	2 028	2 188	-1 027	- 741	- 875
Uruguay	- 533	- 447	195	- 61	- 125	- 77	28	27	71	- 567	- 545	188
Venezuela	14 456	6 001	11 287	-1 204	-1 453	-2 923	- 222	- 617	- 653	13 030	3 931	7 711

Table A - 6 (concluded)

	Capital and financial accounts [a]			Overall balance			Reserve assets [b] (variation)			Other financing [c]		
	2000	2001	2002[d]	2000	2001	2002[d]	2000	2001	2002[d]	2000	2001	2002[d]
Latin America and the Caribbean	**60 044**	**32 851**	**-14 201**	**14 699**	**-18 373**	**-27 646**	**-6 988**	**1 180**	**3 167**	**-7 712**	**17 192**	**24 479**
Argentina	7 647	-17 030	-25 208	-1 218	-21 459	-15 618	440	12 084	4 516	778	9 376	11 102
Bolivia	408	237	43	-39	-37	-293	39	34	303	-	4	-10
Brazil	32 285	19 763	-3 483	8 060	-3 450	-11 178	2 262	-3 307	-302	-10 322	6 757	11 480
Chile	1 103	596	752	337	-596	199	-337	596	-199	-	-	-
Colombia	229	2 432	1 717	870	1 217	138	-870	-1 217	-138	-	-	-
Costa Rica	555	750	1 102	-152	13	165	152	-13	-165	-	-	-
Ecuador	-6 628	320	1 050	-5 707	-230	-127	-307	106	66	6 014	124	62
El Salvador	385	12	260	-46	-178	-124	46	178	124	-	-	-
Guatemala	1 692	1 712	1 194	643	474	22	-643	-474	-22	-	-	-
Haiti	40	94	-32	-46	-2	-81	57	-5	49	-11	7	32
Honduras	192	293	307	-54		64	-119	-147	-214	173	148	151
Mexico	25 269	25 327	21 148	7 110	7 325	7 090	-2 824	-7 325	-7 090	-4 286	-	-
Nicaragua	717	679	678	-199	-266	-210	16	114	-71	183	153	281
Panama	388	-150	557	-328	-304	403	109	-479	-130	219	783	-273
Paraguay	-181	195	-390	-344	-50	-96	215	45	82	129	5	14
Peru	1 437	1 511	1 909	-131	417	781	190	-448	-832	-58	31	51
Dominican Republic	978	1 256	322	-48	515	-553	70	-519	526	-22	4	27
Uruguay	733	847	-4 077	167	302	-3 889	-167	-302	2 322	-	-	1 566
Venezuela	-7 205	-5 994	-12 050	5 825	-2 063	-4 339	-5 316	2 261	4 342	-508	-198	-3

Source: ECLAC, on the basis of figures provided by the International Monetary Fund and national agencies.
[a] Includes errors and omissions.
[b] A minus sign (-) indicates an increase in reserve assets.
[c] Includes the use of IMF credit and loans and exceptional financing.
[d] Preliminary figures.

Table A - 7
LATIN AMERICA AND THE CARIBBEAN: CURRENT ACCOUNT OF THE BALANCE OF PAYMENTS [a]
(Percentages of GDP in current dollars)

	1994	1995	1996	1997	1998	1999	2000	2001	2002[b]
Latin America and the Caribbean	**-3.3**	**-2.3**	**-2.2**	**-3.3**	**-4.4**	**-3.1**	**-2.3**	**-2.7**	**-0.8**
Argentina	-4.3	-2.0	-2.5	-4.2	-4.9	-4.2	-3.1	-1.6	9.4
Bolivia	-1.5	-4.5	-5.5	-7.0	-7.8	-5.9	-5.3	-3.4	-4.3
Brazil	-0.2	-2.6	-3.0	-3.8	-4.2	-4.7	-4.0	-4.6	-1.7
Chile	-3.1	-2.1	-4.1	-4.4	-4.9	0.1	-1.0	-1.8	-0.9
Colombia	-4.6	-5.0	-4.9	-5.5	-5.3	0.8	0.8	-1.5	-2.0
Costa Rica	-2.3	-3.1	-2.2	-3.7	-3.7	-4.3	-4.4	-4.5	-5.5
Ecuador	-4.9	-4.9	0.0	-1.8	-8.6	5.3	5.8	-2.6	-4.8
El Salvador	-0.2	-2.8	-1.6	-0.9	-0.8	-1.9	-3.3	-1.4	-2.7
Guatemala	-4.8	-3.9	-2.9	-3.6	-5.4	-5.6	-5.4	-5.9	-5.0
Haiti	-1.1	-3.2	-4.6	-1.5	-1.0	-1.4	-2.3	-2.8	-1.6
Honduras	-10.0	-5.1	-8.2	-3.6	-2.4	-4.4	-4.1	-4.6	-3.7
Mexico	-7.0	-0.5	-0.8	-1.9	-3.8	-2.9	-3.1	-2.9	-2.2
Nicaragua	-51.2	-42.8	-45.9	-47.1	-39.6	-49.3	-37.7	-37.0	-35.2
Panama	0.2	-6.0	-2.5	-5.9	-12.7	-13.7	-7.1	-1.5	-1.5
Paraguay	-3.5	-1.0	-3.7	-6.8	-1.9	-2.1	-2.1	-3.6	5.5
Peru	-6.1	-8.6	-6.6	-5.8	-5.9	-2.9	-2.9	-2.1	-2.0
Dominican Republic	-2.7	-1.5	-1.6	-1.1	-2.1	-2.5	-5.2	-3.5	-4.1
Uruguay	-2.5	-1.1	-1.1	-1.3	-2.1	-2.4	-2.8	-2.9	1.5
Venezuela	4.3	2.6	12.6	3.9	-3.4	3.4	10.7	3.1	8.2

Source: ECLAC, on the basis of figures provided by the International Monetary Fund and national agencies.
[a] These percentages differ from the figures (with opposite sign) for external saving given in table A - 5. The current account was calculated on the basis of balance-of-payments information issued by official sources. Cuba is not included.
[b] Preliminary figures.

Table A - 8

LATIN AMERICA AND THE CARIBBEAN: EXPORTS AND IMPORTS OF GOODS, FOB [a]

(Annual rates of variation)

	Exports			Imports		
	Value	Volume	Unit value	Value	Volume	Unit value
1994	16.1	9.0	6.5	18.6	16.7	1.6
1995	21.8	12.4	8.4	12.4	5.0	7.1
1996	12.1	11.7	0.4	11.4	11.9	-0.4
1997	11.3	12.3	-0.9	18.4	21.9	-2.9
1998	-1.1	8.3	-8.7	6.1	9.8	-3.4
1999	5.6	6.8	-1.1	-3.7	-2.3	-1.5
2000	19.8	10.8	8.2	16.1	13.8	2.1
2001	-4.1	2.0	-6.0	-2.5	0.8	-3.2
2002 [b]	0.8	1.2	-0.3	-6.7	-7.3	0.7

Source: ECLAC, on the basis of official figures and the International Monetary Fund.

[a] Includes 17 Spanish-speaking countries, plus Brazil and Haiti.

[b] Preliminary figures.

Table A - 9

LATIN AMERICA AND THE CARIBBEAN: INDICES OF GOODS EXPORTS, FOB

(Indices: 1997 = 100)

	Value			Volume			Unit value		
	2000	2001	2002[a]	2000	2001	2002[a]	2000	2001	2002[a]
Latin America and the Caribbean	**125.1**	**119.9**	**120.9**	**128.2**	**130.7**	**132.3**	**97.6**	**91.7**	**91.4**
Argentina	99.9	100.8	97.3	109.2	114.2	113.6	91.5	88.3	85.7
Bolivia	106.8	110.1	112.3	117.4	126.9	132.1	91.0	86.8	85.0
Brazil	103.6	109.5	113.5	122.9	134.0	146.2	84.3	81.7	77.6
Chile	107.3	103.1	102.4	121.2	130.3	132.0	88.5	79.2	77.6
Colombia	112.9	106.0	102.0	110.6	113.5	112.4	102.1	93.4	90.7
Costa Rica	137.7	116.6	125.0	154.0	137.5	151.2	89.4	84.8	82.7
Ecuador	94.1	89.0	96.7	89.7	95.0	101.1	104.9	93.7	95.6
El Salvador	121.6	118.6	123.8	131.8	136.7	143.8	92.3	86.8	86.1
Guatemala	118.4	110.0	101.0	130.9	129.4	119.4	90.5	85.0	84.6
Haiti	159.8	148.5	133.6	158.7	151.8	136.6	100.7	97.8	97.8
Honduras	108.9	105.2	104.5	123.0	126.1	129.2	88.5	83.4	80.9
Mexico	150.7	143.5	145.5	149.0	147.0	146.1	101.2	97.6	99.6
Nicaragua	114.2	109.7	110.1	124.3	134.5	137.1	91.8	81.6	80.3
Panama	87.5	89.9	79.2	86.9	92.0	81.0	100.8	97.8	97.8
Paraguay	70.0	58.6	69.7	77.0	66.8	79.4	90.9	87.8	87.8
Peru	103.0	104.0	112.5	135.3	148.4	154.7	76.1	70.1	72.8
Dominican Republic	124.3	114.4	112.3	132.1	124.0	121.8	94.1	92.2	92.2
Uruguay	85.3	76.7	69.1	99.7	92.5	84.1	85.6	83.0	82.2
Venezuela	139.2	112.8	110.6	101.1	100.6	93.1	137.7	112.1	118.8

Source: ECLAC, on the basis of figures from the International Monetary Fund and national agencies.

[a] Preliminary figures.

Table A - 10

LATIN AMERICA AND THE CARIBBEAN: INDICES OF GOODS IMPORTS, FOB

(Indices: 1997 = 100)

	Value			Volume			Unit value		
	2000	2001	2002[a]	2000	2001	2002[a]	2000	2001	2002[a]
Latin America and the Caribbean	**118.6**	**115.6**	**107.9**	**122.1**	**123.0**	**114.0**	**97.2**	**94.0**	**94.6**
Argentina	83.5	67.1	29.7	91.2	75.4	34.0	91.6	88.9	87.1
Bolivia	97.9	89.9	93.2	104.3	99.0	104.3	93.9	90.8	89.4
Brazil	93.2	92.9	78.9	96.9	99.4	86.1	96.2	93.5	91.6
Chile	88.6	85.0	82.0	88.7	88.6	87.2	99.9	96.0	94.0
Colombia	75.4	83.4	82.1	82.0	93.5	93.0	92.0	89.2	88.4
Costa Rica	127.7	121.8	144.6	135.9	134.7	161.7	94.0	90.4	89.5
Ecuador	75.4	106.8	127.8	79.5	116.3	140.0	94.9	91.8	91.3
El Salvador	131.4	134.0	137.5	125.1	131.5	134.9	105.0	101.9	101.9
Guatemala	133.9	145.1	157.5	132.1	149.3	161.2	101.3	97.2	97.7
Haiti	194.2	188.5	175.2	179.2	181.2	166.7	108.4	104.0	105.1
Honduras	130.9	137.7	137.6	133.1	145.4	145.2	98.4	94.7	94.7
Mexico	158.9	153.4	153.6	162.1	162.1	160.0	98.0	94.6	96.0
Nicaragua	120.2	118.2	119.4	120.8	122.5	123.7	99.6	96.5	96.5
Panama	94.9	90.7	87.8	90.9	90.0	86.3	104.4	100.8	101.8
Paraguay	68.4	59.8	57.0	63.4	57.4	54.7	107.8	104.2	104.3
Peru	85.9	84.1	86.8	88.4	90.1	92.3	97.2	93.3	94.1
Dominican Republic	143.4	132.8	134.4	152.4	146.2	147.1	94.1	90.9	91.4
Uruguay	94.7	83.3	53.5	98.9	90.7	58.6	95.7	91.9	91.4
Venezuela	113.3	127.1	89.8	116.8	134.9	95.7	97.0	94.3	93.8

Source: ECLAC, on the basis of figures from the International Monetary Fund and national agencies.
[a] Preliminary figures.

Table A - 11

LATIN AMERICA AND THE CARIBBEAN: TERMS OF TRADE FOR GOODS, FOB/FOB

(Indices: 1997 = 100)

	1994	1995	1996	1997	1998	1999	2000	2001	2002[a]
Latin America and the Caribbean	**96.1**	**97.2**	**98.0**	**100.0**	**94.5**	**94.8**	**100.5**	**97.6**	**96.6**
Oil-exporting countries [b]	97.7	94.7	99.9	100.0	92.8	96.8	106.8	103.7	103.5
Non-oil-exporting countries	94.4	101.3	95.4	100.0	97.0	90.7	88.4	86.8	85.1
Argentina	97.0	91.8	99.6	100.0	95.4	90.4	99.9	99.4	98.3
Bolivia	88.7	86.5	96.6	100.0	95.1	95.0	96.9	95.6	95.1
Brazil	88.2	96.4	94.5	100.0	100.0	90.2	87.6	87.4	84.7
Chile	101.3	120.4	97.2	100.0	88.2	88.6	88.6	82.5	82.5
Colombia	100.4	95.8	99.4	100.0	91.7	98.3	111.0	104.6	102.7
Costa Rica	93.3	99.4	94.3	100.0	103.2	102.2	95.2	93.9	92.5
Ecuador	97.3	89.3	97.9	100.0	89.0	94.9	110.6	102.0	104.7
El Salvador	86.1	106.2	99.5	100.0	97.5	92.3	87.9	85.2	84.5
Guatemala	94.8	105.4	92.5	100.0	99.4	91.9	89.3	87.5	86.6
Haiti	102.1	105.5	95.6	100.0	102.0	100.5	93.0	94.0	93.1
Honduras	79.8	86.7	80.4	100.0	102.3	95.5	90.0	88.1	85.4
Mexico	99.3	96.1	98.8	100.0	96.5	98.4	103.2	103.2	103.7
Nicaragua	113.8	119.3	105.0	100.0	104.2	96.7	92.2	84.5	83.2
Panama	106.5	96.7	98.0	100.0	99.9	102.4	96.5	97.0	96.0
Paraguay	105.2	100.1	100.1	100.0	92.5	87.8	84.3	84.2	84.2
Peru	92.7	96.9	93.5	100.0	86.9	80.7	78.3	75.1	77.3
Dominican Republic	93.7	98.0	95.8	100.0	101.1	101.9	100.0	101.5	100.9
Uruguay	98.2	103.8	100.4	100.0	107.0	98.5	89.5	90.4	89.9
Venezuela	90.2	90.2	104.3	100.0	72.1	96.6	142.0	118.9	126.7

Source: ECLAC, on the basis of figures from the International Monetary Fund and national agencies.
[a] Preliminary figures.
[b] Net oil exporters: Argentina, Colombia, Ecuador, Mexico and Venezuela.

Table A - 12
LATIN AMERICA AND THE CARIBBEAN: NET RESOURCE TRANSFERS [a]
(Millions of dollars)

	1994	1995	1996	1997	1998	1999	2000	2001	2002[b]
Latin America and the Caribbean	**10 999**	**20 322**	**21 844**	**32 430**	**27 874**	**-3 991**	**- 896**	**-4 444**	**-40 386**
Argentina	8 147	467	5 252	9 412	10 651	5 755	1 055	-15 749	-20 563
Bolivia	- 66	243	506	447	638	324	183	30	- 169
Brazil	- 723	19 951	19 397	5 863	7 257	-1 335	4 076	6 777	-10 193
Chile	2 005	- 624	1 748	4 374	- 164	-3 070	-1 692	-2 161	-1 784
Colombia	2 396	2 991	4 417	3 805	2 069	-2 341	-2 057	- 175	-1 013
Costa Rica	50	312	2	448	- 97	- 660	- 698	- 43	848
Ecuador	554	- 108	- 780	- 349	371	-2 676	-2 024	- 825	- 150
El Salvador	37	343	244	297	231	165	132	- 253	- 27
Guatemala	543	256	421	653	1 118	696	1 482	1 622	904
Haiti	- 1	232	79	85	56	80	19	92	- 14
Honduras	203	65	92	254	150	551	212	293	291
Mexico	- 994	-1 464	-9 659	5 387	4 945	1 661	6 157	11 498	8 866
Nicaragua	524	402	610	836	604	1 051	699	592	756
Panama	- 133	82	249	718	572	749	- 7	88	67
Paraguay	727	262	423	478	189	300	- 30	187	- 342
Peru	3 808	3 028	3 553	3 082	1 003	- 650	- 73	340	486
Dominican Republic	- 784	- 455	- 527	- 593	- 453	- 352	- 85	168	- 786
Uruguay	294	203	185	486	793	254	673	722	-2 588
Venezuela	-5 590	-5 864	-4 368	-3 251	-2 057	-4 495	-8 918	-7 645	-14 976

Source: ECLAC, on the basis of figures provided by the International Monetary Fund and national agencies.
[a] The net transfer of resources is equal to total net capital inflows minus the income balance (net payments of profits and interests). Total net capital inflows correspond to the capital and financial accounts, plus errors and omissions, and the use of IMF credit and loans and exceptional financing. Negative figures indicate net outward resources transfers.
[b] Preliminary figures.

Table A - 13

LATIN AMERICA AND THE CARIBBEAN: TOTAL NET CAPITAL INFLOWS AND NET RESOURCE TRANSFERS

(Billions of dollars and percentages)

	Total net capital inflows			Net payments of profits and interests [a]	Net resources transfers	Exports of goods and services	Net resource transfers as a percentage of exports of goods and services
	Autonomous [b]	Non-autonomous [c]	Total		(5) = (3) - (4)		(7) = (5) / (6)
	(1)	(2)	(3)	(4)	(5)	(6)	(7)
1980	29.2	1.7	30.9	18.9	12.0	106.9	11.3
1981	38.4	1.8	40.1	29.1	11.1	115.6	9.6
1982	3.3	17.2	20.5	38.9	-18.4	105.2	-17.5
1983	-22.1	30.1	8.0	34.5	-26.5	105.4	-25.1
1984	-10.6	23.9	13.3	37.5	-24.2	117.5	-20.6
1985	-16.0	20.3	4.3	35.5	-31.2	112.8	-27.7
1986	-12.1	21.9	9.7	32.7	-22.9	99.2	-23.1
1987	-12.8	25.6	12.8	31.0	-18.2	113.4	-16.0
1988	-19.5	22.8	3.3	34.6	-31.3	130.6	-24.0
1989	-18.6	29.0	10.5	39.0	-28.5	145.8	-19.6
1990	-5.0	21.5	16.6	34.2	-17.6	162.0	-10.9
1991	24.4	11.2	35.5	31.4	4.1	164.3	2.5
1992	48.9	7.7	56.6	30.1	26.5	177.0	15.0
1993	68.5	-2.0	66.5	34.9	31.6	193.6	16.3
1994	41.7	5.5	47.1	36.1	11.0	222.6	4.9
1995	29.8	31.3	61.1	40.8	20.3	265.8	7.6
1996	67.7	-2.6	65.0	43.2	21.8	294.7	7.4
1997	83.6	-2.9	80.7	48.3	32.4	327.0	9.9
1998	68.9	8.9	77.8	49.9	27.9	326.9	8.5
1999	47.8	-0.3	47.5	51.5	-4.0	342.4	-1.2
2000	60.0	-7.7	52.3	53.2	-0.9	407.6	-0.2
2001	32.9	17.2	50.0	54.5	-4.4	391.1	-1.1
2002 [d]	-14.2	24.5	10.3	50.7	-40.4	392.5	-10.3

Source: ECLAC, on the basis of data provided by the International Monetary Fund and official institutions.

[a] Equal to the income balance.

[b] Equal to the capital and financial accounts, plus errors and omissions.

[c] Includes the use of IMF credit and loans and exceptional financing (includes transactions such as external debt forgiveness and accumulation of arrears).

[d] Preliminary figures.

Table A - 14
LATIN AMERICA AND THE CARIBBEAN: RATIO OF TOTAL ACCRUED INTEREST TO EXPORTS OF GOODS AND SERVICES [a]
(Percentages)

	1994	1995	1996	1997	1998	1999	2000	2001	2002[b]
Latin America and the Caribbean	**16.9**	**17.2**	**16.2**	**15.7**	**16.6**	**16.5**	**14.5**	**14.6**	**12.8**
Argentina	26.5	27.8	27.8	29.0	34.6	40.8	39.7	39.2	34.8
Bolivia	14.0	15.1	11.9	14.8	15.1	15.7	14.3	10.4	7.6
Brazil	17.9	21.9	25.3	26.0	28.1	31.6	26.5	26.4	21.9
Chile	8.2	7.3	7.2	7.3	8.2	7.7	7.8	7.7	6.1
Colombia	15.8	15.6	16.2	18.7	19.8	18.0	16.9	17.2	17.7
Costa Rica	6.4	5.7	4.8	4.6	3.6	3.2	4.1	5.1	4.9
Ecuador	18.6	16.8	16.1	15.8	21.1	21.5	20.2	17.2	15.9
El Salvador	6.3	5.9	6.1	8.2	8.0	8.7	8.6	9.4	9.4
Guatemala	5.9	3.9	5.0	4.6	4.2	3.7	4.7	3.4	4.0
Haiti	16.7	14.0	5.4	3.6	2.4	2.4	1.8	2.1	3.2
Honduras	15.5	13.3	11.3	8.8	7.9	8.6	7.5	6.3	5.7
Mexico	16.6	15.2	13.1	10.9	10.1	9.4	8.3	8.0	7.4
Nicaragua	99.7	57.3	45.0	28.3	18.4	19.7	17.1	19.1	15.6
Panama	15.4	22.5	17.0	15.7	19.0	20.7	20.2	17.4	12.3
Paraguay	2.5	2.1	2.1	2.4	2.0	3.1	5.3	6.1	4.8
Peru	34.6	33.1	25.2	19.3	23.6	22.8	21.0	18.5	14.7
Dominican Republic	4.0	4.0	3.3	2.5	2.3	2.2	2.3	2.6	2.3
Uruguay	14.9	16.5	15.9	16.6	18.0	20.9	20.6	23.7	25.8
Venezuela	17.0	16.1	11.2	13.8	15.4	13.1	8.9	10.0	8.8

Source: ECLAC, on the basis of official figures.
[a] Includes interest paid (without deducting the interest received) and interest due and not paid.
[b] Preliminary figures.

Table A - 15
LATIN AMERICA AND THE CARIBBEAN: RATIO OF PROFIT PAYMENTS TO EXPORTS OF GOODS AND SERVICES [a]
(Percentages)

	1994	1995	1996	1997	1998	1999	2000	2001	2002[b]
Latin America and the Caribbean	**4.4**	**5.4**	**5.7**	**5.0**	**5.3**	**6.0**	**6.0**	**5.1**	**5.2**
Argentina	10.4	8.6	7.4	8.9	8.9	8.0	8.1	5.4	-1.2
Bolivia	2.3	3.1	5.4	5.7	6.0	10.9	10.1	11.0	11.7
Brazil	4.7	5.3	7.6	10.3	10.2	9.3	6.6	7.4	8.5
Chile	12.9	11.3	10.2	10.1	6.9	7.0	10.6	10.0	9.7
Colombia	4.6	2.9	4.9	4.0	-0.2	-1.8	4.3	6.2	6.4
Costa Rica	2.0	2.4	1.8	3.4	5.6	21.0	14.7	8.7	0.2
Ecuador	3.1	2.8	3.4	3.2	4.6	4.7	4.7	5.8	4.9
El Salvador	1.6	0.0	0.0	0.0	1.0	3.5	1.6	2.0	1.1
Guatemala	2.6	3.4	4.6	5.1	3.7	4.3	5.8	6.8	8.0
Haiti	0.0	2.0	-0.2	0.0	0.0	0.0	0.0	0.0	0.0
Honduras	2.2	2.4	3.5	2.7	2.9	1.9	2.8	3.1	3.5
Mexico	5.3	3.2	3.9	3.4	4.1	2.4	3.3	3.1	2.0
Nicaragua	3.6	4.7	7.0	6.7	7.0	7.4	7.3	8.3	7.6
Panama	3.7	5.2	5.5	6.1	8.7	11.1	7.9	6.8	2.7
Paraguay	1.0	1.3	1.8	3.8	4.3	3.6	2.9	3.6	-0.1
Peru	6.6	12.8	9.3	11.1	2.9	0.5	4.4	2.9	5.0
Dominican Republic	10.6	10.8	10.7	10.9	9.8	10.1	11.1	12.1	11.9
Uruguay	0.0	1.7	1.3	1.5	0.9	0.9	1.4	3.8	2.4
Venezuela	3.3	3.6	2.9	2.1	1.7	4.1	6.7	3.5	3.0

Source: ECLAC, on the basis of figures provided by the International Monetary Fund and national sources.
[a] Includes reinvested profits.
[b] Preliminary figures.

Table A - 16

LATIN AMERICA AND THE CARIBBEAN: NET FOREIGN DIRECT INVESTMENT [a] [b]

(Millions of dollars)

	1994	1995	1996	1997	1998	1999	2000	2001	2002[c]
Latin America and the Caribbean	**24 383**	**25 789**	**40 279**	**56 969**	**60 576**	**79 577**	**67 792**	**68 654**	**38 986**
Argentina [d]	2 622	4 112	5 349	5 508	4 966	22 630	10 654	3 304	1 741
Bolivia	130	393	474	731	952	983	723	660	654
Brazil	2 035	3 475	11 667	18 608	26 002	26 888	30 497	24 715	14 084
Chile	1 672	2 205	3 681	3 809	3 144	6 203	- 348	3 045	1 139
Colombia	1 298	712	2 784	4 753	2 033	1 336	1 911	2 505	1 251
Costa Rica	293	331	421	404	608	614	400	445	585
Ecuador	576	452	500	724	870	648	720	1,330	1,275
El Salvador [e]	0	38	-7	59	1,103	162	178	260	234
Guatemala	65	75	77	84	673	155	230	456	110
Haiti	0	7	4	4	11	30	13	4	6
Honduras	35	50	91	128	99	237	282	195	143
Mexico [f]	10 973	9 526	9 185	12 830	11 602	12 476	15 318	25 221	13 627
Nicaragua	40	75	97	173	184	300	265	150	174
Panama	402	223	416	1,299	1,296	652	603	513	57
Paraguay	137	98	144	230	336	89	98	90	-20
Peru	3 289	2 550	3 487	2 056	1 580	1 811	662	1 063	2 390
Dominican Republic	207	414	97	421	700	1 338	953	1 079	961
Uruguay	155	157	137	113	155	235	274	319	100
Venezuela	455	894	1 676	5 036	4 262	2 789	4 358	3 300	475

Source: ECLAC, on the basis of figures provided by the International Monetary Fund and national agencies.

[a] Refers to direct investment in the reporting economy minus direct investment abroad by residents (without considering disinvestment in either case). Includes reinvested earnings.

[b] In accordance with the fifth edition of the *IMF Balance of Payments Manual*, all transactions between non-financial direct investment enterprises and their parent companies and affiliates are included in direct investment.

[c] Preliminary figures.

[d] For 1999, includes the value of the investment by REPSOL in Yacimientos Petrolíferos Fiscales. Part of this amount corresponds to the purchase of shares in the company held by non-residents. In the balance of payments, the value of those shares is reflected as a debit under the portfolio investment item.

[e] From 1998 onward the figures are not comparable, since up to 1997 no official records were kept.

[f] For 2001, includes the value of the investment by Citigroup in BANAMEX.

Table A - 17

LATIN AMERICA AND THE CARIBBEAN: INTERNATIONAL BOND ISSUES [a]

(Millions of dollars)

	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003 [b]
Latin America and the Caribbean	**17 931**	**23 071**	**46 915**	**52 003**	**39 511**	**38 707**	**35 615**	**33 579**	**18 215**	**20 631**
Argentina	5 319	6 354	14 070	14 662	15 615	14 183	13 025	1 501	-	-
Brazil	3 998	7 041	11 545	14 940	9 190	8 586	11 382	12 239	6 376	7 804
Chile	155	300	2 020	1 800	1 063	1 764	680	1 536	964	1 450
Colombia	955	1 083	1 867	1 000	1 389	1 676	1 547	4 263	1 729	400
Costa Rica	50	-	-	-	200	300	250	250	250	450
Ecuador	-	10	-	625	-	-	-	-	-	-
El Salvador	-	-	-	-	-	150	50	354	1 252	350
Grenada	-	-	-	-	-	-	-	-	100	-
Guatemala	-	-	-	150	-	-	-	325	-	-
Jamaica	55	-	-	225	250	-	421	691	300	-
Mexico	6 949	7 646	16 353	15 657	8 444	9 854	7 078	9 232	4 914	8 827
Paraguay [c]	-	-	-	-	-	400	-	-	-	-
Peru	100	-	-	250	150	-	-	-	1 930	750
Dominican Republic	-	-	-	200	-	-	-	500	-	600
Trinidad and Tobago	150	71	150	-	-	230	250	-	-	-
Uruguay	200	211	145	479	550	350	443	1 106	400	-
Venezuela	-	356	765	2 015	2 660	1 215	489	1 583	-	-

Source: International Monetary Fund, Research Department, Emerging Markets Studies Division.

[a] Gross issues. Includes medium-term euronotes.

[b] Figures as of June, based on information from Merrill Lynch.

[c] Official information.

Table A - 18

LATIN AMERICA AND THE CARIBBEAN: TOTAL GROSS EXTERNAL DEBT [a]

(Millions of dollars)

	1994	1995	1996	1997	1998	1999	2000	2001	2002 [b]
Latin America and the Caribbean	**570 823**	**626 501**	**648 479**	**675 451**	**766 823**	**763 881**	**740 554**	**726 988**	**726 598**
Argentina	85 656	98 547	110 613	125 052	141 929	145 289	146 575	140 273	134 340
Bolivia [c]	4 216	4 523	4 366	4 234	4 655	4 574	4 461	4 412	4 300
Brazil	153 572	165 447	186 561	208 375	259 496	241 468	236 156	226 067	227 689
Chile	21 768	21 736	22 979	26 701	31 691	34 112	36 477	38 032	40 395
Colombia	21 855	26 340	31 116	34 409	36 681	36 733	36 131	39 039	37 231
Costa Rica	4 133	4 209	3 289	3 086	3 402	3 641	3 748	3 951	4 175
Cuba [c]	9 083	10 504	10 465	10 146	11 209	11 078	10 961	10 893	10 900
Ecuador	14 589	13 934	14 586	15 099	16 400	16 282	13 564	14 411	16 236
El Salvador [c]	2 056	2 168	2 517	2 689	2 632	2 789	2 831	3 148	3 987
Guatemala	2 895	2 947	3 026	3 197	3 618	3 831	3 929	4 100	4 200
Guyana	2 004	2 058	1 537	1 514	1 500	1 196	1 250	1 250	1 200
Haiti [c]	875	901	914	1 025	1 104	1 162	1 170	1 189	1 212
Honduras	4 040	4 243	4 121	4 073	4 404	4 729	4 721	4 802	4 715
Jamaica	3 652	3 452	3 232	3 278	3 306	3 024	3 375	4 146	4 348
Mexico [d]	139 800	165 600	157 200	149 028	160 258	166 381	148 652	144 534	141 000
Nicaragua [c]	11 695	10 248	6 094	6 001	6 287	6 549	6 660	6 374	6 363
Panama [c]	5 505	5 891	5 070	5 051	5 349	5 568	5 604	6 263	6 349
Paraguay	1 271	1 741	1 801	1 927	2 133	2 697	2 819	2 653	2 700
Peru	30 191	33 378	33 805	28 642	29 477	28 704	28 150	27 508	27 999
Dominican Republic	3 946	3 999	3 807	3 572	3 537	3 636	3 682	4 177	4 459
Trinidad and Tobago	2 064	1 905	1 876	1 565	1 471	1 585	1 680	1 638	1 614
Uruguay [c]	4 959	5 193	5 387	5 459	6 036	5 618	6 116	5 855	8 328
Venezuela	40 998	37 537	34 117	31 328	30 248	33 235	31 840	32 274	32 859

Source: ECLAC, on the basis of official figures.

[a] Includes debt owed to the International Monetary Fund.

[b] Preliminary figures.

[c] External public debt.

[d] Public debt does not include investment by non-residents in government securities.

Table A - 19

LATIN AMERICA AND THE CARIBBEAN: RATIO OF TOTAL GROSS EXTERNAL DEBT TO EXPORTS OF GOODS AND SERVICES

(Percentages)

	1994	1995	1996	1997	1998	1999	2000	2001	2002[a]
Latin America and the Caribbean	**248.9**	**228.9**	**214.2**	**201.5**	**229.3**	**218.1**	**177.5**	**181.3**	**180.5**
Argentina	442.3	395.8	390.8	405.6	457.2	523.5	471.4	454.7	469.0
Bolivia [b]	356.9	366.6	332.6	299.5	343.4	349.0	303.4	290.1	278.3
Brazil	313.3	314.3	355.3	352.1	439.5	437.4	365.7	334.7	325.4
Chile	150.7	112.3	113.8	122.8	156.3	162.2	156.6	168.5	181.1
Colombia	205.6	214.3	236.5	242.0	273.1	262.8	230.7	260.8	263.1
Costa Rica	124.6	94.6	68.1	57.7	49.4	44.3	48.4	57.9	57.9
Cuba	...	346.0	275.8	255.3	271.3	257.0	228.8	236.0	255.1
Ecuador	317.1	268.2	259.4	249.3	328.2	310.4	229.7	253.1	263.0
El Salvador [b]	125.4	106.3	114.3	92.3	86.4	87.8	77.3	87.8	105.0
Guatemala	128.8	104.4	108.2	100.2	103.8	110.1	101.8	105.2	112.4
Guyana	343.1	327.1	...	...	...	...	...	...	...
Haiti [b]	1 306.3	468.5	477.2	270.3	230.4	219.5	233.7	267.4	287.8
Honduras	300.6	259.5	214.4	186.6	179.8	211.2	189.1	197.1	191.9
Jamaica	120.6	101.7	97.3	96.4	97.7	87.0	94.1	123.6	138.7
Mexico [c]	196.3	185.4	147.5	122.7	124.2	112.4	82.5	84.5	81.3
Nicaragua [b]	2 522.1	1 674.3	945.9	752.7	757.1	781.0	696.7	683.8	699.7
Panama [b]	73.9	77.4	68.4	60.2	65.3	78.5	71.7	78.2	83.8
Paraguay	33.6	36.3	41.0	48.4	51.1	93.4	96.4	106.2	94.5
Peru	533.4	496.8	462.4	341.6	391.5	372.5	326.8	320.0	303.6
Dominican Republic	75.3	69.8	61.5	50.6	47.3	45.5	41.1	49.8	54.1
Trinidad and Tobago	98.1	68.1	66.6	52.3	50.2	50.4	37.7	36.3	39.4
Uruguay [b]	152.7	148.1	140.0	129.4	145.5	158.1	167.1	178.7	313.3
Venezuela	231.9	180.9	135.0	124.4	158.9	150.2	93.0	115.2	120.7

Source: ECLAC, on the basis of figures provided by the International Monetary Fund and national agencies.

[a] Preliminary figures.

[b] External public debt.

[c] Public debt does not include investment by non-residents in government securities.

Table A - 20

LATIN AMERICA AND THE CARIBBEAN: STOCK EXCHANGE INDICES IN DOLLARS [a]

(Indices: June 1997 = 100)

	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003[b]
Latin America and the Caribbean	**76.2**	**62.5**	**72.5**	**90.6**	**56.0**	**88.0**	**75.1**	**70.5**	**54.5**	**66.5**
Argentina	63.6	69.1	82.1	96.3	68.9	91.9	68.9	47.7	24.0	39.4
Brazil	64.0	49.8	64.9	78.3	44.9	75.0	68.7	54.1	36.2	46.4
Chile	95.8	93.0	77.0	79.6	55.7	75.4	64.8	61.6	52.5	65.6
Colombia	103.5	77.1	80.5	99.9	56.4	45.1	24.8	31.1	34.1	38.7
Mexico	91.1	66.5	77.3	114.1	69.5	125.4	99.8	112.3	93.7	105.3
Peru	66.8	73.1	73.6	83.8	50.5	61.1	44.1	49.9	65.3	82.7
Venezuela	47.8	32.7	75.7	93.3	44.9	39.3	49.7	37.9	24.6	34.3

Source: ECLAC, on the basis of figures provided by the International Finance Corporation (IFC).

[a] Year-end values; overall index.

[b] Figures for June.

Table A - 21

LATIN AMERICA AND THE CARIBBEAN: INDICES OF THE REAL EFFECTIVE EXCHANGE RATE [ab]

(Indices: 2000 = 100)

	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003[c]
Latin America and the Caribbean [d]	**108.4**	**107.2**	**105.7**	**100.7**	**99.2**	**100.7**	**100.0**	**99.2**	**108.4**	**114.6**
Argentina	106.3	113.1	116.3	114.3	109.9	99.8	100.0	95.9	226.4	209.1
Barbados	101.0	104.3	103.3	99.2	101.8	101.5	100.0	98.8	101.8	105.4
Bolivia	109.0	110.7	105.9	103.7	100.0	99.1	100.0	101.3	99.6	106.2
Brazil	83.6	75.6	72.2	71.1	73.5	108.4	100.0	120.2	132.1	139.5
Chile	106.6	99.8	97.3	91.8	94.5	99.3	100.0	112.4	112.7	122.6
Colombia	90.8	87.5	82.6	77.5	83.1	91.8	100.0	104.3	106.0	120.3
Costa Rica	102.6	100.6	101.1	101.6	100.1	101.8	100.0	97.3	98.9	103.4
Ecuador	66.1	66.6	68.0	66.0	64.9	89.1	100.0	70.7	62.4	60.0
El Salvador	118.6	114.4	106.3	103.8	103.4	101.0	100.0	100.0	100.8	102.1
Guatemala	101.2	98.7	94.8	89.8	88.8	98.9	100.0	96.4	89.3	88.2
Honduras	135.8	124.5	127.3	119.8	109.8	104.7	100.0	97.1	97.6	99.2
Jamaica	149.7	139.6	118.7	103.3	98.9	98.6	100.0	101.6	101.8	117.1
Mexico	102.6	151.6	136.2	118.8	118.7	108.3	100.0	94.1	93.8	102.9
Nicaragua	88.8	95.8	98.0	102.0	102.6	102.9	100.0	101.5	105.5	108.7
Panama	98.7	103.7	104.0	104.0	103.0	101.3	100.0	102.8	103.2	105.8
Paraguay	100.6	101.2	98.7	95.1	102.8	97.6	100.0	102.7	111.1	119.0
Peru	93.3	92.5	91.3	91.3	93.0	101.7	100.0	98.0	97.4	99.1
Dominican Republic	107.3	102.5	99.4	98.8	103.6	104.2	100.0	96.2	98.5	113.8
Trinidad and Tobago	108.7	107.6	105.7	109.6	105.6	102.5	100.0	94.7	91.2	90.3
Uruguay	114.7	110.7	111.5	109.2	107.1	98.5	100.0	101.5	121.6	148.8
Venezuela	191.0	150.1	181.3	143.8	117.3	103.0	100.0	95.1	124.5	144.9

Source: ECLAC, on the basis of official figures and figures provided by the International Monetary Fund.

[a] The real effective exchange rate is a weighted average of the real bilateral exchange rates of a country with its main trading partners. The real bilateral exchange rate with any given trading partner is the nominal exchange rate of the country with respect to the partner, deflated by the ratio of the country's inflation index and that of the partner's. The weighted average is obtained by using the relative share of each partner in the country's trade. Each country's index has been calculated as a simple average of the export (fob)– and import (cif)–weighted indices of the real effective exchange rates. The structure of trade in 2001 was used to calculate the indices for 2002 and 2003.

[b] Annual averages.

[c] Average January-June.

[d] Simple average.

Table A - 22
LATIN AMERICA AND THE CARIBBEAN: URBAN UNEMPLOYMENT
(Average annual rates)

	1994	1995	1996	1997	1998	1999	2000	2001	2002[a]	First semester	
										2002 [b]	2003 [b]
Latin America and the Caribbean [c]	**6.6**	**7.5**	**7.9**	**7.5**	**8.1**	**8.8**	**8.4**	**8.3**	**8.9**	**11.2**	**10.9**
Argentina											
28 urban centres [d]	11.5	17.5	17.2	14.9	12.9	14.3	15.1	17.4	19.7	21.5	15.6
Barbados [e]											
Nationwide total	21.9	19.7	15.6	14.5	12.3	10.4	9.2	9.9	10.5	...	...
Bolivia											
Total urban areas [f]	3.1	3.6	3.8	4.4	6.1	7.2	7.5	8.5	8.7	...	...
Brazil											
Six metropolitan areas	5.1	4.6	5.4	5.7	7.6	7.6	7.1	6.2	7.1[g]	12.1	12.2
Chile											
Nationwide total	7.8	7.4	6.4	6.1	6.4	9.8	9.2	9.1	9.0	9.1	8.7
Colombia [e]											
13 cities [h]	8.9	8.8	11.2	12.4	15.3	19.4	17.2	18.2	17.6	18.5	17.6
Costa Rica											
Total urban areas	4.3	5.7	6.6	5.9	5.4	6.2	5.3	5.8	6.8	...	...
Cuba											
Nationwide total	6.7	7.9	7.6	7.0	6.6	6.0	5.5	4.1	3.3	...	...
Ecuador [e]											
Total urban areas [i]	7.8	7.7	10.4	9.3	11.5	15.1	14.1	10.4	8.6	8.8	10.1
El Salvador											
Total urban areas	7.0	7.0	7.5	7.5	7.6	6.9	6.5	7.0	6.2	...	...
Guatemala [j]											
Nationwide total	3.5	3.9	5.2	5.1	3.8	...	...	…	3.6	...	...
Honduras											
Total urban areas	4.0	5.6	6.5	5.8	5.2	5.3	...	5.9	6.1	...	...
Jamaica [e]											
Nationwide total	15.4	16.2	16.0	16.5	15.5	15.7	15.5	15.0	15.1	...	...
Mexico											
Urban areas [k]	3.7	6.2	5.5	3.7	3.2	2.5	2.2	2.5	2.7	2.7	2.9
Nicaragua [j]											
Nationwide total	17.1	16.9	16.0	14.3	13.2	10.7	9.8	11.3	11.6	...	...
Panama [e]											
Total urban areas [l]	16.0	16.6	16.4	15.4	15.5	13.2	15.2	17.0	16.1	...	...
Paraguay											
Total urban areas	4.4	5.3	8.2	7.1	6.6	9.4	10.0	10.8	14.7	...	...
Peru											
Lima metropolitan area	8.8	8.2	8.0	9.2	8.5	9.2	8.5	9.3	9.4	10.3	9.7
Dominican Republic [e]											
Nationwide total	16.0	15.8	16.5	15.9	14.3	13.8	13.9	15.4	16.1	...	...
Trinidad and Tobago [e]											
Nationwide total	18.4	17.2	16.2	15.0	14.2	13.2	12.2	10.8	10.4	...	...
Uruguay											
Total urban areas	9.2	10.3	11.9	11.5	10.1	11.3	13.6	15.3	17.0	15.2	18.4
Venezuela											
Nationwide total	8.7	10.3	11.8	11.4	11.3	14.9	13.9	13.3	15.8	15.5	19.4

Source: ECLAC, on the basis of official figures.
[a] Preliminary figures.
[b] Preliminary figures. For the first half of 2002, figures are given only for countries that have information available for the first half of 2003. The data for Brazil were derived using a new method of measurement that is not comparable to the previous one. Given Brazil's effect on the regional average, the annual and semi-annual figures for the region as a whole are not comparable to each other.
[c] Average weighted by the working-age population. Annual figures include estimates for countries that did not provide data.
[d] Up to May 1995, 25 urban centres.
[e] Includes hidden unemployment.
[f] Up to 1999, departmental capitals.
[g] Calculated using the old methodology, and therefore not comparable to the figure for the first half of 2002.
[h] Up to 1999, the seven metropolitan areas.
[i] From 1999 on, Cuenca, Guayaquil and Quito.
[j] Up to 2000, official estimates.
[k] Represents a large and growing number of urban areas.
[l] Up to 1999, the Metropolitan Region.

Table A - 23
LATIN AMERICA AND THE CARIBBEAN: CONSUMER PRICES
(Percentage variations, December-December)

	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003 [a]
Latin America and the Caribbean [b]	**324.3**	**25.4**	**18.2**	**10.5**	**9.8**	**9.4**	**8.7**	**6.0**	**12.1**	**11.0**
Argentina	3.9	1.6	0.1	0.3	0.7	- 1.8	- 0.7	- 1.5	41.0	10.2
Bolivia	8.5	12.6	7.9	6.7	4.4	3.1	3.4	0.9	2.4	3.2
Brazil	916.4	22.4	9.6	5.2	1.7	8.9	6.0	7.7	12.5	16.6
Chile	8.9	8.2	6.6	6.0	4.7	2.3	4.5	2.6	2.8	3.6
Colombia	22.6	19.5	21.6	17.7	16.7	9.2	8.8	7.6	7.0	7.2
Costa Rica	...	...	13.9	11.2	12.4	10.1	10.2	11.0	9.7	10.2
Cuba	...	...	...	1.9	2.9	-2.9	-3.0	-0.5	7.0	5.0
Ecuador	25.3	22.8	25.6	30.7	43.4	60.7	91.0	22.4	9.4	7.6
El Salvador	8.9	11.4	7.4	1.9	4.2	- 1.0	4.3	1.4	2.8	1.5
Guatemala	11.6	8.6	10.9	7.1	7.5	4.9	5.1	8.9	6.3	5.2
Haiti	32.2	24.8	14.5	15.7	7.4	9.7	19.0	8.1	14.8	44.5
Honduras	29.1	26.9	25.2	12.7	15.7	11.0	10.1	8.8	8.1	7.2
Mexico	7.1	52.0	27.7	15.7	18.6	12.3	9.0	4.4	5.7	2.9
Nicaragua	12.4	10.9	12.1	7.3	18.5	7.2	9.9	4.7	3.9	5.3
Panama	1.4	0.8	2.3	- 0.5	1.4	1.5	0.7	0.0	1.9	1.4
Paraguay	18.3	10.5	8.2	6.2	14.6	5.4	8.6	8.4	14.6	15.7
Peru	15.4	10.2	11.8	6.5	6.0	3.7	3.7	- 0.1	1.5	2.2
Dominican Republic	14.3	9.2	4.0	8.4	7.8	5.1	9.0	4.4	10.5	26.1
Uruguay	44.1	35.4	24.3	15.2	8.6	4.2	5.1	3.6	25.9	24.6
Venezuela	70.8	56.6	103.2	37.6	29.9	20.0	13.4	12.3	31.2	34.2

Source: ECLAC, on the basis of official figures.
[a] Variation from June 2002 to June 2003.
[b] Refers only to those countries for which information is provided.

Table A - 24
LATIN AMERICA AND THE CARIBBEAN: AVERAGE REAL WAGES
(Average annual indices: 1995 = 100)

	1994	1995	1996	1997	1998	1999	2000	2001	2002 [a]	First semester	
										2002[a]	2003[a]
Argentina [b]	101.1	100.0	99.9	99.3	99.0	100.1	101.6	101.0	87.0	87.8 [c]	75.5 [c]
Bolivia [d]	98.5	100.0	99.0	105.1	108.1	115.0	115.9	120.3	124.1	...	...
Brazil [e]	96.3	100.0	107.9	110.8	110.8	105.9	104.8	99.6	97.5	96.2 [c]	88.2 [c]
Chile [f]	96.1	100.0	104.1	106.6	109.5	112.1	113.7	115.5	117.9	118.5 [c]	118.7 [c]
Colombia [g]	99.0	100.0	101.6	104.4	103.0	109.0	113.2	113.5	118.1	115.5 [h]	115.8 [h]
Costa Rica [i]	102.0	100.0	97.9	98.7	104.3	109.2	110.1	111.2	115.7	...	...
Guatemala	89.3	100.0	109.7	112.7	116.8	123.5	128.2	128.9	127.7	...	...
Mexico [b]	114.9	100.0	90.1	89.1	91.5	92.4	98.0	104.5	106.1	102.7 [c]	103.3 [c]
Nicaragua [i]	98.2	100.0	97.9	97.7	104.9	109.6	111.3	116.1	121.1	109.6 [h]	112.4 [h]
Paraguay	93.0	100.0	103.1	102.6	100.7	98.6	99.9	101.3	94.8	...	...
Peru [j]	109.2	100.0	95.2	94.5	92.7	90.7	91.4	90.6	94.9	...	...
Uruguay	102.9	100.0	100.6	100.8	102.7	104.3	102.9	102.7	91.7	99.6 [c]	80.7 [c]
Venezuela [k]	104.8	100.0	76.7	96.3	101.5	96.8	98.3	100.7	90.6	96.5 [h]	82.0 [h]

Source: ECLAC, on the basis of official figures.
[a] Preliminary figures.
[b] Manufacturing.
[c] Average January-May.
[d] Private sector in La Paz.
[e] Workers covered by social and labour legislation.
[f] General index of hourly wages.
[g] Manual workers in manufacturing.
[h] Average January-March.
[i] Average wages declared by workers covered by social security.
[j] Private-sector manual workers in the Lima metropolitan area.
[k] Private sector.

Table A - 25

LATIN AMERICA AND THE CARIBBEAN: PUBLIC-SECTOR DEFICIT (-) OR SURPLUS [a]

(Percentages of GDP)

	Coverage [b]	1994	1995	1996	1997	1998	1999	2000	2001	2002 [c]
Latin America and the Caribbean [d]		**-1.5**	**-0.6**	**-0.5**	**-0.5**	**-1.8**	**-2.0**	**-1.6**	**-2.5**	**-2.0**
Argentina [e]	NNFPS	-0.1	-0.5	-1.9	-1.5	-1.4	-1.7	-2.4	-3.2	-1.5
Bolivia	NFPS	-3.0	-1.8	-1.9	-3.3	-4.8	-3.9	-3.7	-6.5	-8.8
Brazil [f]	CPS	...	...	...	...	-7.1	-1.1	-1.2	-1.1	2.6
Chile	NFPS	1.9	2.4	1.6	0.8	-0.6	-1.5	-0.6	-0.7	-1.6
Colombia	NFPS	0.1	-0.3	-1.7	-2.8	-3.7	-4.1	-4.2	-4.1	-3.6
Costa Rica	NFPS	-5.2	-1.6	-2.5	-1.2	-0.8	-1.6	-2.0	-1.7	-3.9
Ecuador	NFPS	0.6	-1.1	-3.0	-2.6	-5.7	-4.7	1.7	1.2	0.9
El Salvador	CG	-0.7	-0.6	-1.8	-1.1	-2.0	-2.1	-2.3	-3.6	-3.1
Guatemala	CG	-1.4	-0.5	0.0	-0.8	-2.2	-2.8	-1.8	-1.9	-1.0
Haiti	CG	-3.2	-4.1	-2.0	-0.6	-1.1	-1.4	-2.2	-2.8	-2.5
Honduras	CG	-5.5	-3.1	-3.5	-3.2	-1.9	-4.4	-5.7	-6.0	-5.3
Mexico	NFPS	0.2	0.0	0.0	-0.7	-1.2	-1.1	-1.1	-0.7	-1.2
Nicaragua	NFPS	-6.1	-2.5	-5.0	-1.8	0.7	-3.8	-7.3	-10.0	-1.2
Panama	NFPS	3.6	3.5	1.9	0.1	-2.9	-1.4	0.5	-0.8	-2.3
Paraguay	NFPS	2.7	1.2	0.8	0.9	0.2	-3.3	-4.4	-0.4	-2.2
Peru	NFPS	5.8	5.5	4.9	5.0	4.8	4.9	4.0	3.3	2.9
Dominican Republic	CG	-0.6	1.1	0.0	0.9	0.6	-0.5	1.1	0.4	0.1
Uruguay	CG	-1.9	-1.9	-1.8	-1.6	-1.2	-3.8	-4.0	-4.4	-4.7
Venezuela	NFPS	-13.3	-5.7	6.8	3.6	-4.3	0.7	4.3	-4.5	-1.1

Source: ECLAC, on the basis of official figures.

[a] Total income minus total expenditure, expressed in local currency.

[b] Abbreviations used: CG = central government. NFPS = non-financial public sector. NNFPS = national non-financial public sector. CPS = consolidated public sector.

[c] Preliminary estimate.

[d] Does not include those countries for which no information is given. Simple average.

[e] Cash flow basis.

[f] Operational financial balance.

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