

1998-1999



# Economic survey

OF LATIN AMERICA  
AND THE CARIBBEAN



UNITED NATIONS

CEPAL

ECLAC

**ECONOMIC SURVEY OF LATIN AMERICA  
AND THE CARIBBEAN 1998-1999**

The *Economic Survey of Latin America and the Caribbean* is prepared annually by the Economic Development Division with the assistance of the Statistics and Economic Projections Division and the ECLAC regional and national offices, under the overall supervision of Barbara Stallings, Chief of the Economic Development Division. Hubert Escaith was responsible for technical coordination of the present edition of the Survey.

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### Notes

The following symbols have been used in the tables in this 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.

**ECONOMIC COMMISSION FOR LATIN AMERICA  
AND THE CARIBBEAN**

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OF LATIN AMERICA  
AND THE CARIBBEAN  
1998-1999**



**UNITED NATIONS**



**ECONOMIC COMMISSION FOR LATIN  
AMERICA AND THE CARIBBEAN**

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## Foreword



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The **Economic Survey of Latin America and the Caribbean, 1998-1999** is the fifty-first edition in this series and incorporates a number of innovations, including new graphics and the use of a CD-ROM format for the statistical appendix. A new methodology has also been used in the preparation of the country studies (Parts Two and Three). This methodology is based on national accounts statistics denominated in the local currency and uses the base year employed by the relevant country, rather than figures in United States dollars. The statistical information used in the chapters on regional issues (Part One) is denominated in dollars, as in previous years, and 1995 is used as the base year for the calculations at constant prices.

Apart from these changes, the modifications that were introduced in 1995 in the **Survey's** coverage of regional economic conditions have been maintained in this edition. Once again, the **Survey** has been published in a single volume consisting of three parts. Part One presents an overview of the regional economy in 1998 and the first half of 1999. This summary has also been published as a separate document. The other six chapters in Part One review the economic performance of the region in 1998 and go on to analyse selected aspects of the economic situation during the first half of 1999. The eighth chapter assesses the impact of the global financial crisis on the region's economies.

Part Two presents reports on the performance of the 20 countries of Latin America during 1998 and includes information on the first quarter of 1999. Part Three is devoted to an analysis of the economic situation in the countries of the English-speaking Caribbean.

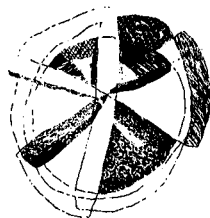
The statistical appendix supplied on CD-ROM provides ready access to data for recent years and permits the preparation of spreadsheets covering a longer time period. It also includes the full text and graphics in electronic format.





## First part

### The region





## Chapter I

### Summary

---

#### 1. Introduction

The international financial crisis that began in Asia in mid-1997 hit the economies of Latin America and the Caribbean more heavily than originally anticipated. Following the region's excellent performance in 1997, when gross domestic product (GDP) grew by 5.4%, growth in 1998 fell back to 2.3%, owing in part to external shocks of two types, namely, those stemming from the international financial crisis and those originating in a series of natural disasters. Much of this decline occurred in the second half of the year. In the first six months of 1999, nearly all Latin American countries were either reporting a sharp slowdown in economic growth, or else were in full-blown recession. Nonetheless, the signs are that there will be a recovery in the third and fourth quarters of 1999. According to ECLAC projections, regional GDP will shrink slightly for the first time in the 1990s, and will only start to grow again in 2000.

The behaviour of the external sector was at once cause and effect of the growth performance. Whereas the value of exports fell in 1998 for the first time in over 10 years, imports lost momentum but still continued to

expand; as a result, the region's current account deficit grew from an average of 3.4% of GDP in 1997 to 4.5% in 1998. This was partly due to a steep deterioration in the terms of trade. The trade gap widened, and foreign capital became scarcer and more expensive.

Faced with the possibility of significant external imbalances, many governments and central banks decided to adjust their economies by restricting fiscal expenditure and raising interest rates. To begin with, there was a tendency to avoid using devaluation as a way to alter relative prices, despite the negative implications this would have for growth. Later, however, the policy stance began to change as the authorities opted for more active exchange-rate management. The combination of slower growth and some degree of currency depreciation is expected to bring the current account deficit back down to about 3.5% of GDP in 1999.

Capital flows were not sufficient to cover the deficit in 1998, so external accounts were balanced by drawing down reserves and by making greater use of funds from the International Monetary Fund (IMF). Not surprisingly, weaker portfolio investment was the

main reason for smaller foreign capital inflows overall, which dropped from a record US\$ 85 billion in 1997 to US\$ 68 billion in 1998. While foreign direct investment held steady at around US\$ 60 billion, bonds, bank loans and share purchases all fell steeply. In 1999, total capital inflows are expected to approach 1998 levels, and, given a reduction in current account deficits, it will probably not be necessary to draw on reserves again.

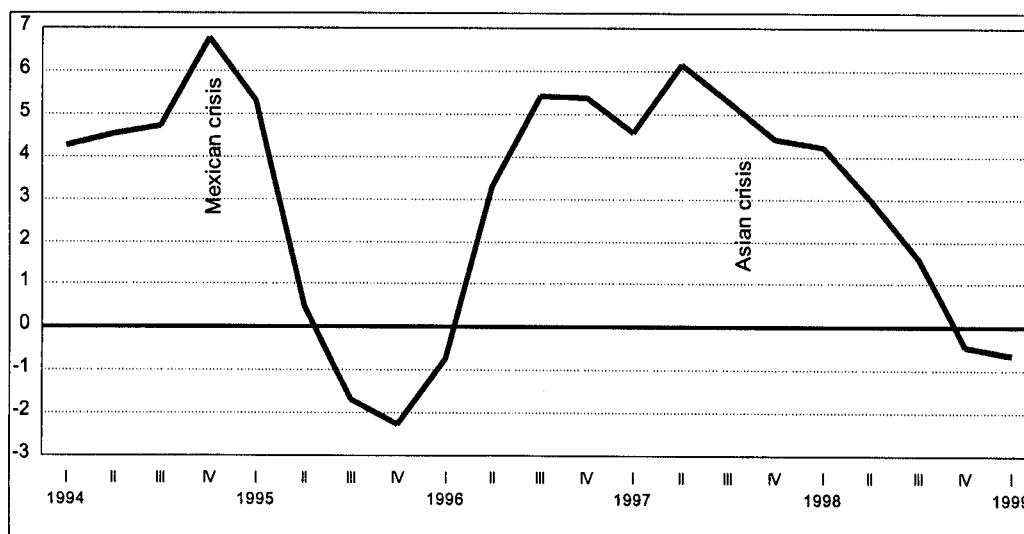
Prices have been kept under control, partly as a result of slower growth, but also because of an apparent slowdown in the inertia of inflation. Despite a weakening of local currencies and a series of supply-side disturbances, average inflation in the region will be around 10% in 1999, a level similar to that of the two preceding years. The fact that inflation has remained low has had a positive impact on real wages, which rose on average by 1% in 1998 among countries for which data are available, although almost half of them experienced increases of over 2%. Nonetheless, following the upturn in 1997, employment has begun to decline, with the average rate of unemployment rising from 7.5% in the first half of 1998 to 8.5% a year later, its highest level of the decade.

Brazil is the country that has attracted the most attention throughout this entire period, for both positive and negative reasons. The shock waves from the inter-

national financial crisis buffeted the region as the *real* came under speculative attack, first in October 1997 and then again in August 1998. As the Government decided on both occasions to raise interest rates, in order to defend the currency and secure the gains already achieved on the inflation front, growth in the Brazilian economy plummeted in 1998, causing spillover effects in many neighbouring countries. Initially, several observers had expected that the sharp devaluation of the *real* in January 1999 would lead to substantially higher inflation and produce an economic contraction of around 4% to 5%. The fact that the Brazilian economy has posted much better results than anticipated, in terms of both economic activity and inflation, has also aroused more optimistic expectations for the rest of the region.

The 1998-1999 downswing has affected the South American countries much more than the rest of the region. Mexico, Central America and many parts of the Caribbean have come through relatively unscathed thanks to their close links with the still booming United States market; their maquila sectors acted as a special source of buoyancy and job creation. The smaller economies also depend less on portfolio flows, and this to a large extent has protected them from the volatility of the international financial market. On the other hand, given that South America has stronger ties

Figure I.1  
**LATIN AMERICA AND THE CARIBBEAN: QUARTERLY GROSS DOMESTIC PRODUCT**  
(As percentages of variation with respect to the same quarter of the previous year)



Source: ECLAC, on the basis of official figures.

both with Europe, where growth was slow, and with Asia, where economic activity contracted, it was hit by negative trade shocks that compounded the financial crisis. Intra-regional trade, of great importance in South America, also contracted; prices of raw materials fell substantially, and volume of exports of these products grew more slowly than in previous years.

Macroeconomic policy in the region has been put to the test on many occasions over the past two years, with governments having to face difficulties on several fronts. In general, policy makers have performed satisfactorily, often taking unpopular decisions in order to preserve hard-won gains on the inflation front and elsewhere. Nonetheless, in taking such decisions, they have tended to rely on high interest rates and have been reluctant to let their currencies weaken; as a result, the measures taken have often exacerbated the problems they were intended to overcome. Given the evidence that crises are more frequent in the increasingly globalized world economy and in the more open economies of the region today, the tools that have been used to deal with these crises will need to be appraised in the months to come, to see whether better responses could be offered next time.

The exchange rate is an area of special concern, as it is the most controversial aspect of current macroeconomic policy, and one which has very significant ramifications in other policy domains. Although a more thorough analysis is needed, and there may be individual exceptions, the events of this decade (like those of earlier periods) are evidence that great caution is needed when an overvalued currency is used to control inflation.

As events have shown, prolonged use of such a policy nearly always leads to higher current account deficits. An overvalued currency discourages exports, especially of non-traditional products, thereby perpetuating a country's dependence on primary products, which are especially vulnerable to price fluctuations. At the same time, with more open economies, imports are encouraged and the trade gap widens. In the financial sphere, a policy of exchange-rate appreciation encourages a preference for borrowing in hard currency, and this puts constraints on future policy-making. Apart from this, overvaluation at some point is bound to generate expectations of devaluation, thereby promoting speculation against the currency.

It is important, however, to bear in mind the context in which this policy was implemented. For all the other policies to work and produce investments to boost growth in the future, it was essential to bring

down inflation, which had risen to three-, four- and even five-digit levels. Apart from this, the huge capital inflows that had characterized the first half of the 1990s made it extremely difficult to avoid overvaluation, even in cases where this was not an explicit policy aim.

Nonetheless, the new low-inflation climate existing in most countries of Latin America and the Caribbean at the end of the 1990s provides an opportunity to reconsider the use of different policy tools. In particular, it is now possible to move towards more flexible exchange-rate regimes; this would help to reduce current account deficits by promoting exports and discouraging imports, and allow more manoeuvring room in controlling the volatility of capital flows. It would also permit faster growth, which in turn would help to reduce unemployment and poverty, although growth alone cannot be expected to solve these problems.

Several governments have taken measures of this kind; Mexico and Brazil are the two best examples, having moved from semi-fixed to floating exchange rates. Other countries have taken less drastic steps by either devaluing or widening the bands in which their currencies float. At the same time, some analysts and national economic authorities are looking beyond the concept of fixed exchange-rate schemes and have begun to discuss abandoning local currencies altogether. One possibility would be to adopt the United States dollar as the circulating currency, but this requires solving the problem of lender of last resort. Another alternative would be to adopt regional or subregional currencies, as a Latin American equivalent of the euro. Whatever one's opinion may be on the possible long-term advantages of this model, including the trade-offs between greater monetary stability and loss of demand-management tools, most of the region's governments feel that the time is not ripe for going down one of these paths.

Of course, exchange-rate policy is but one of the issues —albeit a very important one— on the policy agenda for the next few years, and it needs to be considered in the light of other macroeconomic tools, paying special attention to the matter of coordination. Furthermore, the goals of macroeconomic policy need to be extended beyond controlling inflation to include objectives such as raising domestic saving rates, promoting and diversifying exports, reducing the debt ratio and controlling volatility. Each of these measures would help towards achieving the growth with equity to which every government aspires.

## 2. The external sector

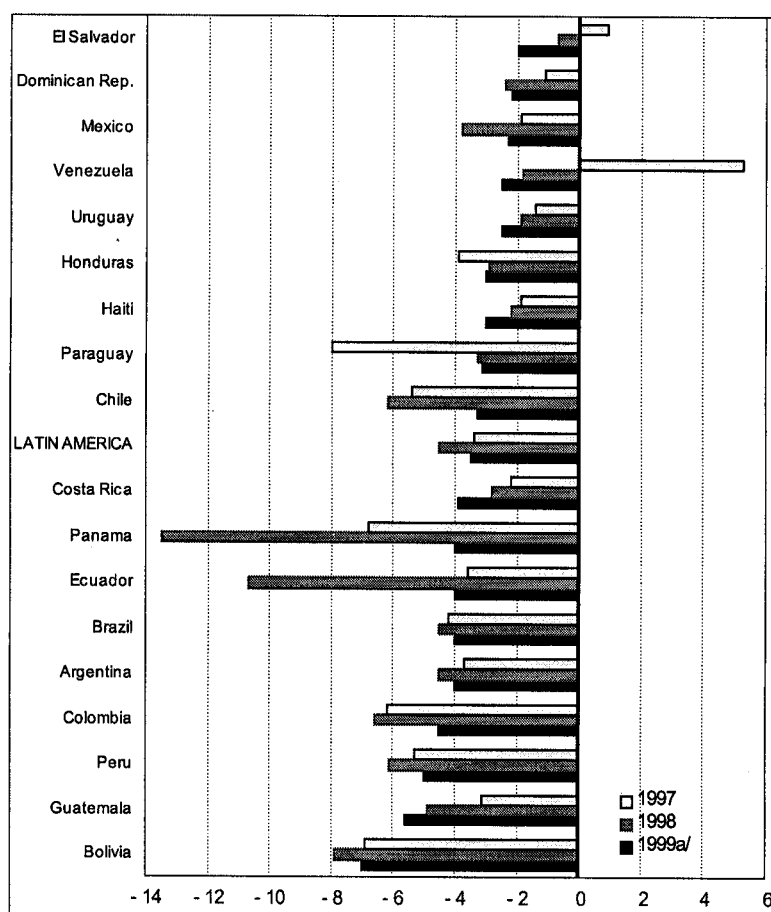
The crisis that erupted in Asia in 1997 was transmitted to the region through the external sector, and had a negative impact on merchandise trade and capital flows. On the trade front, its main manifestations were an abrupt fall in commodity prices, which fell to unprecedentedly low levels, and a slowdown in export demand in many countries. These factors led to a fall in unit values of exports and a reduction in the growth of export volumes, respectively, which in some countries was compounded by the destruction of export crops by catastrophic weather conditions. The overall result was a

contraction of regional export earnings (by nearly 2%) for the first time since 1986.

This problem was compounded by a scarcity of external financing, which led many countries to take steps to curb the growth of imports, which was already becoming unmanageable. External purchases slowed down abruptly in terms of value, although in view of the lower prices of imports, volumes did not react strongly until the second half of 1998.

As a result, the trend towards larger current account deficits persisted through most of 1998, and the

Figure 1.2  
**LATIN AMERICA AND THE CARIBBEAN: CURRENT ACCOUNT BALANCE**  
(As a percentage of GDP)



Source: ECLAC, on the basis of figures from national sources and the International Monetary Fund.

<sup>a</sup> Preliminary estimates.

region's aggregate shortfall for the year as a whole grew to US\$ 89 billion. As a percentage of GDP, the regional deficit rose from 3.4% to 4.5% (see figure I.2), a ratio only comparable to that of the early 1980s. As capital inflows were insufficient to bridge the gap, the region ended 1998 with an overall balance-of-payments deficit of US\$ 21 billion, with Brazil accounting for nearly US\$ 18 billion of this total. The deficit was covered, in equal proportions, by drawing down reserves and by using IMF loans and other types of emergency financing.

Although the widening trade gap was the main cause of the deterioration on current account, where deficits were spread among all the countries of the region, higher interest payments and profit repatriation also played a part. These outlays amounted to 2.5% of regional GDP, although in some countries, such as Chile, Costa Rica, Dominican Republic, Mexico and, especially, Ecuador, they were much higher. Interest payments grew only moderately despite an expansion of the external debt stock, since international interest rates came down. On the other hand, a further rise in current transfers made it possible to reduce current account deficits in several Central American and Caribbean countries, where such transfers are substantial.

The deterioration of the current account began to level off in several countries in late 1998, and the trend has strengthened in 1999. Thus, in this year, the regional deficit is expected to narrow to some US\$ 75 billion (3.5% of GDP), and, provided the current international climate remains stable, it should be possible to finance it without using reserves.

### **Weaker exports compound the slow adjustment of imports**

The change in conditions from the previous year led to a significant fall in external trade in the region as a whole, albeit from the particularly high levels resulting from the 1997 expansion, one of the largest in recent decades. This, however, did not immediately alter the trend towards a larger regional trade deficit. The difference was that previously the widening gap between imports and exports had been caused by an import boom, whereas in 1998, it was mainly the result of weaker exports. A lengthy adjustment in imports was needed for the gap to begin to narrow.

These general results were representative of most of the South American countries, plus Nicaragua and Panama, all of which suffered in various ways from the international crisis and weather-related disasters. On the whole, these countries earned less from their ex-

ports, and had to substantially curtail imports. In several cases, the value of external purchases fell sharply in 1998.

In contrast to these results, another group of countries (comprising most of the Central American and Caribbean countries, and, to a lesser extent, Mexico) performed well. These countries saw a continuation of upward trends in export volumes and foreign purchases, and even in the terms of trade (except in El Salvador and Guatemala, where they fell slightly, and in Mexico). A decisive factor in these countries' performance was their ability to take advantage of the relative robustness of the United States market, thanks particularly to the steady growth of the maquila industry. Despite the differences between these two groups, all countries shared a feature in common: a general deterioration in their 1998 trade balances.

The shrinking of regional export values was heavily influenced by a slowdown in the most dynamic component of the region's trade, namely, intra-regional trade. In 1998, the value of trade between the countries of the Latin American Integration Association (LAIA) broke a 12-year rising trend to fall by 6%, although trade within the Southern Common Market (Mercosur) declined by much less than this (0.5%). In contrast, intra-zonal exports in the Central American Common Market increased by 9%, in keeping with the generally expansionary tone of trade in that subregion; even so, intra-zonal trade expanded by less than total sales in these countries.

In the first quarter of 1999, commodity prices continued to slide, although the steepest falls had already taken place, and by the end of the quarter, some prices were showing signs of recovery. The price of oil, in particular, rose sharply on the back of a new agreement by the Organization of Petroleum Exporting Countries (OPEC) to limit supplies. In most of the region's larger economies, the slowdown in exports noted in the second half of 1998 intensified, and in the first quarter of the following year, merchandise export values in Argentina, Brazil, Ecuador, Paraguay and Uruguay plunged by between 15% and 25% from their still high levels of the same period a year earlier. Paraguay and Uruguay also suffered the full impact of the sharp devaluation of the Brazilian real in early 1999.

Colombia and Chile also saw their merchandise exports slip, but to a lesser extent. The damage caused to exports by the hurricanes in Central America became more evident; for example, coffee sales by Central American countries fell sharply in the October 1998-May 1999 harvest period. On the other hand, Costa Rica saw a new increase in total export earnings,



as did Mexico also, and this had a decisive effect on the regional aggregate.

Imports displayed the same tendency as in the final months of the previous year, as the adjustment intensified. In general, purchases in the early months of 1999 were sharply down from the same period a year earlier. Among countries for which data are available, there were sharp cutbacks, ranging between 10% and 40%, in Colombia, Ecuador, Paraguay, Chile, Argentina, Peru, Brazil and Uruguay (in that order). On the other hand, some Central American countries, such as Costa Rica and El Salvador, maintained their levels of foreign purchases or even managed to increase them, as did Mexico, whose sharp increase was reflected in a rise in the regional aggregate (see figure I.3).

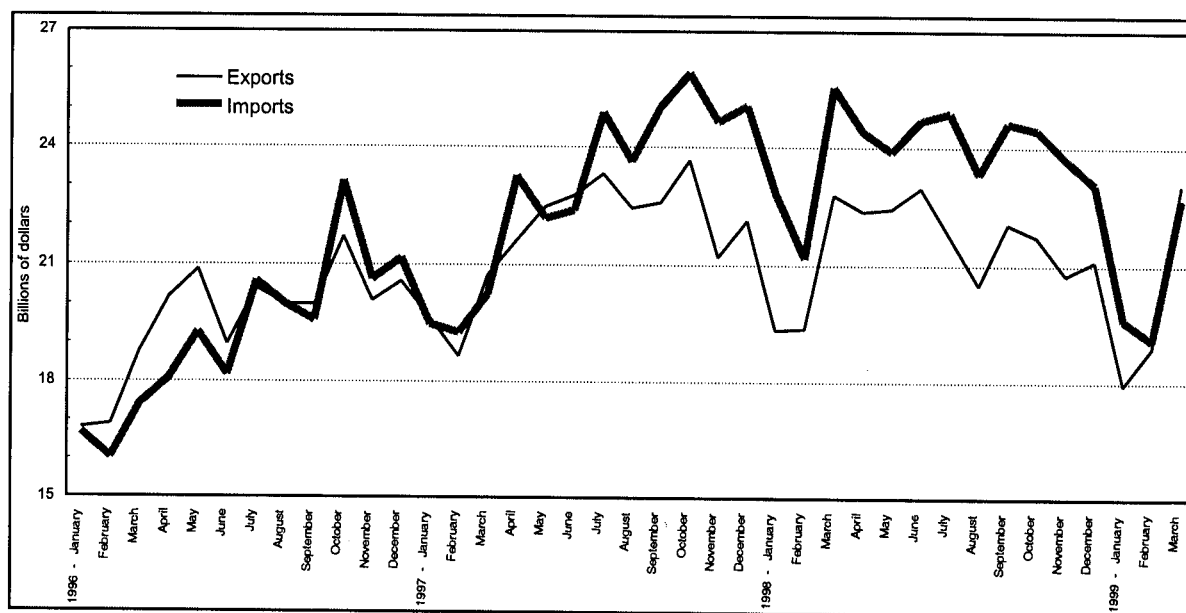
Along with a continuation of the cutback in imports, forecasts for the rest of 1999 point to some easing of the slump in exports, although a marked improvement is unlikely. High levels of commodity stocks, accumulated as a result of the imbalance between supply and demand in recent years, persist on

world markets. The upturn in demand for such products is likely to be restrained by weak growth in the world economy for the second year running, which the United Nations expects to be below 2%. The most positive influence on the demand side relates to the incipient recovery expected in the economies of South East Asia, which bottomed out in 1998. On the other hand, the likely contraction of the region's economies will probably produce the opposite effect, since it will have an adverse impact on the large intra-regional trade sector.

### Capital inflows fall

Capital inflows fell from the record level of US\$ 85 billion in 1997 to US\$ 68 billion in 1998, owing to the international financial crisis. The trend in early 1999 suggests that autonomous capital inflows will remain close to 1998 levels. Compensatory capital will also be used, particularly in Brazil, but the amount is not yet known.

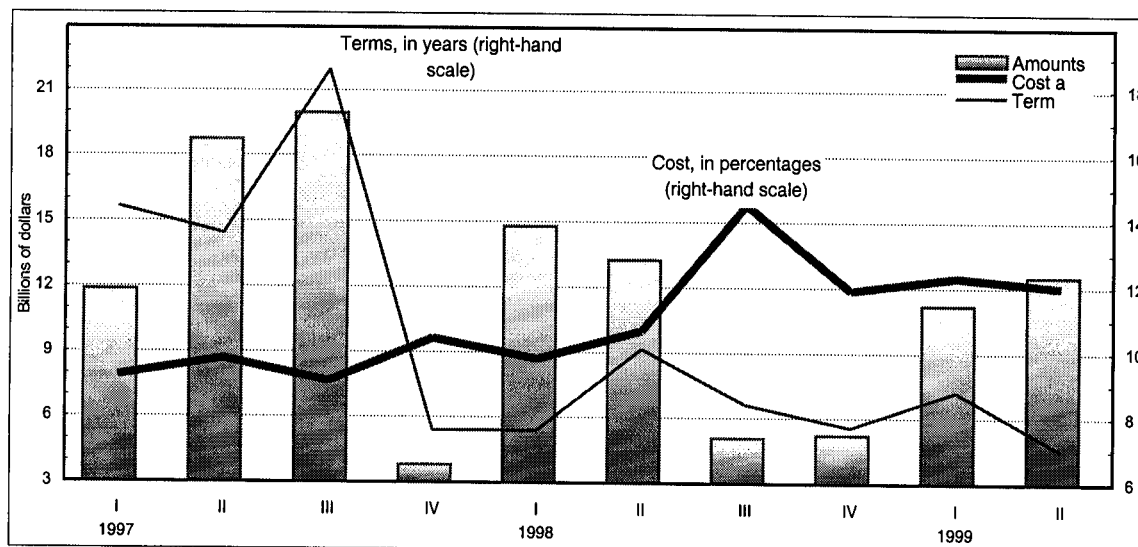
Figure I.3  
**LATIN AMERICA AND THE CARIBBEAN: TRADE IN GOODS<sup>a</sup>**  
(Billions of dollars)



Source: ECLAC, on the basis of official figures.

<sup>a</sup> Includes Argentina, Bolivia, Brazil, Chile, Colombia, Costa Rica, Ecuador, Mexico, Paraguay, Peru, Uruguay and Venezuela.

Figure I.4  
LATIN AMERICA AND THE CARIBBEAN: INTERNATIONAL BOND ISSUES



Source: ECLAC, on the basis of figures from official sources, the World Bank and the International Monetary Fund.

<sup>a</sup> Sum of the average spread for bond issues plus the yield of long-term United States Treasury bonds.

Throughout 1996 and until September 1997, plentiful amounts of capital flowed towards the countries of Latin America and the Caribbean. Following the worsening of the Asian crisis in October 1997, however, external financing for the region became scarcer and more expensive. This phenomenon occurred in four stages, beginning in the fourth quarter of 1997, when the cost of external financing rose and short-term capital inflows diminished. During the second phase, in the first two quarters of 1998, the volume of capital inflows picked up, but their cost was high in comparison with the first three quarters of 1997.

The third phase began in August 1998, with the repercussions of the Russian debt moratorium affecting all the Latin American countries. This led to a shortage of capital, particularly in respect of the more volatile capital flows, and a further rise in the cost of external financing. Brazil was one of the countries most seriously affected, and required an international financial assistance package under which disbursements began in December 1998. The fourth phase began in mid-February 1999 with a modest recovery of capital inflows in a somewhat more favourable international context; however, the cost of external financing remains burdensome for several countries and even for the region as a whole (see figure I.4).

Net inflows of all types of external capital except foreign direct investment (FDI), decreased. The latter remained plentiful, and financed two thirds of the region's balance-of-payments current account deficit for 1998. Half of all foreign direct investment went to Brazil, while other countries of the region experienced diminished inflows, albeit in relation to exceptionally high levels in 1997, as in the cases of Colombia, Mexico and Venezuela; however, some of the smaller economies, including Costa Rica and the Dominican Republic, successfully attracted a considerable volume of FDI. Unlike the case in previous years, in 1998 and the first half of 1999, the main destination of FDI seems to have been the acquisition of private assets, particularly in South America.

There was a considerable drop in bond financing, from US\$ 54 billion in 1997 to US\$ 38 billion in 1998; leaving out amortization, the level for 1998 was only US\$ 13 billion. Inflows from bond issues remained highly concentrated in Argentina, Brazil and Mexico. The activity was at its most intense in the first half of 1998 and from March 1999 onwards. Financing conditions deteriorated, especially following the Russian moratorium in August 1998; from then until October of the same year, Latin American governments and enterprises avoided issuing debt.

In April 1999, there was a sharp upturn in the volume of bond issues and an improvement in financing conditions; seven governments of the region—four in South America and three in Central America—issued bonds on international financial markets for a total of US\$ 10 billion. The average term for these issues was eight years, and the average spread was 550 basis points (5.5%) over United States Treasury yields (5.0%); thus, in April 1999, the annualized cost of this financing was 10.5%.

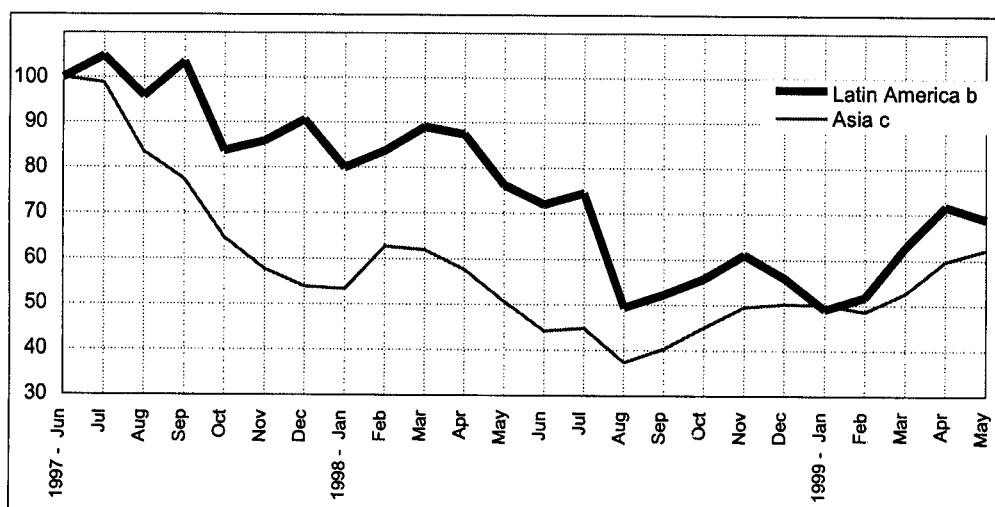
There was a significant decline in bank lending in the second half of 1998 and the first quarter of 1999. These international banking flows were seriously affected by the Russian moratorium, and have recovered much more slowly than bond placements. Lending to Brazil was very limited, particularly in the third quarter of 1998, and there was some reduction in lending to Chile, Colombia and Venezuela during the same period. In most Latin American countries, short-term lending continued to focus mostly on foreign trade transactions, and was not restricted, except in the case of Brazil in the first two months of 1999.

In 1998, share capital accounted for an outflow from the region in the order of US\$ 5 billion, with the largest amounts being withdrawn from Brazil, and Chile, Mexico and Peru also experiencing considerable outflows. Unlike

the case in previous years, there were almost no issues of American Depositary Receipts (ADRs). This took place against the background of an extraordinary slump in stock market equity values. Between June 1997 and September 1998, there was a cumulative fall of 45% in the regional share price index expressed in dollars, and the region's principal stock markets suffered widespread losses. From October 1998 onwards, share prices began to recover, despite continuing fluctuations, but as of June 1999, they still had not returned to the levels of late 1996 (see figure I.5).

In 1999, foreign direct investment will represent the main source of capital inflows to the region; it may even come close to the unusually high 1998 figure of US\$ 60 billion. Bond issues are also expected to come close to 1998 levels. On the other hand, financing from multilateral agencies is expected to be greater than before, particularly for certain countries such as Argentina and Brazil. This support is particularly important in the current situation, given the increasing difficulty of obtaining external financing. In addition, the International Monetary Fund (IMF) is expected to continue in 1999 to disburse the resources for Brazil envisaged in the 1998 financial assistance programme.

Figure I.5  
LATIN AMERICA AND THE CARIBBEAN: STOCK EXCHANGE  
DOLLAR-DENOMINATED PRICE INDEXES<sup>a</sup>  
(Indexes, June 1997 = 100)



Source: ECLAC, on the basis of figures from the International Finance Corporation.

<sup>a</sup> Values at month's end.

<sup>b</sup> Includes 331 companies from Argentina, Brazil, Chile, Colombia, Mexico, Peru and Venezuela.

<sup>c</sup> Includes 1,077

companies from China, India, Indonesia, Korea, Malaysia, Philippines, Pakistan, Sri Lanka, Thailand and Taiwan, Province of China.

### 3. Macroeconomic policy and reform

Given the complexity of the external situation, national macroeconomic management teams were severely put to the test in 1998 and the first quarter of 1999. The improvement in external conditions observed in the second quarter of 1999 should make their task less difficult for the second half of the year.

The situation created by the international financial crisis highlighted the vulnerability of the region in relation to external capital flows and the limited manoeuvring room allowed in national macroeconomic policy for dealing with financial and trade liberalization. Extremely cautious policies have therefore prevailed, particularly in the monetary sphere, in those countries that have high external or fiscal deficits, or where balances in those areas had deteriorated as a result of falling export prices.

This was particularly true of certain South American countries and, to a lesser extent, Mexico. These countries were forced to hold down growth in domestic demand because of the shortage of external capital. Macroeconomic policies in the Central American and Caribbean countries did not have to undergo similar adjustments. As mentioned above, the makeup of their external trade, their orientation towards North America and their still embryonic financial markets generally sheltered them from the more direct consequences of the international crisis.

#### The fiscal situation remains difficult

The fiscal situation in 1998 brought to light certain problems of coordination in the use of the fiscal, monetary and exchange-rate tools of macroeconomic policy. Owing to the scarcity of current receipts caused by the crisis in that year, spending policies had to be kept as austere as possible, but efforts to limit the deficit were hindered by the direct and indirect effects of monetary and exchange-rate policies. In particular, the high interest rates needed in order to defend exchange rates increased the financial cost of servicing domestic public debt. In late 1998, this was compounded by the tax-revenue implications of the economic slowdown, which will continue to affect Government finances in 1999.

The non-financial public sector deficit rose to an average of 2.4% of GDP in the countries of the region, some of which ended 1998 with very high deficits

—over 6% of GDP in Brazil, Ecuador and Venezuela. The mediocre performance of public-sector saving, which fell to the lowest levels recorded in the 1990s, and loss of access to domestic and external financial markets made it more difficult to finance capital spending. Public-sector investment declined for the second year in a row, particularly in the larger economies.

The impact of the fall in government saving capacity was magnified by two other factors. The first was a gradual reduction in public-sector borrowing capacity. Although the current public debt situation is not a serious problem in most of the countries of the region, the growing debt servicing burden reduces their ability to enter into new financial commitments and limits the flexibility of fiscal policy. In 1998, the cost of interest on public debt averaged about 3% of GDP in the countries of the region. Secondly, the need to refinance large amounts of debt from time to time restricted the governments' financial manoeuvring room, especially when—as was the case during part of 1998—external financing was practically impossible to obtain.

The outlook for 1999 does not suggest that there will be any reduction in fiscal imbalances in most of the countries of the region. Levels of economic activity were still low in the first two quarters, hindering efforts to improve tax receipts, particularly in South America. Recovering commodity prices should, however, provide greater income for exporting countries, particularly the oil-producing ones. In a number of Caribbean and Central American countries, as well as in Colombia, Ecuador and Peru, the need for reconstruction work following natural disasters will push spending upwards. The servicing of public debt will continue to weigh heavily on public sector finances, especially where the external debt burden has been worsened by the effects of devaluation.

#### Foreign exchange policy becomes more flexible

Initially, exchange-rate policy was not used for adjusting relative prices or to reduce pressure from internal demand on external accounts. There were various reasons for this reticence. Firstly, in early 1998, the external disturbances originating in Asia were not expected to last. Secondly, there was a reluctance to jeopardize the progress in cutting inflation that had in many cases been achieved by using some kind of nomi-

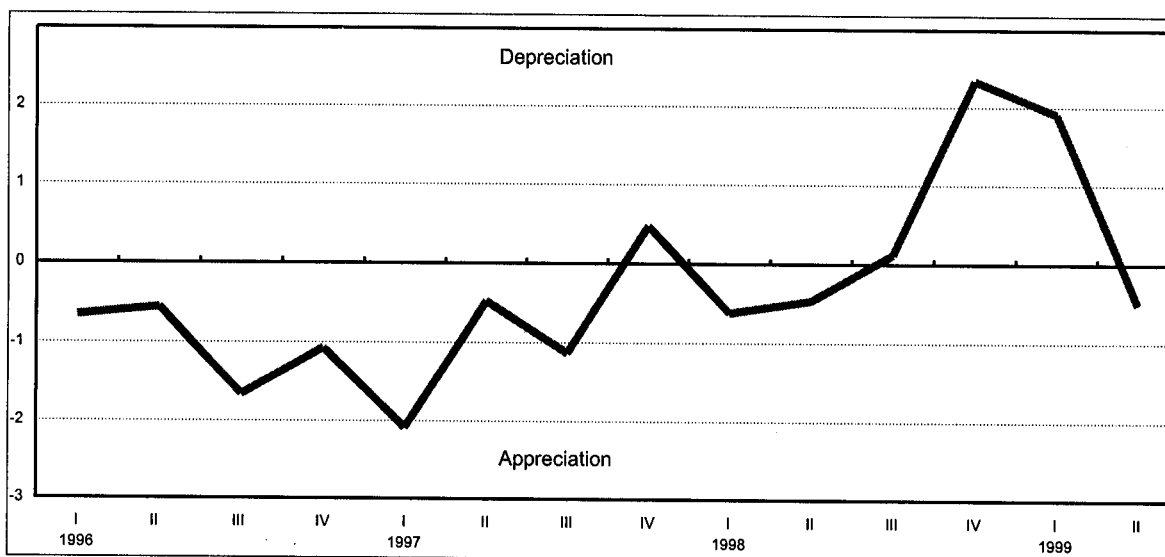
nal exchange-rate anchor. Thirdly, when the external situation became highly volatile in the second half of 1998, and uncertainty prevailed on foreign-exchange markets, monetary authorities sought to limit the rate of devaluation in order to avoid the danger of overshooting. Lastly, they tried not to worsen the vulnerability of the financial sector; it is worth recalling that private external debt has increased significantly in recent years, leaving many enterprises exposed to exchange-rate risk.

Nonetheless, increasing current account deficits in the course of the year and the episodes of capital flight which characterized the moments of greatest uncertainty on foreign-exchange markets (US\$ 23.5 billion were lost in September alone) put pressure on the international reserves of many countries, particularly Brazil, but also Chile, Colombia, Peru and Venezuela. Taking the year as a whole, losses of external assets totalled more than US\$ 10 billion (US\$ 7.7 billion in Brazil alone), and the amount financed through IMF loans and other emergency financing was even greater. This foreign-exchange drain forced several countries to adopt greater exchange-rate flexibility. Those which had been controlling short-term capital inflows (Chile and Colombia) loosened the restrictions and modified

their exchange-rate band systems. Brazil was able to defend its exchange rate, albeit at the cost of a heavy loss of reserves and with the help of an international aid package. This did not suffice, however, to avoid the devaluation of the *real* in January 1999. The Ecuadorian sucre was also devalued, owing to both external difficulties and domestic problems.

With moderate and declining rates of inflation, these devaluations entailed a real depreciation of national currencies, ending the steady appreciation which had been occurring since 1988, and was only briefly interrupted at the time of the Mexican crisis in 1994. This process of appreciation, which had already begun to slow down in 1997, gave way to depreciation as of the third quarter of 1998 (see figure I.6). This new trend, which seemed to be slowing in the second quarter of 1999 thanks to the improving economic outlook in the region, brought about an average annual depreciation at the regional level of slightly over 1.5% in the first half of 1999. During that period, the annual rate of depreciation exceeded 10% in five countries: Brazil, Colombia, the Dominican Republic, Ecuador and Peru (see figure I.7). The trend may continue in the second half of 1999, as domestic interest rates decline in those countries experiencing recession.

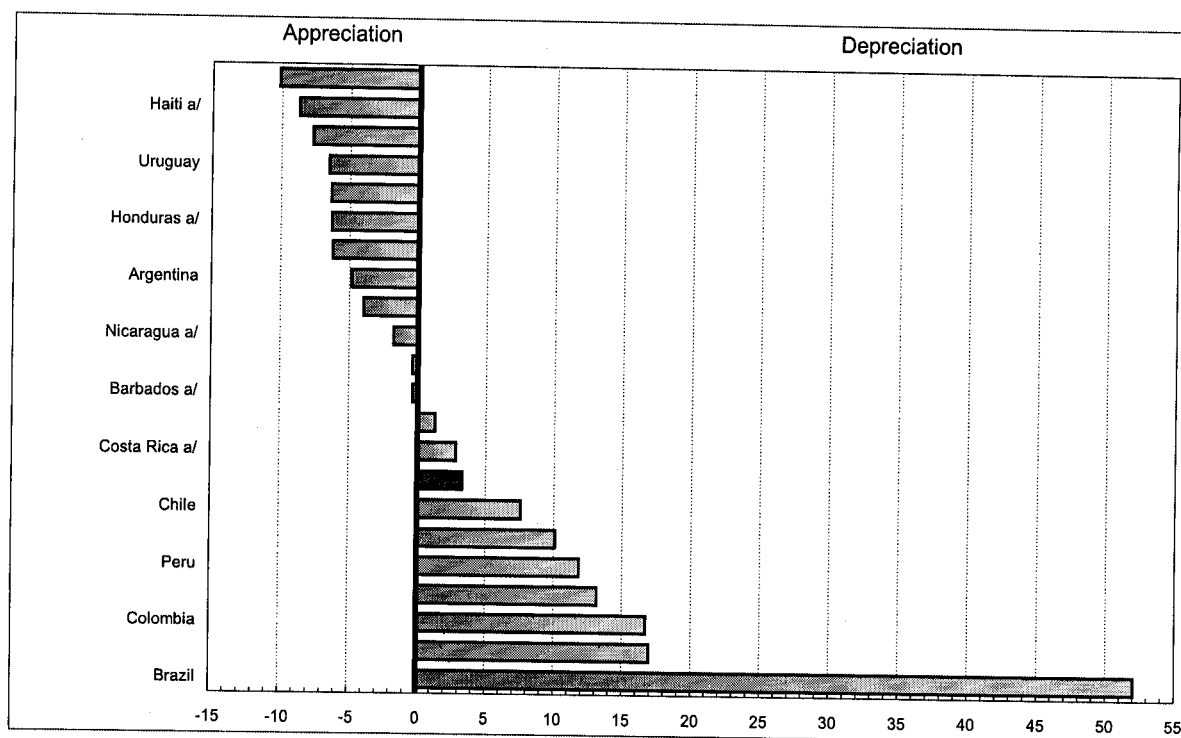
Figure I.6  
**LATIN AMERICA AND THE CARIBBEAN: QUARTERLY VARIATIONS IN THE REAL EXCHANGE RATE**  
(Simple average)



Source: ECLAC, on the basis of official figures.

Note: Higher figures indicate depreciation of the national currency.

Figure 1.7  
**LATIN AMERICA AND THE CARIBBEAN: REAL EFFECTIVE EXCHANGE RATE**  
*(Annual variation at first quarter 1999)*



Source: ECLAC, on the basis of official figures.

Note: An increase in the index indicates a depreciation of national currency.

<sup>a</sup> First quarter.

<sup>b</sup> Simple average.

### Monetary policy plays a key role in adjustment efforts

In a situation in which fiscal policy did not help hold down domestic demand, and governments preferred not to resort to devaluations, much of the burden of the adjustment made necessary during 1998 by the worldwide crisis was borne by monetary policy. In the region as a whole, monetary growth tended to slow because of the decline in international reserves and domestic credit. Real interest rates rose again, reversing the downward movement observed since 1996. This regional trend was particularly strong in South America; the countries of Central America and the Caribbean, less hard hit by the worldwide crisis, adopted more relaxed monetary policies.

The main effect of monetary restrictions was on means of payment, since no drastic fall in deposits was observed. The stability of financial saving in the region (except in countries affected by banking crises, such as Ecuador, Jamaica and Paraguay) was one of the key factors which helped to limit the negative impact of external disturbances. Real interest rates tended to rise in most countries, although at different times, with the largest increases taking place in the countries that were most affected by the international crisis or where the authorities took more drastic steps in response to pressure on foreign-exchange markets.

This monetary policy was generally successful in that the main short-term goals were achieved, particularly that of preventing the world financial crisis from destabilizing foreign exchange markets and pro-

ducing inflationary outbreaks. Nevertheless, the high interest rates needed in order to accomplish this were very costly for a number of countries, either because of the recession in the real economy or because of the fragile state of the fiscal and banking sectors.

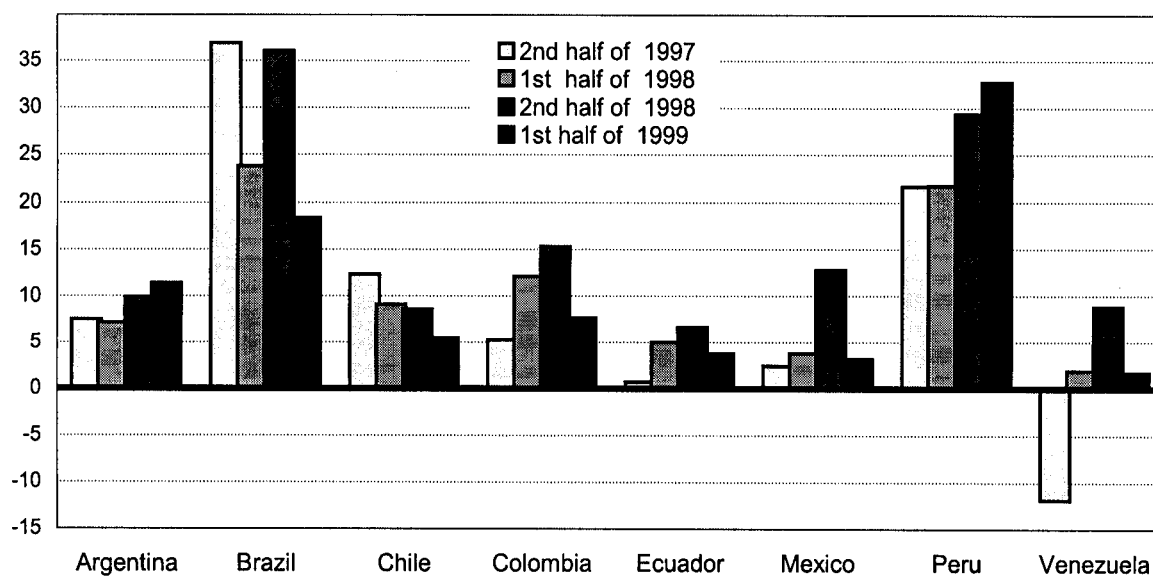
To correct such recessionary biases, somewhat more expansionary macroeconomic policies were adopted in the first half of 1999, although they remained cautious owing to conditions at the international level. The swift normalization of international and regional financial markets following the Brazilian devaluation and the improved outlook for external trade generally allowed some relaxation of monetary austerity. On the foreign-exchange markets, the trend towards devaluation was reversed towards the end of the first quarter, allowing more leeway for cutting domestic interest rates (see figure I.8). In many economies, interest rates have returned to the levels of early 1998. This has given rise to hopes of a revival of domestic economic activity following almost nine months of recession in the larger South American economies.

### Structural reforms continue despite the crisis

The disturbances afflicting the region's economies did not halt structural reforms, although they did affect them to some extent. Privatizations continued in those countries where the process had begun only recently. Since Brazil was one of them, receipts in 1998 rose to a record level of US\$ 42 billion; 85% of that amount was accounted for by Brazil, thanks to the sale of one enterprise, Telebrás. Other countries also carried out significant privatizations; these, however, involved smaller amounts in absolute terms. El Salvador, Guatemala and Panama sold State-owned enterprises for amounts which represented between 7% and 8% of GDP. Most of the sales in the region took place in the telecommunications (60%) and electric power sectors (30%).

The process continued in 1999 with, among others, the sale of a 15% stake in the Argentine company Yacimientos Petrolíferos Fiscales (YPF) for more than US\$ 2 billion and of the Brazilian firm Comgas de São Paulo for US\$ 1 billion. Nevertheless, economic difficulties in Brazil and Ecuador early in the

Figure I.8  
LATIN AMERICA AND THE CARIBBEAN: ANNUALIZED REAL INTEREST RATES  
(End of period)



Source: ECLAC, on the basis of official figures.



year led to the postponement of a number of privatization projects, and it is highly unlikely that the 1998 levels will be matched. Nonetheless, considerable headway is being made in granting private-sector concessions for the building and operation of infrastructure projects (including roads, railways, metro systems, ports, airports, sewerage networks and postal services).

The transfer to the private sector of State-owned productive assets has increasingly drawn attention to institutional weaknesses in the region. Consequently, reforms designed to improve the efficiency of the State and strengthen its supervisory and regulatory capabilities have become more and more important. Argentina, Mexico and Peru opened up their telecommunications sectors to competition in 1998, several years after they were privatized. In Chile, weaknesses in the regulation of the electric power sector became apparent when a drought disrupted power supplies and forced the Government to take legislative measures to strengthen the regulatory framework. Improved awareness of the problem recently led countries such as Brazil and Colombia to liberalize the electric power and telecom-

munications sectors, once they had established regulations to ensure competition.

A number of countries, including Ecuador, Paraguay and Jamaica, continued to suffer from the financial crisis. Efforts to establish regulatory frameworks and strengthen the financial system were continued, and contingency measures were taken to increase liquidity in countries that had been most affected.

The impact of the crisis was also felt in the area of trade reforms. Faced with worsening trade balances, several countries considered taking moderate steps to restrict imports. The devaluations in Brazil in January 1999 and in Ecuador in March 1999 led some countries—including Argentina, Bolivia, Colombia, Ecuador and Mexico—to implement such measures, but these did not call into question the trade liberalization which had characterized the 1990s. This process continued either unilaterally, as in Chile and Panama, or in the context of existing free trade agreements or regional integration schemes, under which further steps were taken towards the liberalization of trade within the region.

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## 4. Domestic economic performance

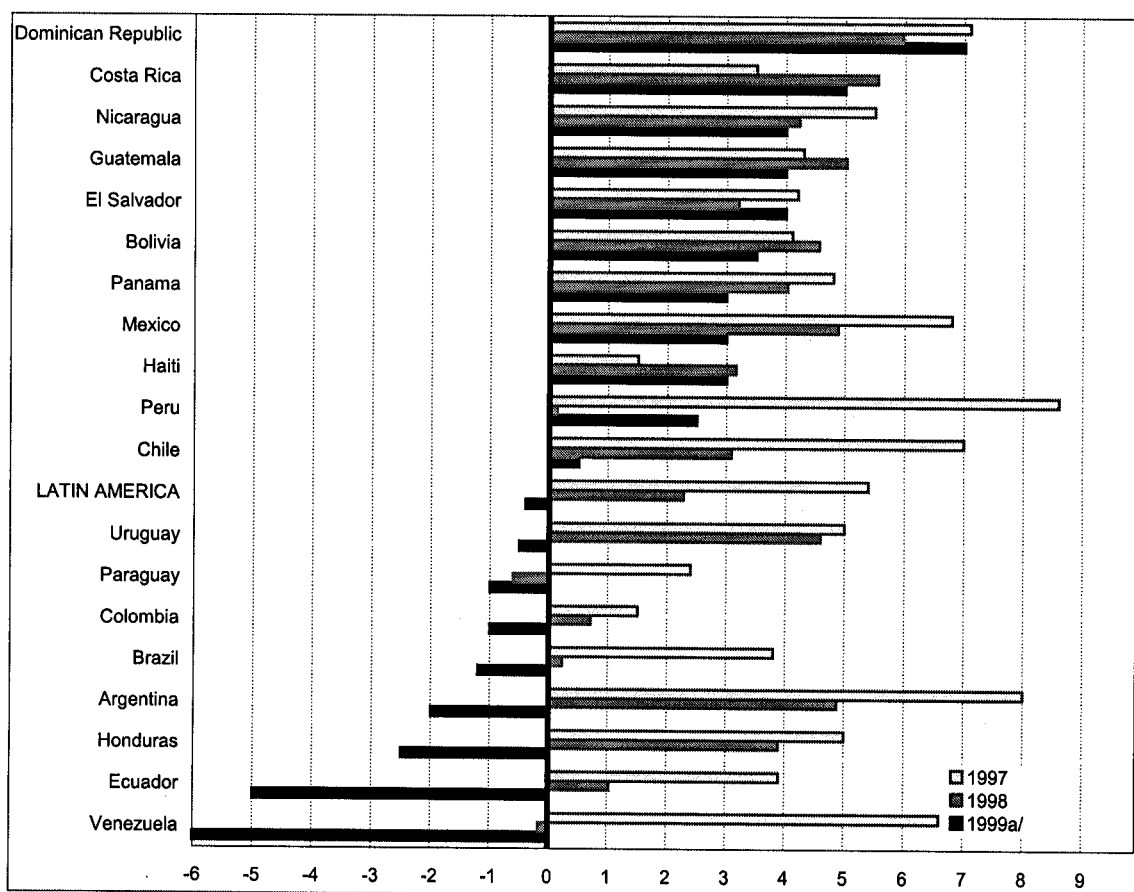
### Growth slows down sharply in the region

Economic growth slowed considerably in the countries of Latin America and the Caribbean in 1998 (2.3%), marking a three-percentage-point decline in comparison with the previous year, when the region had recorded its strongest performance in 25 years. This reversal of the latest cycle of regional economic expansion (which had begun in late 1995 with the recovery from the Mexican crisis) occurred in the second half of 1997. From this moment on—and, especially, from the second quarter of 1998—there were signs of a slowdown (see figure I.1). Thanks, however, to the strong momentum that had built up, growth in the region continued into the first half of 1998. Once this inertial effect had worn off, recessionary trends—stemming from the international financial crisis and the tighter macroeconomic policies adopted to deal with it—prevailed, culminating, by year-end, in negative growth.

This poor performance lasted into the first half of 1999, so that only slight growth is expected for the current year. Since most countries of the region have high population growth rates, per capita regional GDP increased by a mere 0.7% in 1998, and is expected to contract in 1999. This setback will mean that the overall improvement in per capita GDP for the decade will be barely 15%.

This gloomy picture is partly due to poor economic results in most of the South American countries, particularly, Argentina, Brazil, Chile, Colombia, Paraguay, Peru and Venezuela, where GDP growth fell by between 3 and 7 percentage points compared with the levels recorded in 1997. Given the size of Brazil's economy, that country's weak growth of just 0.2% accounts to a large extent for the modest rate of growth at the regional level. Indeed, leaving out Brazil, the figure for the region would have been 3.5%. Generally speaking, the Central American and Caribbean countries, which were less hard hit by the global financial crisis,

Figure 1.9  
**LATIN AMERICA AND THE CARIBBEAN: GROSS DOMESTIC PRODUCT**  
*(Annual growth rates)*



Source: ECLAC, on the basis of official figures.

<sup>a</sup> Preliminary estimates.

posted stronger growth. The two most buoyant economies were Costa Rica, with 5.5% GDP growth, a significant improvement over its 1997 performance, and the Dominican Republic (see figure I.9).

The overall unfavourable trend in the terms of trade had a significant impact on national income in all countries, with regional growth in this indicator averaging only 1.2% in 1998. The most dramatic case was that of Venezuela, where national income plunged by nearly 8%, following the sharp fall in oil prices and the downturn in activity levels. On the other hand, income in the Dominican Republic and the Central American countries expanded at a higher rate than GDP, since the

slump in the price of oil, an input imported in vast quantities by these countries, worked to their advantage.

The decline in the terms of trade and in foreign capital inflows, combined with the effect of macroeconomic policies geared towards restraint of domestic demand, account for the low levels of consumption and investment, and a smaller increase in export volumes. In 1998, economic activity in the region also suffered supply shocks, in particular those caused by the intense drought or heavy rains associated with the El Niño weather pattern (or its counterpart, La Niña), which resulted mainly in loss of agricultural output, disruptions in cold water fisheries and damage to the infrastructure.

Hurricanes George and Mitch, which battered countries in Central America and the Caribbean, caused massive losses, although their impact on the level of activity will be felt more keenly in 1999.

### Investment and national saving lose momentum

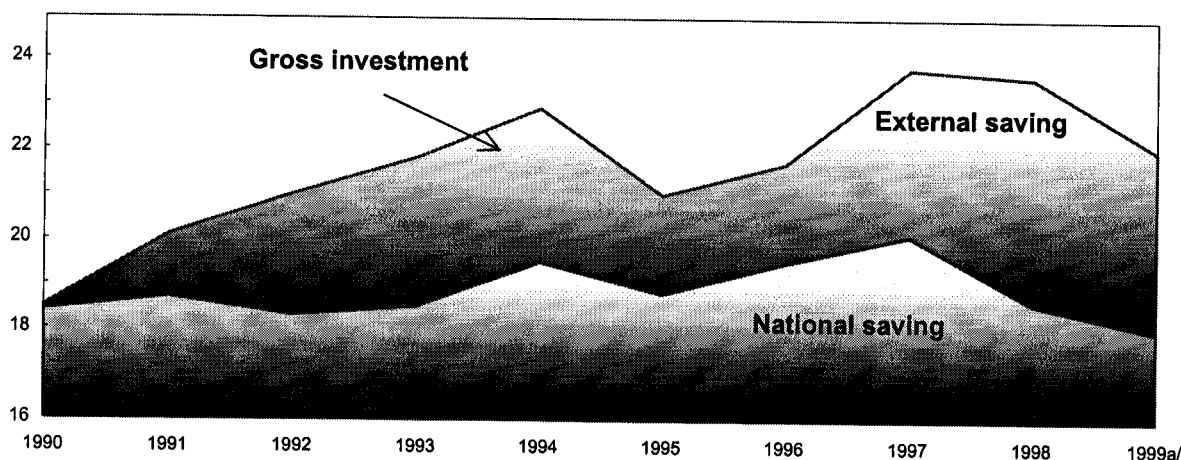
In 1998, the growth of total investment fell sharply in most countries of the region, owing to the negative impact of the international crisis. In Argentina and Mexico, it slowed considerably, and gross investment declined in Brazil, Chile, Colombia, Guatemala, Paraguay, Peru and Venezuela. On the other hand, some of the smaller countries, including Bolivia, Costa Rica, Dominican Republic, Haiti and Uruguay, were unaffected, and even recorded increases in gross capital formation.

The postponement of major projects was reflected in lower public investment, while the rise in interest rates put a damper on private investment, especially in the case of small and medium-sized enterprises. The increase in financial costs in local currency and the higher exchange-rate risk involved in foreign borrowing had an effect on both fixed investment and inventory levels. Nevertheless, private investment was boosted in

several countries by foreign direct investment, which continued to play a dynamic role through new injections of capital in energy projects, manufacturing and services. In some countries, productive capital stock and transport and communications infrastructure were damaged in natural disasters.

The role of external saving in investment financing increased considerably, by more than one percentage point of GDP; in fact, this was a widespread phenomenon which occurred in 15 of the 19 economies for which data were available. The national saving rate declined to just under 19%, returning to the levels of the early 1990s, after having stood at around 20% for two years (see figure I.10). This decline was due in part to the unimpressive fiscal outturn, since public saving fell to its lowest level of the decade. These fiscal imbalances and the resulting decline in national saving may be a reflection of the deterioration in the terms of trade in 1998, which had caused regional income to decline by 1% of GDP. This effect was particularly pronounced in Chile, Ecuador and Venezuela; however, the situation was favourable in Central America and the Caribbean.

Figure I.10  
**LATIN AMERICA AND THE CARIBBEAN: SAVING AND INVESTMENT RATIOS**  
(As a percentage of GDP in dollars at constant 1995 prices)



Source: ECLAC, on the basis of official figures.

<sup>a</sup> Preliminary estimates.

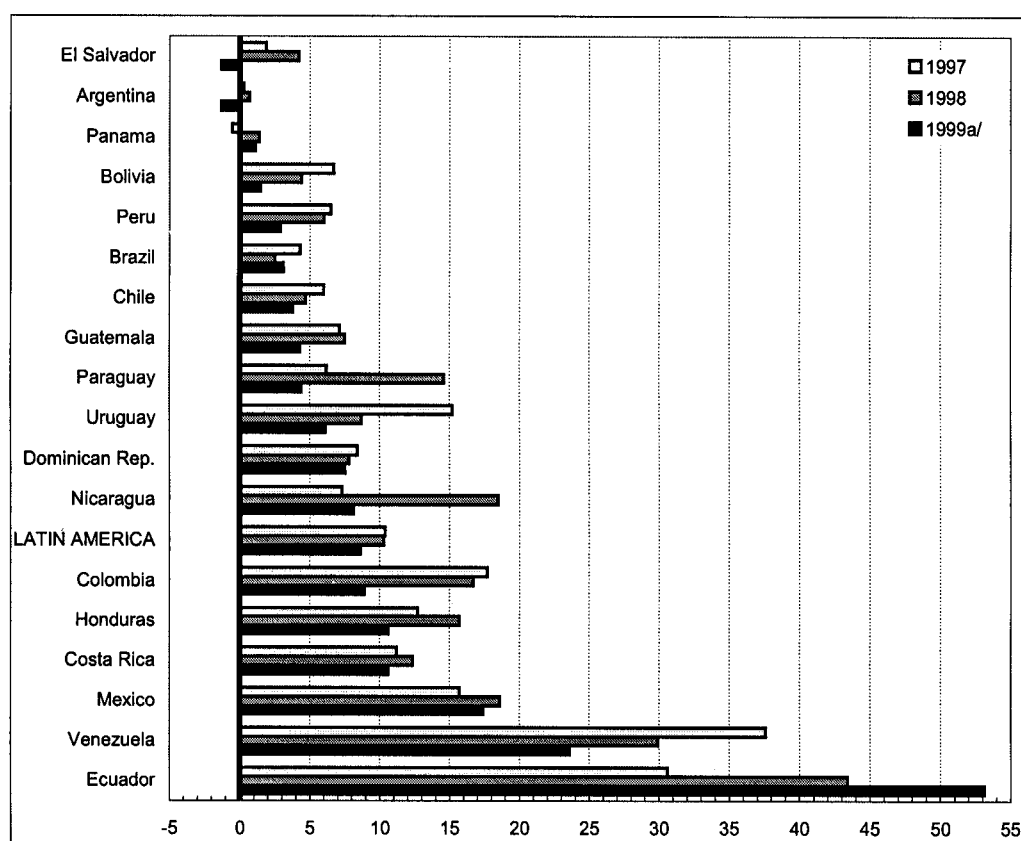
### Prices become more stable

Inflation in Latin America and the Caribbean stabilized at around 10% in 1998, having dropped sharply over the previous four years; price increases in the last biennium were at the lowest level in 50 years. In the first half of 1999, average inflation for the region fell further, with the 12-month variation to June 1999 amounting to less than 9%, although it could rise in the second half of 1999. The case of Brazil is particularly interesting: despite the steep devaluation in mid-January, prices rose very little—just slightly more than the 1998 rate of 2.5%. This slowdown in the rate of inflation, even after authorities had stopped using the exchange-rate as an anchor, is a key factor in the success of the country's macroeconomic adjustment. On

other occasions during the period, movements triggered by prices, whether exchange-rate adjustments or supply shocks, did not generate widespread or lasting inflationary trends. This rapid abatement in domestic price increases shows that the inertial effects of inflation—in particular price indexation—are on the wane in the region.

The positive trend in prices was a general pattern in the region, since 14 of the 22 countries under review recorded single-digit annual inflation in 1998. In 1999, two other countries also achieved this, while, in Argentina and El Salvador, prices actually fell. In 1998, six other countries posted inflation of between 10% and 20%, but in the two remaining countries, it was well over 20%: nearly 30% in Venezuela and more than 40% in Ecuador (see figure I.11).

Figure I.11  
LATIN AMERICA AND THE CARIBBEAN: CONSUMER PRICES  
(Twelve-month variations)



Source: ECLAC, on the basis of official figures.

<sup>a</sup> To June 1999.

In three countries (Ecuador, Nicaragua and Paraguay), prices rose more steeply in 1998 than in the previous year. In Ecuador, inflation was up by 13 percentage points with respect to 1997; it more than doubled the 1997 figure in Nicaragua, reaching 18%, and in Paraguay, prices rose by nearly 15%, eight points more than in 1997. In the first half of 1999, however, the latter two countries were able to reverse this unfavourable trend, rolling inflation rates back to less than 10%.

In 1998, domestic price movements in the economies of the region were influenced, in one way or another, by a number of factors, including the financial problems affecting the global economy, which called into question the counter-inflationary strategy based on a nominal exchange-rate anchor. Up to now, although these problems have posed serious difficulties for the foreign-exchange market and for monetary- and fiscal-policy management in some countries, they have not had any immediate impact on inflation. Restrictive monetary policies adopted by most of the countries affected and the recessionary trends that have been emerging since the fourth quarter of 1998 have also helped to keep price increases at their current low levels, even in cases where there has been a sharp devaluation. The fall in international prices for imported commodities, especially oil, also contributed to this generally favourable performance.

A series of supply shocks had an adverse effect on inflation in 1998, in particular the catastrophic weather conditions experienced in the region since the second half of 1997. These caused serious shortages in mass consumption products and inflationary surges on domestic markets, but price rises have tended to be reversed once supplies have returned to normal on domestic markets, without leaving signs of major inertial effects on the underlying inflationary trend.

### Unemployment rises

The economic slowdown was reflected in worsening labour-market conditions throughout the region, interrupting the improvement observed in the previous year. Unemployment rose from 7.3% to 8.0%, its highest level in 15 years, owing to the imbalance between a strong expansion in labour supply—the result of an increase in the overall participation rate—and weak job creation. This regional trend is, however, largely attributable to Brazil's poor performance; elsewhere in South America, the main indicators only started to weaken towards the end of 1998. The job situation improved in comparison with the previous year in a third

group of countries—comprising Mexico, Central America and the Caribbean—with the strongest rally observed in Mexico.

Job creation rates, especially for wage-earners, dropped substantially in comparison with 1997, when the recovery in economic growth had significantly boosted the demand for labour. Employment rose by a mere 2.0% (compared with 3.1% in 1997) and the number of wage-paying jobs went up by 1.9% (compared with 2.7% in 1997). Against this background, the majority of new jobs had to come from the informal sector. An analysis by sector reveals a further contraction in agricultural employment and weak growth in manufacturing. New jobs were concentrated in construction and, above all, in tertiary activities, with financial services, corporate services and property management—which grew strongly—accounting for a significant proportion, while commerce and social, community and personal services also made a strong contribution.

Beyond these general regional trends, the employment situation varied considerably from one country to another. In almost all the southern countries, rising unemployment and sluggish job creation coincided with a strong expansion in the role of the informal sector and a stagnation or a fall in real wages. Some of these countries saw their employment situation worsen, especially in late 1998 and early 1999, while Brazil, Colombia and Ecuador have been struggling with a worsening labour situation since 1997, if not earlier (see figure I.12a).

In contrast with these trends, Mexico and the Central American and Caribbean countries performed fairly well. Less seriously weakened by unfavourable economic conditions outside of the region, and benefiting from the strength of the United States economy, these countries generally achieved economic growth above the regional average; they were able to reduce unemployment, attain high rates of job creation and record certain improvements in terms of job quality indicators. Moreover, wage-paying jobs accounted for a higher share of new jobs as a result of stronger labour demand; again, unlike the situation in the South American economies, there was a relatively strong increase in job creation, even in the manufacturing sector.

The first months of 1999 witnessed a further decline in the employment situation, in keeping with the slowdown in economic activity. Stagnation or reduction in the employment rate during the first half of the year pushed up unemployment in Brazil, Chile, Colombia, Ecuador, Uruguay and Venezuela, in some cases to levels considerably higher than those recorded for the same period of the preceding year. Of the larger econo-

Figure I.12a  
**LATIN AMERICA AND THE CARIBBEAN: URBAN EMPLOYMENT RATE**  
*(Working population as a percentage of the working-age population, first half of each year)*

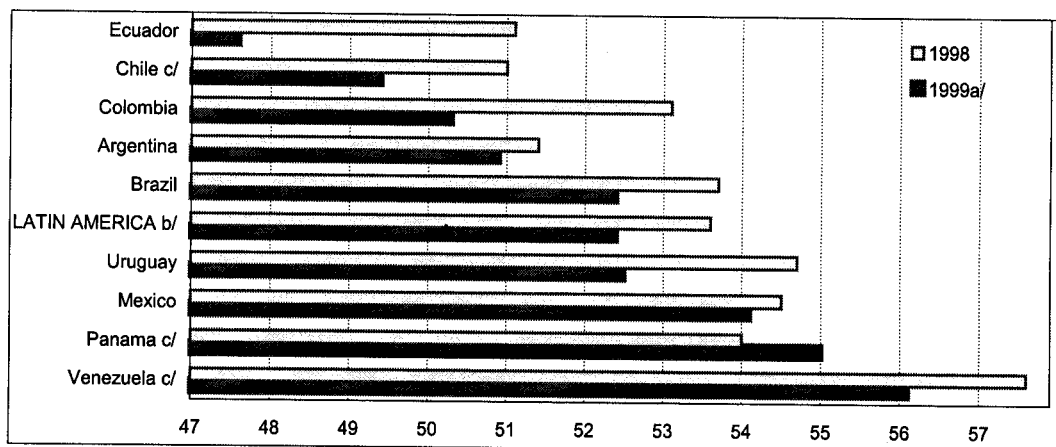
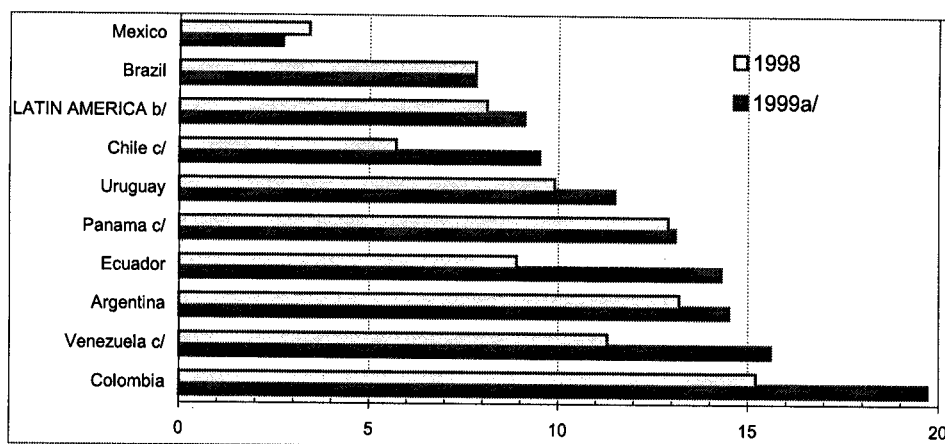


Figure I.12b  
**LATIN AMERICA AND THE CARIBBEAN: URBAN UNEMPLOYMENT RATE**  
*(As a percentage of the economically active population, first half of each year)*



Source: ECLAC, on the basis of official figures.

<sup>a</sup> Preliminary figures.

<sup>b</sup> Weighted average.

<sup>c</sup> Nationwide.

mies in the region for which information was available, only Mexico had a lower unemployment rate than in the same period of 1998, although, here again, employment dipped slightly in the first half of 1999,

and job creation in the formal sector declined (see figure I-12b). Nevertheless, towards the end of the first half-year, unemployment showed signs of falling in Brazil, as the outlook for growth improved.

**Real wages are maintained**

As already noted for the previous year, the trend in real wages varied slightly between countries. The deterioration in the labour market came late in the year, and was not sufficient to have a decisive influence in raising nominal wages. Moreover, the slower rise in consumer prices helped to protect the purchasing power of nominal wages, with real wages increasing moderately, so that the regional weighted average was 0.7%. This virtual stagnation was due mainly to the situation in the major South American economies, where the purchasing power of wage income rose by over 2% in half the countries of the region.

The steepest increases occurred in Bolivia, where inflation fell significantly in the second half-year; in Costa Rica, where economic growth picked up; in Nicaragua, where public-sector wages rose sharply, and in Venezuela, where real wages have been recovering from the heavy losses sustained between 1992 and 1996. Real wages also increased in Mexico, following a downswing that lasted several years. At the other end of the spectrum, the most notable declines were recorded in Ecuador, where there was a surge in inflation, and in Guatemala (-3.8%), where purchasing power fell for the first time in seven years. In the other countries for which data were available, real wages did not vary substantially.





## Chapter II

# Macroeconomic policy

### 1. Main trends

Events in 1998 exposed the region's vulnerability to the caprices of external capital flows and showed just how little manoeuvring room is available to national economic policy-makers. Countries suffering from chronically high external deficits and those whose trade or fiscal accounts were exposed to international price fluctuations had to restrain domestic demand in order to bring it into line with the meager inflow of foreign capital.

**THE FRAGILITY** of the public sector detracted from the efforts of the various countries in the region to use fiscal policy to enhance their macroeconomic stability. Given their uncertain financial status, many countries were forced to keep as tight a grip as possible on spending, but negative external shocks obstructed attempts to rein back fiscal deficits.

This was particularly true of a number of South American countries and, to a lesser extent, Mexico. In a situation where fiscal policy was not helping to check domestic demand and where policy-makers were refraining from using devaluation as a means of easing the pressure on external accounts, a great deal of the burden of the adjustment fell on monetary policy. The policies applied in this area were generally successful

in achieving their main objectives, which were, more specifically, to limit the global financial crisis' contagion of the foreign-exchange market and to forestall any significant devaluation. The high interest rates required to achieve these goals took a heavy toll, however, not only on the real economy (recession in the final quarter of 1998), but also on the performance of the fiscal and banking sectors in some countries. Central American and Caribbean countries did not have to make a similar adjustment because they were shielded from the effects of the international crisis by their trade patterns (they are net importers of commodities), their orientation towards North American and European markets, and the fact that their financial markets are still at an incipient stage of development.

The turmoil seen in the currency market during 1998, together with the devaluation of the Brazilian *real* in January 1999, rekindled the debate as to what type of exchange-rate regime would be the most appropriate given the new circumstances confronting the region's economies. A further consideration relevant to this debate was the appearance of the euro as a key component of the European convergence and integration process, particularly insofar as it relates to two issues of concern to the region. The first refers to the question as to what type of exchange rate policy is the most suitable in a context of increasingly liberalized trade and capital accounts. The discussion of this point has focused, in particular, on the relative merits of fixed versus flexible exchange-rate regimes and, as regards the former, on the advisability of replacing existing national monetary units with some other currency of an extra- or supra-national nature as a way of warding off speculative attacks.

The second issue relates to the need to make faster progress in coordinating macroeconomic policies among the members of trade integration schemes. This concern, which has already been addressed by the countries of the Central American Common Market (CACM) and the Andean Community, was raised at

meetings of the Southern Common Market (Mercosur) held in the first half of 1999.

Another issue that has arisen in the area of macroeconomic policy coordination, but this time at the national level, has to do with how difficult it has become to maintain consistency among monetary, exchange-rate and fiscal policies because of the extreme vulnerability of public accounts. Rising real interest rates have driven up the service on the domestic public debt, both because of its size in absolute terms and because of its high degree of liquidity. The scant countercyclical response capacity of fiscal expenditure in times of crisis—due perhaps to its rapid growth during economic booms and the difficulty of obtaining financing for larger (albeit temporary) fiscal deficits on domestic and foreign credit markets at such times—has given fiscal policy a procyclical bias. In order to correct this, public finances will need to be programmed on a multi-year basis so that the countries concerned can achieve additional degrees of freedom by running up surpluses in boom periods and building up reserves to cushion cyclical downswings (as is being done in Chile, for example, through the use of the Copper Stabilization Fund and in Venezuela, where a petroleum stabilization fund has recently been established).

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## 2. Fiscal policy and public finance

The fiscal situation in Latin America and the Caribbean in 1998 was a cause of concern for several reasons. First, the savings rate of the region's non-financial public sector (NFPS) fell to its lowest level of the decade without being offset by any increase in saving by private agents. Second, the region failed to achieve a primary surplus, which indicates that, even without the debt problem, the public sector would still not be in a strong financial position. Third, public investment has been declining steadily since 1997. Fourth, the average NFPS deficit widened to 2.4% of GDP—its highest level of the decade—and although this average figure is relatively modest, several countries ended the year with substantial shortfalls.

Despite the adoption of contingency measures to strengthen revenues and curb spending, income decreased and expenditure rose. These efforts did have a

positive effect, however, on the budgetary items—on both the revenue and the expenditure side of the ledger—over which the Governments have the most discretionary control. Nonetheless, it was not enough to make up for the losses caused by the influence of external factors on budget items that are less susceptible to direct government control. On the revenue side, weakening international prices for some export products cut into non-tax receipts. On the expenditure side, the need to maintain high interest rates in order to cope with the currency crisis affecting so many of the countries made it impossible to curb the increase in the service payments on the domestic public debt.

In 1999, both revenue- and expenditure-related factors will continue to hinder fiscal consolidation efforts, and a slowdown in economic activity could have an even more negative impact on revenues than in

1998. Although international commodity prices are expected to rebound, this is unlikely to be sufficient to offset the effects of the economic slowdown. On the expenditure side of the ledger, further investment will be needed to restore the infrastructure damaged by natural disasters over the last two years, and several Governments have already introduced adjustment measures in order to meet urgent social needs. Furthermore, the cost of domestic borrowing will remain high so long as a tight monetary policy is maintained. For all of these reasons, Governments have redoubled their efforts to counteract such impacts via tax changes and cuts in operating expenditures.

#### **(a) Trends in fiscal revenue**

Although the discretionary measures taken to boost revenues had positive results, their effects were not powerful enough to offset various adverse external shocks. For the second year in a row, NFPS fiscal revenues decreased in approximately half of the countries in the region, and total revenues fell on average by 0.5% of GDP (see table II.1) as a result of reductions in both current and capital receipts. The increase in tax receipts was not large enough to counterbalance the decrease in non-tax revenues and, in fact, the countries that experienced the worst setbacks in this respect were those whose export products had decreased in price. In Ecuador, Mexico and Venezuela, revenues declined from their 1997 levels by between 2.5% and nearly 11% of GDP, mainly because of the slump in international oil prices, which, in turn, hurt the financial accounts of exporters in those countries. In Chile, public-sector revenues were down by 1% of GDP from the year before, mainly owing to the performance of the State copper industry.

At the regional level, the average tax burden increased for the second year running, thus attesting to the effectiveness of the discretionary measures applied by the Governments to deal both with the projected reduction in non-tax revenues and with the expected slowdown in economic growth in 1998. Most of the countries were able to garner additional resources and, as a result, only Argentina, Chile, Haiti and Paraguay saw tax revenues decline because of a decrease in indirect taxation. Guatemala, Honduras and Nicaragua were able to boost their tax revenues by between 1% and 3% of GDP by raising tax rates, especially in the case of indirect levies; these efforts were also bolstered by the greater buoyancy of the Central American economies, where the financial crisis was felt less strongly

than elsewhere in the region. In Brazil, the measures contained in the Government's fiscal adjustment package succeeded in raising tax revenues, especially in the case of income tax receipts. In Bolivia, higher taxes on hydrocarbons helped to make up for lower non-tax revenues.

The oil-producing countries, which suffered the steepest cuts in total income, managed to make significant gains in terms of tax collection. These countries have traditionally had a relatively modest tax burden, as they can normally rely on non-tax sources of income; as the latter began to decline, however, they took steps to build up their receipts. Ecuador's and Venezuela's tax burdens rose to their highest levels of the decade (10% and 11% of GDP, respectively) thanks to gains in indirect taxation, particularly customs duties. In Mexico, tax receipts rose by nearly 1% of GDP.

#### **(b) Trends in fiscal expenditure**

Two thirds of the countries in the region incurred higher expenses in 1998, pushing average fiscal expenditure, as measured in terms of GDP, to its highest level of the decade (see table II.1). Cutbacks in capital expenditure were not enough to counteract the sharp rise in current spending.

On average, current expenditure rose by nearly 1% of GDP. There were three main reasons for this. First, half of the countries had higher interest payments on their debts. Several of them, including Brazil, Colombia and Ecuador, tightened up their monetary policy to forestall a depreciation of their currencies, which had come under pressure because of the external financial crisis, and this raised the cost of domestic borrowing. Nevertheless, given the contraction in external financing, several Governments had no alternative but to borrow locally at a higher cost.

Second, the financial requirements of decentralized State agencies increased for various reasons, most of which had to do with the reform process. An extreme example in this respect was found in Bolivia, where pension-system reforms generated a fiscal cost equivalent to 4% of GDP, as the old system ceased to receive contributions but still had to pay out benefits to pensioners. Similarly, the pension reforms being implemented in Uruguay continued to require transfers to the mixed pay-as-you-go and capitalization system, and the Brazilian social security system was also running a deficit. In addition to the reforms being introduced in this area, investments were made in strengthening local government and in the privatization of State enter-

Table II.1  
**LATIN AMERICA AND THE CARIBBEAN: NON-FINANCIAL PUBLIC SECTOR ACCOUNTS**  
*(As percentages of GDP)*

	Total revenue		Current revenue		Tax revenue		Total expenditure		Current expenditure		Interest payments		Financial balance	
	1997	1998 <sup>b</sup>	1997	1998 <sup>b</sup>	1997	1998 <sup>b</sup>	1997	1998 <sup>b</sup>	1997	1998 <sup>b</sup>	1997	1998 <sup>b</sup>	1997	1998 <sup>b</sup>
<b>Latin America and the Caribbean</b>	<b>23.3</b>	<b>22.8</b>	<b>21.9</b>	<b>21.7</b>	<b>13.9</b>	<b>14.5</b>	<b>24.7</b>	<b>25.3</b>	<b>18.9</b>	<b>19.7</b>	<b>2.5</b>	<b>2.7</b>	<b>-1.4</b>	<b>-2.4</b>
Argentina	17.2	16.6	17.0	16.5	17.0	15.4	18.6	17.8	17.4	16.7	1.8	2.0	-1.4	-1.2
Bolivia	30.3	30.9	28.9	29.6	12.8	14.0	33.7	34.9	26.5	28.6	1.6	1.4	-3.4	-4.0
Brazil	28.9	32.1	24.9	27.5	13.4	15.4	34.1	40.2	31.1	36.6	3.3	7.7	-6.1	-8.0
Chile	32.0	31.0	31.1	30.3	17.9	17.7 <sup>c</sup>	31.2	31.7	25.0	25.6	0.4	0.7 <sup>c</sup>	0.8	-0.7
Colombia	33.6	33.5	31.6	31.4	19.5	20.1	36.7	37.2	24.4	26.3	3.8	5.1	-3.1	-3.7
Costa Rica	29.8	30.0	29.7	30.1	16.5	17.0	31.3	31.1	25.7	25.6	5.0	4.3	-1.5	-1.1
Ecuador	23.8	20.3	23.8	20.3	9.1	9.8	26.3	26.5	20.0	20.6	5.0	5.0	-2.6	-6.2
El Salvador	15.6	16.3	15.4	15.5	10.8	11.2	17.4	18.3	13.5	14.5	1.5	1.5	-1.7	-2.0
Guatemala <sup>c</sup>	9.1	10.4	9.0	10.4	8.5	9.6	10.6	12.8	6.5	8.1	0.8	1.1	-1.5	-2.4
Haiti <sup>c</sup>	9.1	8.9	9.1	8.9	9.1	8.9	11.2	11.4	9.8	9.3	0.8	0.8	-2.0	-2.4
Honduras <sup>c</sup>	17.5	18.9	16.8	18.5	14.1	16.8	20.3	22.2	16.1	16.9	4.3	3.3	-2.8	-3.4
Mexico	23.0	20.6	15.8	14.3 <sup>c</sup>	9.8	10.5 <sup>c</sup>	23.6	21.8	15.1	14.2 <sup>c</sup>	3.6	2.5 <sup>c</sup>	-0.6	-1.2
Nicaragua	39.2	40.6	33.6	37.1	27.3	30.1	40.9	39.5	26.1	26.8	4.7	4.5	-1.8	1.1
Panama <sup>c</sup>	19.2	18.9	18.4	18.2	12.0	12.0	19.6	23.3	17.0	19.5	3.4	3.5	-0.4	-4.5
Paraguay	21.1	21.2	20.7	21.0	11.8	11.1 <sup>c</sup>	20.7	21.0	14.1	15.1	0.5	0.7 <sup>c</sup>	0.4	0.2
Peru <sup>c</sup>	14.2	14.0	14.1	13.8	12.0	12.0	15.0	14.9	11.7	12.0	1.6	1.7	-0.9	-0.9
Dominican Republic <sup>c</sup>	16.1	16.2	15.9	15.8	14.8	15.0	15.4	15.2	11.2	11.3	0.5	0.5	0.8	1.0
Uruguay	32.0	32.6	32.0	32.6	18.4	18.6	33.2	33.1	29.3	28.7	1.5	1.4	-1.2	-0.6
Venezuela	31.9	21.0	28.1	20.8	10.1	11.0	29.3	27.6	17.9	17.6	2.9	2.8	2.6	-6.6

Source: ECLAC, on the basis of official figures.

<sup>a</sup> Calculated on the basis of figures in local currency at current prices.

<sup>b</sup> Preliminary figures.

<sup>c</sup> Refers to central government.

prises. For example, the Government of El Salvador decided to increase its spending on municipal development, and the Panamanian authorities had to absorb the cost of paying off labour contracts in newly privatized firms.

Third, in most countries government consumption expenditure, especially payroll expenses, continued to rise. However, some countries that did manage to cut current spending chose to realize those savings specifically on consumption costs. The Mexican Government reduced current expenditures by 1% of GDP by means of three programmed cuts during the year, while in Argentina, current outlays were lowered by 0.7% of GDP in line with the country's agreement with the International Monetary Fund (IMF). Haiti and Uruguay managed to cut their operating costs by 0.5% of GDP.

Many of the adjustments that were made involved scaling back capital investment, which decreased in the region for the second year running. In

Bolivia, Colombia, Nicaragua and Venezuela, capital expenditure fell by between 1% and 2% of GDP, partly because of a cutback in investment by State-owned enterprises. The Governments of Guatemala, Haiti, Honduras and Panama, on the other hand, increased their capital expenditure. In the case of Haiti, this included investments in the sorts of capital goods that have traditionally been received through foreign aid, while in Honduras reconstruction work had to be carried out in areas ravaged by Hurricane Mitch. The Government of Panama, meanwhile, undertook investments to upgrade the nation's infrastructure.

### (c) Trends in the overall balance and its financing

The combination of all these factors resulted in a fiscal deficit equivalent to 2.4% of GDP, which was more than one point above the average for the decade.

Whereas only three countries in the region had recorded deficits of over 3% of GDP in 1997, seven exceeded this level in 1998. At one end of the spectrum, Brazil, Ecuador and Venezuela turned in negative balances in excess of 6% of GDP; in the first case this was due to higher interest payments, while in the other two it was attributable to a slump in oil revenues. At the other extreme, only three countries closed out their NFPS accounts for the year with a surplus. The Nicaraguan public sector, which had posted a deficit of 2% of GDP in 1997, managed a surplus of 1% thanks to an expansion of revenues and cutbacks in physical investments. In Paraguay, where the fiscal surplus has shrunk over the last three years owing to increased investment by public-sector enterprises, fiscal accounts ended the year with a small positive balance. In contrast to this, the Dominican Republic saw its public-sector surplus expand despite the unplanned expenditures required to repair the damage caused by Hurricane Georges, which were met out of special funds.

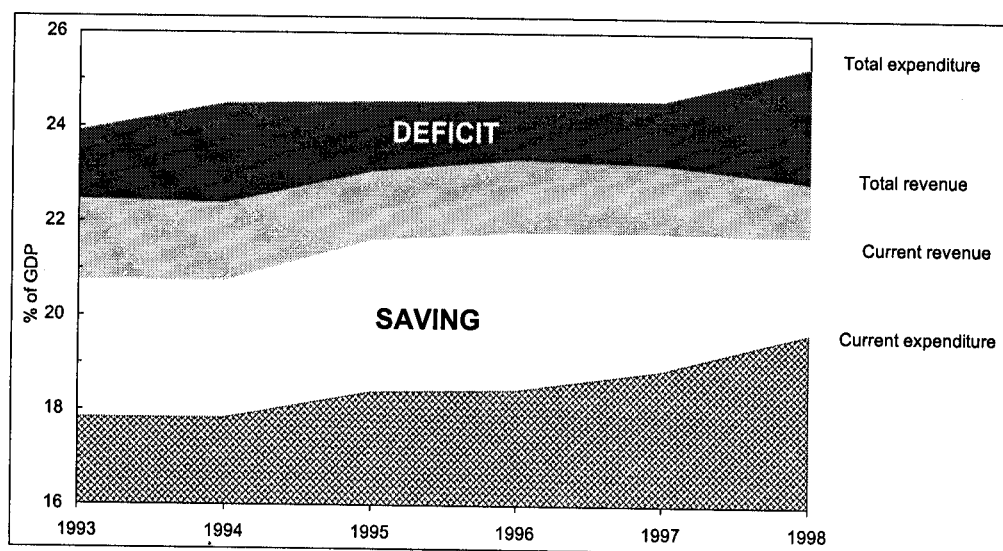
Public-sector saving (revenues less current expenditure) fell for the second year in a row, thus slipping to 30% below its 1997 level, as current revenues stagnated and current expenditure rose sharply (see figure

II.1). Although most of the countries managed to post a positive savings rate, the overall figure —2% of GDP— was a record low for the decade, and four countries had negative rates. Brazil has been unable to save for the last four years because of its costly interest payments. Panama saw what had been a positive performance in this respect reversed as a consequence of higher privatization-related expenses. On the other hand, Argentina and Haiti managed to reduce their dissaving to quite low levels.

The primary balance (financial balance before interest payments) was almost nil for the first time in a decade owing to a combination of flat revenues and higher government operating and capital expenditures. Eight countries failed to achieve primary surpluses; Bolivia and Venezuela were the worst off, the former because of an increase in reform-related expenditure and the latter due to a downturn in non-tax revenues.

Over half of the Governments in the region had to finance a major part of their deficit with domestic funds, despite the high relative cost of doing so, because of the contraction in the supply of external funding caused by the financial crisis affecting most of the South American countries.

Figure II. 1  
FISCAL POSITION OF THE NON-FINANCIAL SECTOR, 1993-1998



Source: ECLAC, on the basis of official figures.

### 3. Foreign exchange policy

As had become evident in earlier years,<sup>1</sup> the trend in the real exchange rates of the countries of the region has been influenced more strongly by financial factors than by changes in economic or commercial fundamentals (productive development, terms of trade). This tendency towards overvaluation has weakened, however, as a result of the global financial crisis that began to make itself felt in the region in October 1997 and struck with full force in August and September 1998.

As this crisis is predominantly financial in nature and has thus raised doubts about the speculative investment strategies that were previously being used in so-called "emerging markets", its most obvious effects have taken the form of short-term capital outflows and turbulence in the stock market. Exchange rates have been affected mainly by three factors: (i) the revision of sovereign risk ratings by international investors; (ii) the extent of net capital outflows; and (iii) the response of the monetary authorities. In the case of raw-materials exporters, this financial component has been compounded by a terms-of-trade shock.<sup>2</sup>

The rapid transition from a risk-taking international market to a risk-averse one cut off the region's access to the international bond market in the second half of 1998. During the same period, capital outflows led to a net decrease in international reserves for the first time since the financial crisis that erupted in Mexico in late 1994.

#### (a) Foreign exchange policies and markets

To control or prevent the loss of international reserves, the vast majority of the countries involved preferred to defend their currency by means of very stringent monetary policies rather than giving into speculative pressures and adjusting the nominal exchange rate.

There were three main reasons why this strategy was used. Early in the year, the regional effects of what was still being referred to as the "Asian" crisis were expected to be transitory, and there appeared to be no need

to adjust the real economy via a change in relative prices. Indeed, in the second quarter of 1998, the international situation seemed to be improving. Devaluation would also have jeopardized the creditable progress achieved in the fight against inflation, which in many cases had been achieved at the expense of an overvalued real exchange rate, because the stabilization strategy had been based on the use of the nominal exchange rate (whether fixed or adjusted with a crawling peg) as an anchor.

In August, when the financial crisis ceased to be "Asian" and became global in scope, the monetary authorities were again reluctant to adjust the exchange rate because markets had now become too volatile, and introducing limited adjustments in a climate of such widespread uncertainty would have meant running the risk of triggering speculative attacks on a large scale. After several years of sustained external capital inflows and overvalued local currencies, many local debtors were exposed to foreign-exchange risk. A significant adjustment in the exchange rate would have put these debtors in a very difficult position and would have pushed firms that were oriented towards the domestic market and had borrowed in foreign currencies into bankruptcy, thereby undermining the stability of the financial system.

Accordingly, the monetary authorities of the affected countries (mainly Mexico and those of South America, with Argentina being a special case because of its foreign-exchange regime) used their international reserves to defend the currency or to rein in its depreciation. After having climbed by US\$ 16 billion the year before, reserve assets were drawn down by over US\$ 10 billion in 1998, with losses being concentrated in four countries (Brazil, Chile, Colombia and Venezuela). Venezuela alone spent nearly US\$ 4 billion of its copious international reserves to defend the currency band against speculative onslaughts. Even in countries with freely floating exchange rates, such as Mexico, the authorities intervened in the currency market in the period between August and October to avert unduly wide

1 See ECLAC, *Economic Survey of Latin America and the Caribbean, 1997-1998* (LC/G.2032-P), Santiago, Chile, September 1998. United Nations publication, Sales No. E.98.II.G.2.

2 For further information on this point, see the discussion of the effects of the crisis in the region in chapter VIII.

swings. In Brazil, for example, borrowers having a significant degree of exchange risk exposure took advantage of this breathing space to hedge their foreign-currency positions.

The policy used by the Brazilian authorities to defend the crawling peg put a significant drain on reserves during the second half of the year, despite a slight acceleration in the rate of depreciation (averaging 8.3% for the year) and extremely high interest rates. Unlike what had happened in October 1997, when the first speculative attack was launched against the *real*, interest rate hikes in the second half of 1998 were unable to halt speculative movements. In fact, they actually stimulated such movements because of their impact on public finances. The drain on reserves (which at the height of the crisis shrank by US\$ 24 billion in just two months) amounted to US\$ 8.5 billion for the year as a whole, and the Government of Brazil was forced to seek external assistance. Anxious to keep the financial crisis from spreading further, the international community responded promptly, and in November announced a US\$ 41.5 billion aid package for the country to be coordinated by IMF. Although this agreement also provided for a supplementary contribution to the country's reserve funds of over US\$ 9 billion, renewed reserve

losses in early 1999 forced the Government to adopt a free float, thereby instituting a *de facto* devaluation (see box II.1).

This state of affairs sparked speculation against the region's weaker currencies and ultimately led to the devaluation of the Ecuadorian sucre. Colombia was another country that made a determined effort to defend its exchange rate, until it was finally forced to raise its currency band by 9% in August 1998. Even so, exchange-rate pressures did not ease until late in the year, when domestic liquidity decreased in the wake of a dollar-denominated public bond issue and the country received a number of multilateral loans. However, in June 1999 the currency band had to be raised again by a further 9%. Paraguay also had to back off from its defense of its currency in 1998 because of the low levels reached by its international reserves, and the guaraní consequently depreciated by 25% in nominal terms, although the difficulties in this country's domestic financial sector also played a part. A similar pattern was seen in Jamaica, which also had to use reserves to shore up its currency.

In general, however, no major exchange rate movements or changes in foreign exchange policy occurred in the region, although Brazil and Ecuador did

#### Box II.1 THE BRAZILIAN ECONOMY IN THE FIRST HALF OF 1999

##### Devaluation and volatility in January and February

The shaky position of the Brazilian economy from mid-1998 onward, which put a heavy drain on international reserves, became critical in early January 1999. In response to the worsening situation, the Government tried to contain exchange-rate movements by widening the currency band, but just two days later it was forced to abandon this system and put the real into a free float. The result was a steep devaluation (from 1.22 to 2.20 reals to the dollar).

Great uncertainty prevailed throughout January and February and, because the stabilization process was in its infancy, there was fear of an impending devaluation such as those that had occurred in Mexico and the Asian countries, which had generated powerful inflationary pressures and pushed these economies into recession. During the first few weeks, the Central Bank seemed to lack a strategy for curbing the steep climb of the dollar

and, to make matters worse, it announced a change of leadership. Although nearly US\$ 36 billion in reserves was still on hand, the level of reserves had been drawn down by US\$ 50 billion over the preceding six months, and the authorities were facing a large number of bond and bank loan maturities in the first five months of the year. The lack of a strategy for controlling the devaluation of the currency fueled fears that further extraordinary measures might be implemented, especially with respect to the public debt, because of the large fiscal deficit generated, in large part, by the very high interest rates resulting from the monetary authorities' austerity policy.

##### Recovery from March onward

In March, a number of factors began to assuage the more negative expectations that had existed regarding the performance of the Brazilian economy. The newly-installed officials that had recently taken up the reins at the

Central Bank announced a substantial increase in domestic interest rates, thereby signaling the adoption of a strategy for controlling the devaluation of the currency. It also became apparent that the impact of the devaluation had largely been absorbed by the public sector—thus averting a financial crisis—thanks to the hedging mechanisms made available to the private sector in the form of futures and securities indexed to the exchange rate. In addition, renegotiations with IMF and the authorization received to use part of the international aid package to stabilize the foreign exchange market confirmed the developed countries' support for Brazil's economic policy. This enabled the Central Bank to intervene immediately in the foreign exchange market and was crucial in restoring economic agents' confidence and containing the devaluation. A turnaround occurred during March and April, and the real appreciated by 25% in nominal terms as the exchange rate dropped back to around 1.65 to the dollar.



#### Concluded Box II.1

In addition, the passage of fiscal measures in Congress, together with the publication of the first favourable results on government balance sheets, helped to allay fears that the country's domestic borrowing capacity was being depleted. Expectations of a decline in the debt/GDP ratio as a result of growing primary surpluses, privatizations and falling real interest rates have been reinforced by the fiscal outturns announced in recent months. For example, the consolidated public sector achieved a primary surplus equivalent to 3.5% of GDP in the first four months of 1999, in contrast to the situation existing in the corresponding period of 1998, when the sector had only managed to break even.

Apart from these economic policy developments, the extremely favourable trend of inflation in recent months has clearly played a role in generating greater optimism. Following an inflationary spike in February, the rate of price increases abated in March and then continued to subside further in April and May, when monthly price rises returned to their pre-devaluation levels. On the basis of these results, the Central Bank initiated a series of steep interest-rate cuts which brought annual rates down from 40% in early March to 21% by the end of June.

Meanwhile, the figures on economic growth for the first quarter of 1999 proved to be better than expected, with GDP falling by just 1% compared to the same quarter a year earlier. A strong upswing in agriculture (9%) prompted an upward revision of GDP estimates (which had put

the projected decline at 4%) for 1999. This new-found optimism is summed up in the revised projections, according to which annual inflation is expected to come in at below 10% and the recession is likely to be much shallower, with GDP expected to shrink by only 1%.

April also saw the resumption of trading in Brazilian securities on the international market with the placement of a US\$ 2 billion issue, although at higher rates than those paid before the crisis of August 1998.

#### Tempered optimism

In June, fears about the performance of the Brazilian economy returned, especially with regard to its external accounts. The cumulative value of merchandise exports for the year to April was down by 16% from the same period in 1998, and imports were 20% lower; the result was another trade deficit, this time of slightly over US\$ 400 million. This adverse turn of events caused the targets for the merchandise trade surplus to be slashed from US\$ 11 billion to US\$ 4 billion. Some of the numerous reasons for this disappointing export performance were low commodity prices on international markets, financing difficulties in the early months of the year and, from mid-May onward, the spillover effects of worsening economic problems in Argentina, which is one of the main markets for Brazilian products.

Meanwhile, the recession in the domestic economy continued, with levels of unemployment, although lower than expected, nonetheless climbing to record levels in several metropolitan areas. The slump in the labour market had a strong impact on wages. In addition, major

branches of production, such as the automotive and electronics industries, were still adjusting their output levels downward in response to the contraction of both domestic and external demand.

The recession continued to block an upturn in tax revenues, and this heightened fears that the fiscal adjustments that were being made would not be sustainable over the medium term. There was also evidence that a number of one-off factors had played a part in the promising improvement seen in the primary result for the first four months of the year, including receipts whose legality was being challenged in the courts, pre-payments made in connection with the privatization of Telebras and smaller outlays for wage payments.

A further consideration is that the future course of inflation still entails some significant risks, the most important of which is the behaviour of the exchange rate. Recent hikes in fuel prices and electricity and telecommunications rates show that the impact of the devaluation has not yet fully worked its way through the economy. Moreover, with interest rates falling in recent months and economic growth likely to revive, anti-inflation policy cannot continue to be based on the recession. However, the main challenge for the Brazilian economy will be to restore investor confidence, which is currently at a very low ebb. Achieving this will require a highly satisfactory fiscal performance in order to halt the alarming upward trend in the public debt/GDP ratio.

allow their currencies to float freely in the first quarter of 1999. In many of the countries that applied a crawling-peg system (most of the region), it proved possible to limit adjustments to modest changes in the currency band, as was done in Chile and Honduras. In the case of the Dominican Republic, the adjustment that had to be made in the exchange rate was not a reaction to speculation against the currency but was instead an outgrowth of the implementation of a structural reform aimed at putting an end to the dual (official and commercial) exchange rate system, which penalized exporters.

#### (b) Trends in the real exchange rate

In 1998, the currencies of the countries of the region recovered from the exchange-rate effect generated by the first external shock in October 1997 and then continued on their upward course until the second quarter of 1998, when their cumulative appreciation since 1995, calculated as a simple average, amounted to 9%. After a third quarter when opposing trends offset one another, real local-currency exchange rates began to fall steeply in the fourth (a quarterly downturn of 2.3%,

when calculated as a simple average), and this trend continued (1.9%) into early 1999 (see figure II.2). Despite these year-end declines, the average real exchange rate for the countries of the region as a group still appreciated by 1.2% for 1998 as a whole.

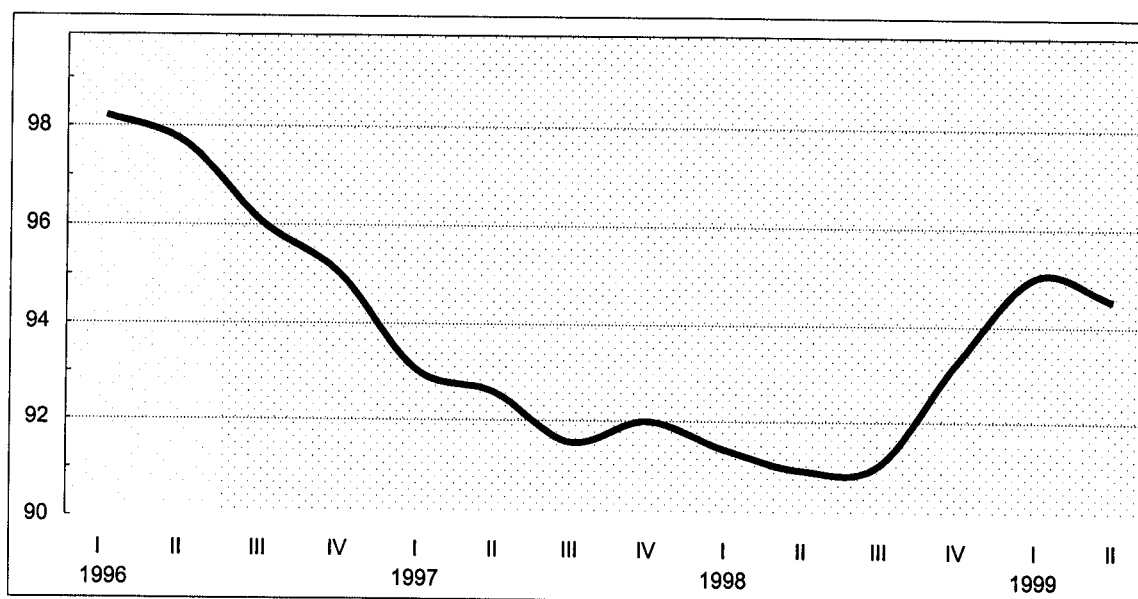
This mean trend for the Latin American and Caribbean countries conceals very marked cross-country differences, however. As may be seen in figure II.3, the currencies of five countries appreciated by more than 5% (three Caribbean countries—Trinidad and Tobago, Jamaica and Haiti— plus Honduras and Venezuela). The exceedingly steep appreciation of Venezuela's currency was directly related to that country's persistently high level of inflation and the currency-based stabilization strategy adopted by its monetary authorities.

At the other end of the spectrum, Paraguay registered the largest real depreciation (–10%), despite a significant surge in inflation (prices rose by almost 15%)

due to the strong downward pressure on the currency, as mentioned above. The real depreciation in Colombia was also the result of the change in the nominal exchange rate, as the upward trend of domestic prices eased slightly. In the case of the Dominican Republic, however, the 8% slippage in the currency was basically a reflection of the technical adjustment mentioned above and is expected to be less marked in future thanks to the changeover from a fixed exchange-rate system to a crawling peg.

In the important case of Brazil, where the cumulative real appreciation resulting from the domestic stabilization strategy was one of the weak points of the Real Plan, the *real* depreciated by nearly 5% against the currencies of the country's main trading partners. As noted earlier, this turnaround was not sufficient to protect the country from speculative attacks, and the devaluation of January 1999 led to a further real depreciation of 32% in the first quarter.

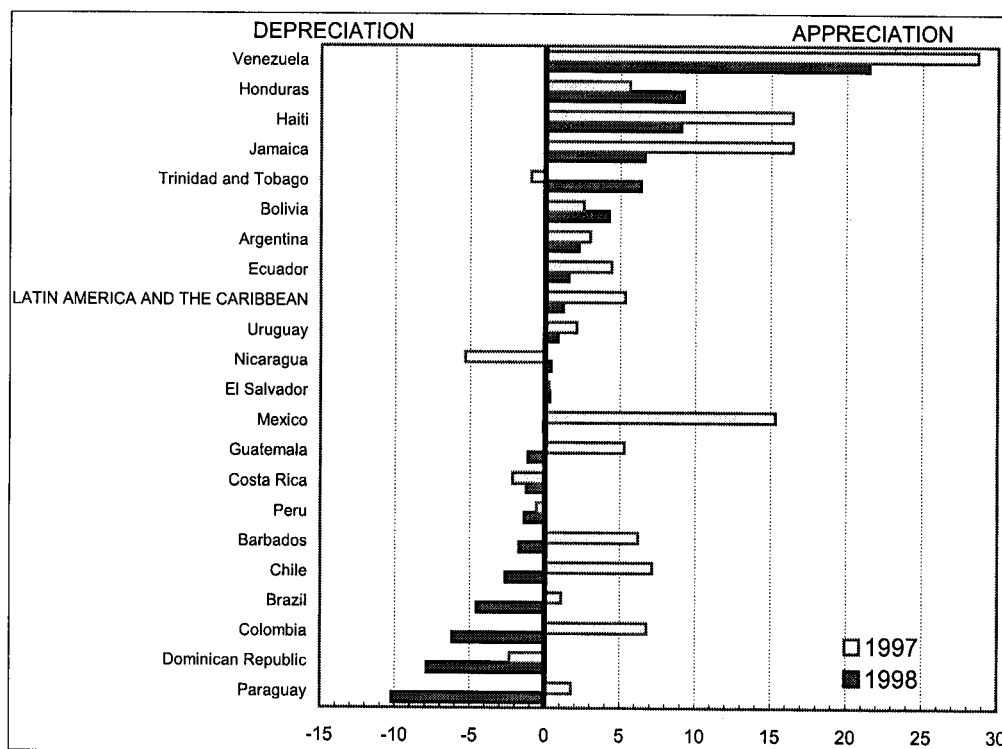
Figure II.2  
**LATIN AMERICA AND THE CARIBBEAN: REAL EXCHANGE RATE**  
(Simple average, index: 1995=100)



Source: ECLAC, on the basis of official figures.

Note: A rise in the index signifies a depreciation of the local currency.

Figure II.3  
**LATIN AMERICA AND THE CARIBBEAN: REAL EXCHANGE RATE**  
**APPRECIATION OR DEPRECIATION**  
*(Annual variation)*



Source: ECLAC, on the basis of figures from official sources and IMF.

#### 4. Monetary policy

Restrictive monetary policies predominated in the region. This was especially true in South America (the Andean Community, Mercosur and Chile) and in Mexico, while the Central American and Caribbean countries adopted a more flexible stance. The interest rate was the main tool used by the monetary authorities to control liquidity, ease tensions in the foreign-exchange market and diminish inflationary pressures associated with its fluctuations. This variable was used either directly, via a change in the interbank rate (Chile and Colombia) for example, or through open-market operations (Central America, Mexico, Paraguay and Venezuela).

Some changes were also made in legal reserve requirements. These measures were not always aimed at gaining greater control over money creation in the banking system, however; on many occasions they were also designed to improve the banks' profitability and boost demand for government paper. In Bolivia, the reserve requirement was converted into an investment fund composed of interest-bearing instruments, and in Brazil the cash reserve requirement applying to time deposits was replaced by a reserve held in public-sector securities. The reserve requirement was lowered in both Costa Rica and Peru, while in Honduras it

was discontinued and replaced by open-market operations. On the other hand, El Salvador raised its reserve requirements to control the expansion of liquidity. A similar measure was applied by the Banco de México in early September when it began to require banks to maintain interest-bearing deposits with the central bank.

### (a) The money supply

#### Trends in the main aggregates

The trends of the main monetary aggregates in 1998 were in line with the turnaround seen in the second half of 1997 and underscored the differences existing between the Caribbean and Latin America in terms of their phases of the economic cycle.

As is shown in figure II.4, in October 1997 the region saw an abrupt reversal of the expansion of the monetary base that had accompanied the recovery of production in Latin America following the December 1994 Mexican crisis and the problems experienced by the banking sector in several of the region's countries. When computed as a simple average for the countries of this subregion, the annual growth rate for this variable, after having shot up to very high levels in August (27% with respect to the same month in 1996), began a sharp descent that intensified throughout 1998, reaching negative values by the fourth quarter of the year.

This contraction was especially marked in Brazil, where the economy had remonetized in 1996 and 1997 thanks to the steep drop in inflation. The real decrease in base money amounted to 13% in December 1998 compared to the same month of 1997. However, the annual average remained positive (18%) owing to the momentum built up in the initial months of the year. The money supply was even tighter in the countries of the Andean Community, as the sharp downswing seen at the end of the year (an annual rate of 16% as of December, on average, for the countries of the subregion) came on top of a monetary slowdown in the preceding months (base money shrank by an average of 6% for the year). With the exception of Brazil, the Southern Cone countries also applied exceedingly prudent policies (the real money supply grew by just 2% on average for the year and exhibited a slight contractionary tendency in the final months). In Central America the real money supply also tended to stagnate in the latter months of 1998, but the average figure for the year as a whole was much higher (19%). In Mexico, on the other hand, the growth rate for the stock of base money picked up towards the end of the year after having been subject to a

quite cautious form of policy management throughout the reference period.

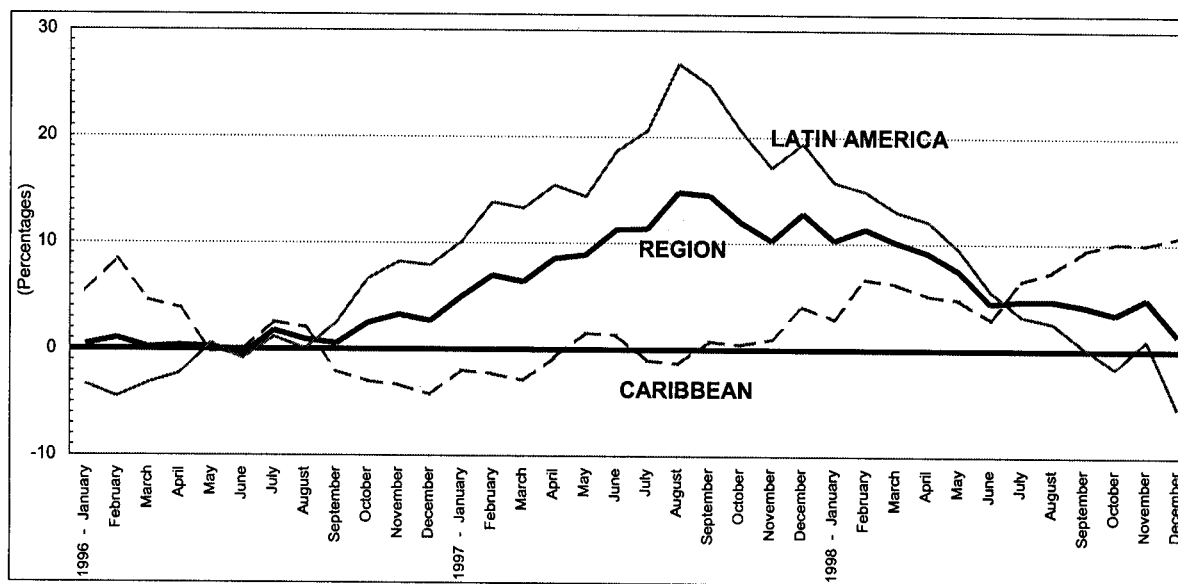
In contrast to prevailing trends in Latin America, the Caribbean countries, which suffered less turbulence from the global financial crisis and in fact benefited from its effect on the terms of trade for goods, saw a continuation of the slow expansion of the monetary base that had begun in 1997. This trend gathered momentum during the second half of the year, and real growth rates climbed to two-digit levels in half of the Caribbean countries considered; the expansion of this variable then continued to strengthen, with the 12-month variation as of December coming in well above (four percentage points) the annual average, with very few exceptions (Bahamas, Grenada and the Netherlands Antilles).

The contrast between the two subregions in terms of the authorities' policies concerning the base money stock was mirrored in the behaviour of the monetary aggregates of the banking system as a whole, although the differences have not been so clear-cut in the case of quasi-money.

The trend of the money supply (M1) was very similar to that of the monetary base, although with a certain lag. The slowdown did not become generally noticeable in Latin America until February 1998, but from September on, the money supply's average real growth rate turned negative. In December, the 12-month rate of variation, measured as a simple average for the Latin American countries, was approaching -5%, thus reflecting the recessionary climate that had pervaded the real economy, with several countries posting sharply lower quarterly growth rates and, in some cases, negative ones (Argentina, Brazil, Chile, Colombia, Ecuador, Peru and Venezuela).

Unlike what happened with M1 and the monetary base, the slowdown in the growth of quasi-money (including foreign-currency deposits) was not so sharp as to produce a negative average rate for the Latin American countries as a whole. Nonetheless, the impact of the monetary authorities' austerity policy could also be seen here, as the real average growth rate declined by seven percentage points with respect to 1997. Given the existing climate of moderate inflation, interest rate hikes encouraged substitution between money and quasi-money, especially if the latter is taken to include foreign-currency deposits as well. The figures illustrate a significant fact: despite the climate of uncertainty prevailing as a result of the global financial crisis, either there was no general withdrawal of bank deposits at all or, where this did happen, it was due to problems peculiar to the banking system in the countries involved

Figure II.4  
**LATIN AMERICA AND THE CARIBBEAN: MONETARY BASE: REAL 12-MONTH VARIATION**  
*(Simple average)*



Source: ECLAC, on the basis of figures from official sources and IMF.

(Ecuador, Paraguay). This stability in financial savings patterns was one of the key factors in limiting the negative effects of external disturbances on the economies of the region.

In the Caribbean, the overall trend of the money supply also failed to respond immediately to the expansionary policy applied to the monetary base. The real annual growth rate drifted downward during the first half of 1998 after having peaked in January, and it was not until late in the year that signs of an upswing began to be seen. Meanwhile, quasi-money continued to grow apace (at a rate of around 10% in real terms). Signs of a slowdown emerged towards the end of the year, particularly in Barbados, where the annual growth rate turned negative in December after having topped 5% for the year as whole.

### Expansionary factors

The factors contributing to the expansion of liquidity varied from country to country. In the larger economies, such as those of Brazil and Mexico, the growth of public-sector domestic credit was fairly steady

throughout much of the year, but ended with a sharp correction in the final months (see table II.2). In medium-sized and small economies subject to external liquidity constraints, variations in the money stock were mainly driven by the availability of foreign funds. This was particularly true in the countries of the Southern Cone (except Brazil) and the Andean Community (apart from Ecuador). The prudent nature of the macroeconomic policies implemented in this group of countries was also reflected in the slow growth rate registered for public-sector borrowing despite widening fiscal deficits.

In contrast to these patterns, in the Caribbean and Central American countries —where the impact of the global financial crisis was weaker— external liquidity had less of an influence on monetary expansion in 1998. In these countries, the growth of domestic credit was comparable to, if not greater than, that of foreign assets. In Central America, apart from Honduras, credit to the public sector remained tight for the second year running, and the expansion of domestic credit stemmed mainly from lending to the private sector.

Table II.2  
**LATIN AMERICA AND THE CARIBBEAN: DOMESTIC LIQUIDITY EXPANSION FACTORS, 1997-1998**  
*(Real growth rates)<sup>a</sup>*

	Latin America and the Caribbean	Southern Cone:		Community	Central America	Mexico	Caribbean
		(1) Brazil	(2) Other countries				
<b>Public sector credit</b>							
		<b>Annual average</b>					
1997	37.9	66.2	114.3	48.4	-0.3	125.0	11.2
1998 <sup>b</sup>	17.5	88.8	-1.8	14.4	0.7	112.7	16.8
		<b>December-December variation</b>					
1997	45.5	199.4	56.4	58.2	2.6	158.4	28.6
1998 <sup>b</sup>	1.3	-33.8	-11.1	11.7	4.8	32.5	0.2
<b>Private sector credit</b>							
		<b>Annual average</b>					
1997	10.8	-3.1	10.3	21.0	14.3	-25.8	9.4
1998 <sup>b</sup>	14.0	5.4	14.8	16.3	23.4	-4.3	11.2
		<b>Annual average</b>					
1997	15.9	4.6	12.2	26.8	22.4	-14.0	13.3
1998 <sup>b</sup>	9.3	5.4	10.9	4.4	20.8	-7.4	7.7

Source: ECLAC, on the basis of official figures and data from the International Monetary Fund.

<sup>a</sup> 12-month variation deflated by consumer prices. Simple country average. <sup>b</sup> Preliminary figures.

### (b) Interest rates

In contrast to the situation in 1997, when nominal interest rates trended downward throughout the region, the behaviour of this variable in 1998 was very uneven. A few countries saw a continuation of the previous year's decline; interest rates also fell in 1998 in Honduras, the only country under review in which the nominal interest rate did not fall in 1997. In most cases, however, this downward trend reversed itself and the cost of money rose. Taking a simple average of the countries considered, nominal interest rates on deposits climbed by 3.4 percentage points (340 basis points) and lending rates by 5.4 points, whereas in 1997 these rates had slipped by 4.8 and 6.0 percentage points, respectively.

The trend of the nominal interest rate is usually a function not only of monetary and exchange-rate policies and changes in the supply and demand for money, but also of inflationary expectations. Such expectations remained under control at the regional level, with a few exceptions (Ecuador, Nicaragua and Paraguay, where

they increased, and Venezuela, where they eased somewhat but were still quite high). Accordingly, the trend of the interest rate mainly reflected monetary policy measures oriented towards reducing domestic spending and defending the exchange rate. It is therefore not surprising that the largest increases occurred in the countries that were most severely affected by the international crisis and the scarcity of foreign financing, which included, in particular, Brazil, where the annual lending rate rose by an average of 45 percentage points for the year, Venezuela (32 points) and Ecuador (7 points).

In Ecuador, the country's external difficulties were compounded by problems of a domestic nature and disturbances in the financial system. As a result, the deposit rate was raised by 12 points more than the lending rate in order to retain depositors and avert a liquidity crunch in the banking sector. Similar situations arose in Paraguay, where, on average, deposit and lending rates rose by 4.3 and by only 2.7 points, respectively, and in Colombia (8.5 points versus 7.8).

The rise in interest rates also reflected a widening of public-sector deficits in countries where these deficits had to be financed mainly on the domestic market. In such instances, the combination of external liquidity constraints and monetary restraint magnified the impact on the interest rate. Such was the case in Brazil, for example, where the net public debt swelled by more than 8% of GDP in 1998. In Colombia, Ecuador and Venezuela the situation was similar. Rising interest rates tend to put strong pressure on current public expenditure, especially when the public debt has a very short maturity profile or carries variable rates, and a vicious circle is generated between the expanding fiscal deficit and rising interest rates. In Brazil, 70% of the public sector's domestic debt is indexed, and the average term of public debt instruments is just three months. As a result, the increase in financial costs very quickly fed through into higher public expenditure on interest payments, which amounted to nearly 8% of GDP (up from 5% in 1997).

Given the firmer rein kept on inflation during the last two years, nominal interest rate hikes were reflected directly in real rates. Measured as an annual average, real mean deposit rates rose by 4.1 percentage points between 1997 and 1998 in the countries of the region and lending rates by 6.3 points. In most of the countries for which information is available, the bulk of the increase occurred in September and October, when rates peaked before starting on a downward trend that continued into the first quarter of 1999 (except in Brazil, where interest rates were driven higher by the devaluation of the *real*). This pattern also coincided with movements in the spreads over benchmark rates that Latin American bond issuers had to offer on international financial markets. As a result, annual increases measured as of December 1998 were smaller (2.7 and 4.5 percentage points for deposit and lending rates, respectively) than the mean figures for the year.

Using the average annual deposit rates in 1997 and 1998<sup>3</sup> as a basis for comparison, the largest increases were seen in Venezuela (29 percentage points), Colombia (7 points) and Brazil (6 points); in all three of these

countries, significant nominal interest rate hikes coincided with decreases in inflation. Two countries registered reductions: Bolivia (-5 points) and Paraguay (-0.4 points). In the case of Paraguay, the decline was attributable to an upturn in inflation which lowered the real cost of money.

After having narrowed in 1997, the spread between lending and deposit rates widened significantly, reaching a regional average of over 14 points. Although this mean figure was heavily influenced by the extremely high levels reached by spreads in a few countries (e.g., Brazil) and may also in part be a reflection of a *de facto* dollarization of financial operations in others (Bolivia, Uruguay), the fact remains that in over half of the countries the spread was still above 10 points. The magnitude of this figure signals the existence of unresolved problems in the banking sector which are hindering a smoother intermediation of saving and investment.

The stringent approach taken by monetary policy-makers, together with the resulting constraints on liquidity and higher financial costs of attracting deposits, put national banking systems in a difficult position on several occasions.<sup>4</sup> This was particularly the case in countries whose banking sectors were still suffering from the effects of earlier crises, such as Colombia, Ecuador, Mexico and Paraguay. In fact, the unstable situation with regard to bank liquidity during the second half of the year was one of the factors that led the authorities to relax their monetary policy. This was especially true of Colombia, where the authorities took a series of steps in October and November to lower the reserve requirement. Changes were also made in reserve requirements in order to make sure that banks could accrue interest on their reserves (Bolivia) and to facilitate the placement of government securities, as was done in Brazil in August 1998.

The same principle was applied in Chile and Colombia, where, in order to improve foreign-exchange liquidity, the corresponding reserve requirements were lowered in response to the financial crisis. Similar reductions for foreign-currency bank deposits were made in Ecuador.

3 As the relevant instruments of deposit are generally quite homogeneous (30- to 60-day term deposits), deposit rates are more appropriate for making comparisons between countries than the rates on short-term bank loans, which tend to vary according to the type of operation and client concerned.

4 Chapter III, on structural reforms, provides an outline of the situation in the financial sector and the reforms that are under way.

## Chapter III

### Structural reforms

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#### 1. General trends

The second wave of privatizations, which had begun in 1996, continued in 1998 and yielded a record level of revenues. Reforms designed to correct institutional weaknesses continued to be implemented, but less intensively than before. Reform processes in some countries were hindered by the international financial crisis, particularly in the areas of trade and finance.

**WITH STRONG** leadership from Brazil, privatizations in 1998 generated more than US\$ 40 billion in receipts. The Central American countries were also very active in this respect, particularly in the electric power and telecommunications sectors. The privatization process is losing momentum, however, since the bulk of former State assets has already been sold off.

The measures implemented in the course of the 1990s have revealed a number of institutional shortcomings in the countries of the region, thus underlining the need for reforms in this area to improve the efficiency of the State and its supervisory and regulatory capacities. The most serious problems stem from the failure to regulate privatized natural monopolies, where the new relationships among producers,

consumers and the State generally lack transparency; hence the need to strengthen the regulatory and consumer protection roles of State institutions. Although the existence of such problems is recognized, stronger action is required in order to overcome them.

As for social security reforms, in 1998 an individually funded system entered into operation in El Salvador, and Venezuela laid the legal foundations for the introduction of a similar system.

The international financial crisis and the monetary austerity measures adopted in its wake had the effect of weakening financial institutions in a number of countries; this made it necessary to take steps to mitigate the situation and to tighten up financial oversight and monitoring.



A number of problems arose in connection with the implementation of trade reforms in 1998 and especially in the first half of 1999 as a consequence of the international financial crisis. Many of the countries of the region, particularly in Central America, nonetheless moved forward with the implementation of trade

reform measures under the programmes established for that purpose within the framework of free trade agreements or regional integration schemes. Regional integration processes also continued, despite occasional setbacks.

## 2. Public-sector reforms

Public-sector reforms in 1998 included a number of privatizations which brought in an enormous amount of revenue, particularly in Brazil, but in Central America as well. There was also some progress in relation to social security reform and State institution-building.

### (a) Privatization

The wave of privatizations that began two years earlier continued to swell, with record receipts being posted in 1998. The countries of the region took in revenues totalling close to US\$ 42 billion, an unprecedented level of returns from such operations. The privatization process will soon have run its course, however, since in many of the so-called "first-wave" countries (Argentina, Chile, Peru and Mexico), most State enterprises have already been placed in private hands. Plans to privatize State assets are still under way in those countries that adopted a gradual approach (such as Colombia), in countries where the process began later (Brazil and the Central American countries) and in those suffering from problems of instability (Ecuador and Venezuela).

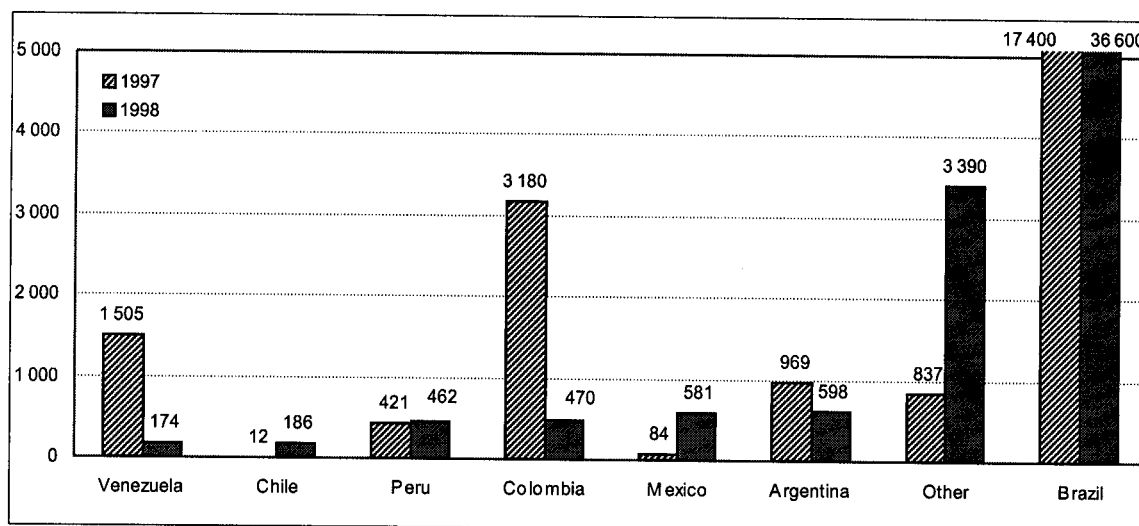
The fact that privatizations in 1998 yielded such sizeable proceeds despite the international financial crisis was clearly due to Brazil's leading role in this process (see figure III.1), since the US\$ 36.6 billion in receipts obtained by Brazil made up 85% of the overall figure for privatizations in the region in 1998. These exceptional results also underlined the need for stable inflows from foreign investors. Long-term capital, which behaves differently from short-term speculative capital, has maintained a strong presence in the region because it is attracted to projects whose profitability does not hinge upon cyclical economic developments. Since privatizations offer such opportunities, it is not surpris-

ing that privatization revenues were so high in 1998. Another factor is that structural reforms and the progress made in terms of macroeconomic stabilization have made the region's economies very attractive to domestic and foreign investors, thus spurring large investment inflows throughout the 1990s. Unlike the situation during the debt crisis of the 1980s, economic authorities in most of the countries have succeeded in cushioning the worst impacts of the financial crisis by means of prudent macroeconomic management and improved supervision of the financial sector. The fact that the authorities have resisted the temptation to back-track on the structural reform process and have thereby ensured that the region remains attractive to investors has probably played an influential role in making this record level of privatization receipts possible.

The Central American countries also turned in an outstanding performance in 1998. After the years of political and economic instability which delayed the introduction of structural reforms, these countries began implementing large-scale changes in the mid-1990s. There was a particularly large number of privatizations in 1998, with Guatemala taking in about US\$ 1.56 billion, El Salvador US\$ 860 million and Panama US\$ 620 million. These sums were equivalent to 8.3%, 7.3% and 6.7% of GDP, respectively, as compared to 4.7% of GDP for Brazil.

From a sectoral viewpoint, privatization operations were clearly concentrated in the telecommunications industry in 1998, chiefly because of the huge sum realized from the sale of Telecomunicações Brasileiras (Telebras). The proceeds of US\$ 19.01 billion from this sale made it the largest privatization operation in the region's history. The electric power sector contributed 30% of total privatization receipts, and the combined share of these two sectors thus came to 90% of the total,

Figure III.1  
**LATIN AMERICA AND THE CARIBBEAN: PRIVATIZATION REVENUES,**  
**BY COUNTRY, 1997 AND 1998**  
*(Billions of dollars)*



Source: ECLAC, on the basis of official figures.

will all other sectors together accounting for only 10% of the total yield (see figure III.2).

The sectoral breakdown by country also reflects the predominance of the telecommunications and electric power industries. In Guatemala, the share of telecommunications was 60% and that of the electric power sector, 40%; the figures for El Salvador were 35% and 65% respectively. In Panama, the electric power sector contributed 87% and in Colombia, 100%. The exceptions were those countries where the privatization process is already winding down. In Chile, for example, the sale of a sanitation company made up 75% of the total, which was the same percentage represented by privatizations of railways and airports in Mexico.

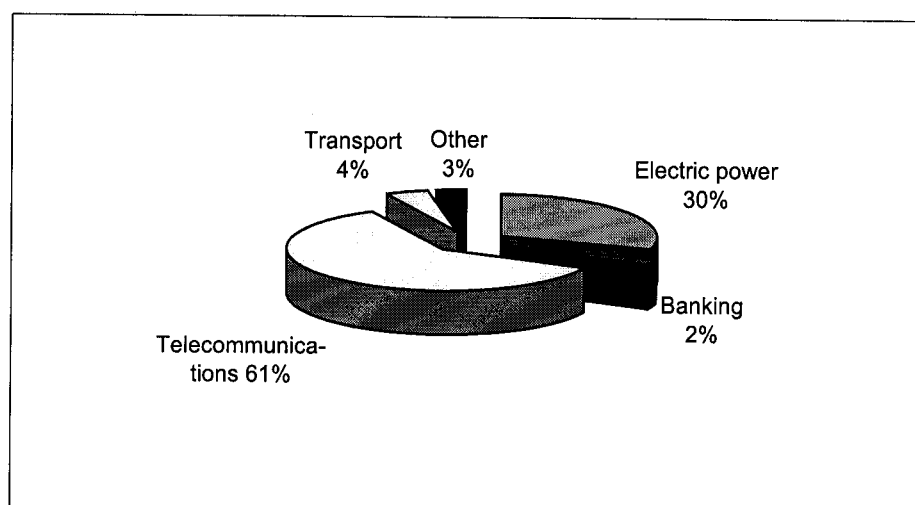
In 1998 the list of buyers of State assets was once again headed up by Brazilian enterprises, which tend to confine their purchases to business concerns within their own country. However, the percentage of public-sector Brazilian assets acquired by international investors is increasing from year to year. Among the other countries on the list, United States and Chilean companies continued to increase their presence in the countries of Latin America and the Caribbean. A relatively new phenomenon is the notable increase in the

presence of European enterprises in the region, particularly from Spain and Portugal.

In its broadest sense, the term "privatization" includes concessions as well. This has been a high-growth area in recent years owing to the strong interest shown by domestic and foreign investors in taking part in projects of this type and to the existence of a sizeable unmet demand for infrastructure in most Latin American and Caribbean countries as a consequence, to a great extent, of the debt crisis of the 1980s.

The range of concession projects existing in the region includes roads, railways, subway systems, ports, airports, sanitation systems, postal systems, etc. The Chilean highway concession programme includes a total of US\$ 6.5 billion in projects up to the year 2003 and, of this sum, concessions amounting to US\$ 3.45 billion have already been tendered. Argentina awarded operating concessions for 33 airports in early 1998, which will bring in US\$ 171 million annually for the next 30 years. In addition, the international consortium which won the concession has undertaken to invest at least US\$ 2.075 billion, bringing the total (concession plus investment) up to US\$ 7.4 billion over 30 years. The Government of Mexico has also begun awarding airport concessions and has announced that it will do

Figure III. 2  
**LATIN AMERICA AND THE CARIBBEAN: SHARE OF PRIVATIZATION REVENUES,  
 BY SECTOR, IN 1998**



the same for the postal system. Peru, too, has announced its plans to offer port and airport concessions. Chile's port privatization programme has run into trouble with lawsuits and has been postponed for the time being.

Despite the continuing volatility of the international situation, many countries have drawn up ambitious plans for 1999 that include such elements as privatization programmes for the electrical power industry in Brazil, Colombia and Ecuador. One of the

most significant privatizations to be carried out thus far in 1999 was the Argentine Government's sale of 15% of its shares in Yacimientos Petrolíferos Fiscales (YPF) for US\$ 2.011 billion. In April 1999, following a currency crisis in the first quarter, Brazil sold 53% of the Companhia de Gas de São Paulo for US\$ 1 billion, which was almost double the floor price. Two electric power companies were also sold in the Dominican Republic for a total of almost US\$ 310 million.

Table III. 1  
**LATIN AMERICA AND THE CARIBBEAN: PRIVATIZATION REVENUES, 1990-1998<sup>ab</sup>**  
*(Millions of current dollars)*

	1990	1991	1992	1993	1994	1995	1996	1997	1998	Total
Argentina <sup>c</sup>	2 139	1 896	5 312	4 589	1 441	1 340	1 033	969	598	19 317
Bolivia	-	-	7	14	-	848 <sup>d</sup>	874 <sup>e</sup>	-	-	21
Brazil	-	1 564	2 451	2 621	1 972	910	3 752	17 400	36 600	67 270
Chile	29	117	21	-	203	3	579	12	186	1 150
Colombia	117	105	27	4	681	138	1 476	3 180	470	6 198
Mexico	3 580	10 716	6 799	2 507	771	-	-	84	581	25 038
Peru <sup>c</sup>	-	3	208	317	2 578	946	2 460	421	462	7 395
Venezuela	10	2 276	30	32	15	21	2 090	1 505	174	6 153
Other	1	25	31	95	868	75	68	837	3 390	5 390
<b>Total</b>	<b>5 876</b>	<b>16 702</b>	<b>14 886</b>	<b>10 179</b>	<b>8 529</b>	<b>3 433</b>	<b>11 458</b>	<b>24 408</b>	<b>42 461</b>	<b>137 932</b>

**Source:** For 1996 and 1998, official information and own calculations on the basis of Latin Finance, Privatisation International, Latin American Weekly Report, Latin American Economy and Business. Period 1990-1995, R. Cominetti, "La privatización y el marco regulatorio en Bolivia y Nicaragua; un análisis comparativo", Reformas de políticas públicas series, No. 43 (LC/L.973 and Add.1), Santiago, Chile, ECLAC, 1996.

<sup>a</sup> Cash proceeds plus proceeds in the form of external and domestic bonds reported at their value in the secondary market, except in the case of Brazil, for which domestic bonds are reported at their nominal value.

<sup>c</sup> Includes concessions. <sup>d</sup> Includes US\$ 51 million in privatization and US\$ 797 million in capitalization. <sup>e</sup> Capitalization.

### (b) Institutional changes and market regulation

The structural reforms of the 1990s drew attention to the lack of efficiency in the public sector. Institutional shortcomings make it difficult or impossible to establish clear and transparent rules for dealings between the public and private sectors. Privatizations are only one aspect of public-sector reform; of equal importance are institutional reforms designed to improve the efficiency of the State and its supervisory and regulatory capacity. The "re-invention" of the State thus encompasses such other matters as administrative and judicial reforms, improvements in regulatory and legal systems, etc.

Some Latin American countries have implemented reforms aimed at increasing the independence of the judiciary; in others, however, stagnant and unwieldy structures persist. In their fight against corruption, some countries have begun to adopt measures to improve the transparency of State functions. Costa Rica, for example, has adopted a code of ethics for public servants in order to define what is acceptable behaviour and what is not. To the same end, Uruguay passed anti-corruption legislation in late 1998.

A number of countries have pressed on with fiscal reforms in an effort to provide the State with a more stable and reliable revenue base that will lay the foundations for improved efficiency in government. In most cases, tax reforms in 1998 included the reduction or elimination of tax exemptions and/or measures designed to cut down on tax evasion and smuggling (Argentina, Colombia, Ecuador, Honduras, Suriname, Venezuela). Brazil sought to reduce government spending by raising the taxes paid by civil servants and adopted measures that permit municipal and state governments to lay off personnel under certain circumstances and to set limits on staff salaries and benefits. In Ecuador, as part of a package of 61 bills currently before Congress, the main changes being proposed in this area include the abolition of tax and tariff exemptions, the reintroduction of the income tax and the creation of taxes on corporate assets and motor vehicles.

Other measures include the modernization of government financial management in Panama and the introduction of an integrated financial management system in Honduras to improve the monitoring and management of public spending. Bolivia adopted a reform plan for the customs system, while Ecuador set up the Ecuadorian Customs Corporation and an internal revenue service in an effort to reduce tax evasion. As part of El Salvador's fiscal decentralization programme, legislation was adopted to create an eco-

nomic and social development fund for the country's municipalities.

The weakness of the region's institutional framework is particularly evident in the area of market regulation; an especially serious problem in this respect is that a number of public services are natural monopolies. In such cases, consumers will not benefit to any great extent from privatizations unless they are coupled with appropriate regulatory systems. The basic problem here is one of information asymmetries, where economic authorities lack the necessary information to establish appropriate parameters; this creates a situation that is conducive to the formation of strategic behaviour patterns on the part of the monopoly enterprise.

The telecommunications sector is an instructive example in this respect. Countries that opened up this industry to private enterprise in the early 1990s (Argentina, Mexico and Peru) generally chose to privatize State-owned companies without laying them open to competition and/or without setting up an efficient regulatory system —something that they ultimately did in 1998. In contrast, several of the countries that were "late" in introducing structural reforms chose to create an efficient regulatory system first and to open up the sector to competition from the very start of the privatization process; the procedure used in Brazil provides a good example of this. Two years before the State privatized Telebras (its telecommunications company), preparations began for setting up an independent regulatory body, and the following year new telecommunications legislation was passed in order to create a transparent regulatory framework. Meanwhile, Telebras was being restructured with a view to maximizing its sale price. Finally, it was broken up into 12 companies, all of which were privatized on the same day. This strategy reduced the concentration of the market so that improvements in services could be made swiftly.

The electric power sector is also an interesting case in a number of ways. One similarity with the telecommunications sector is the lack of suitable regulatory systems for this industry in the countries that pioneered the privatization process. The Chilean electric power sector, which began to be privatized in the 1980s, is a typical example. A severe drought in 1998 and 1999 revealed substantial weaknesses in the regulatory and organizational structure, and the Government had to start rationing electric power, which took a heavy toll on the production sector and the population in general. This situation was met by a rapid response from the Government, which has taken steps to strengthen the regulatory system.

The momentum generated by the structural reform process has been another interesting development. Mexico, for example, has made a great deal of progress in implementing numerous structural reforms, but the measures taken in the electric power sector have fallen far short of the radical reforms carried out in other countries. Demand for electric power has tended to grow quickly, with an annual increase of 6% expected for the coming 10 years; this makes the electric power supply one of the major bottlenecks in the country's economic development process. However, since the public sector lacks the resources to make the required investments, the economic authorities recently proposed the necessary constitutional changes so that the sector could be opened up to private investors. In contrast, other countries appear to have foreseen this type of problem and are taking steps to prevent the formation of such bottlenecks. The Central American countries, for example, are planning to set up a common electric power grid in the subregion in the medium term. The idea will be to establish a spot market in which electric power can be freely bought and sold. It is believed that this type of competition will bring down energy generation costs, as will the possibility of taking advantage of economies of scale within this much larger market.

Another interesting case from the standpoint of regulatory issues, which has also been characterized by a dynamic of its own as a consequence of the structural reform process, is the petroleum sector in Argentina, where the arrival of private investors and competition has paved the way for mergers and acquisitions. For example, the Spanish firm Repsol S.A. recently acquired a controlling stake in YPF. Since Repsol already owns the Astra oil company, the acquisition of YPF gives it control over more than half of the country's oil production and refining industry. This prompted Congress to adopt an antitrust law providing for the creation of a special commission armed with legal powers to ensure competition. By opening up access to the private sector, these kinds of structural reforms clearly entail a redefinition of the relationships existing among consumers, producers and the State, with the State taking on new tasks in such areas as regulation and consumer protection.

### (c) Social security reforms

Social security reform is the third pillar of the public-sector reform process of recent years. Social security systems have been partly or completely overhauled in Argentina, Bolivia, Brazil, Chile, Colombia,

El Salvador, Mexico, Peru and Uruguay. In El Salvador, a new individually-funded system began functioning in 1998, with licences being granted to five private pension fund management companies (AFPs). In their first year of operation, these funds collected slightly more than US\$ 100 million in contributions and signed up about 620,000 people, surpassing their goal of 500,000 new members. A noteworthy aspect of this process has been the practice of "importing" capital and technology, since Chilean fund managers and United States and Spanish financial groups have stakes in El Salvador's AFPs. As part of what has become a widespread phenomenon in the region, pioneers in various areas of structural reform are "exporting" their technical know-how and drawing upon the experience they have acquired in order to take advantage of the new opportunities opened up by such reforms.

In late 1998, Venezuela enacted social security legislation to pave the way for the creation of private pension funds. Under the new law, private funds may start up operations in January 2000. The system will be a mixed one, since a portion of the contributions will be paid into individual capitalization funds and the rest will be channeled into a compulsory "solidarity fund", which is designed to ensure wider coverage and a more equitable system. Employers will pay 75% of the contributions and employees 25%.

AFPs already exist in Brazil, but they have attracted a relatively small share of the total numbers of contributors. The reforms currently being implemented under the Real Plan are of a more fiscal nature. In November 1998, a package of measures was adopted to reduce the cost for the public treasury of the State social security system. These measures include the establishment of a minimum retirement age for public employees and the replacement, for the purpose of pension calculations, of the concept of years of service by that of the length of time that contributions have been paid into the system. The legislation providing for these measures was bogged down in Congress for a considerable period of time, but was then adopted without further ado when the exchange-rate crisis erupted in October 1998.

In the countries where these revamped social security systems have been functioning for a number of years, there have been two disquieting developments. First, the institutional consolidation process has continued through mergers and acquisitions. In Chile, the number of AFPs had fallen from 20 in 1990 to eight by early 1999. In Argentina, the number of AFPS, which was 25 in 1994, currently stands at 14, and of the 17 which began operating in Mexico in 1996, there are

now 13 left. If these processes continue, they may lead to excessive market concentration, which would represent a suboptimum situation in terms of the interests of consumers. Second, this process was spurred forward in 1998 by the poor performance of AFPs in most of the countries of the region. In Argentina, for example, AFPs posted a negative rate of return of 1.5% on average, while in Chile the figure was 1.1% for the same period; in both cases, these outturns were well below historical annualized rates. Under such circumstances, the larger companies have a better chance of weathering the crisis, expanding their market shares and absorbing their smaller competitors, thereby increasing market concentration.

These types of consolidated private pension systems have also been expanding into other countries, diversifying their investments and standardizing their

practices at the regional level. In Chile, where the above practices have been especially notable, the AFPs began to expand into other Latin American countries several years before those of other Latin American countries started to do so, and have recently been branching out into Europe (Poland) as well. Furthermore, they are permitted to invest contributions in an increasingly wide variety of financial instruments both within Chile and abroad, and the percentage of their assets which they are allowed to invest in other countries is also increasing. The International Federation of Pension Fund Administrators (FIAP) has proposed that investment criteria should be standardized at the regional level in order to facilitate portfolio diversification and give contributors mobility within the region. These measures would also improve the operation of the region's capital markets and broaden the range of options available to domestic and foreign investors.

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### 3. Financial and capital-market reforms

Having liberalized their financial systems in the early 1990s, the countries of the region have been strengthening their regulatory frameworks in recent years. The banking crises that have occurred during the decade in many of the countries, together with the Mexican crisis (known as the "tequila effect"), have revealed shortcomings in the systems used for regulating, supervising and monitoring the region's financial systems. It has become clear that, in the absence of prudential regulatory mechanisms, the liberalized financial sector is subject to systemic crises owing to principal-agent and moral hazard problems. This has prompted the countries of the region to reform their regulatory and oversight mechanisms and to bolster their financial systems. The Asian crisis of 1997 and its worldwide repercussions in 1998 and 1999 have demonstrated that these efforts have borne fruit, since, with the exception of Ecuador, the international financial crisis has not led to widespread financial disturbances in the region.

Financial and capital-market reforms were influenced by two factors in 1998. On the one hand, the economies of the region continued their efforts, as in previous years, to strengthen their regulatory frame-

works and financial systems. On the other hand, these efforts were overtaken by the international financial crisis, and in some cases the position of the financial sector worsened significantly. In most instances, economic authorities responded to external impacts with monetary measures, owing to the inflexibility of fiscal policy in the short term and uncertainties as to the effectiveness of exchange-rate adjustments (there were fears that such steps might trigger uncontrollable devaluations). Consequently, restrictive monetary policies created difficulties for both the real and the financial sectors. Financial indicators generally worsened; in some countries this produced problems in specific areas, and in others, such as Colombia, it led to more widespread difficulties. The banking crises in Paraguay and Jamaica, on the other hand, began three years ago and thus were not caused either by the international crisis or by the response of the economic authorities to that crisis. The banking crisis in Ecuador represents an intermediate case in the sense that pre-existing negative trends have been aggravated by the effects of the international crisis.

Panama was one of the countries that was working to establish prudential regulatory mechanisms and to

strengthen its financial system in 1998. New banking legislation introduces modern standards of financial regulation (in accordance with the recommendations of the Basle Committee on Banking Supervision), provides for a banking superintendency to be set up in order to strengthen prudential regulation mechanisms, and introduces improved standards for bank deposit coverage and security. A legislative package was approved in Suriname in order to improve financial supervision, adopt enabling clauses for the rules of the Bank for International Settlements in Basle, strengthen the Central Bank's regulatory machinery, and liberalize the financial sector and open it up to international investors. A number of measures were also adopted in Uruguay to improve the financial standing of the banking system.

In Mexico, a new institution was created to administer some US\$ 65 billion in liabilities (equivalent to 15% of GDP) resulting from the bail-out package put together for the banking system during the Mexican crisis in December 1994. The Bank Savings Protection Institute (IPAB), which takes the place of the Bank Savings Protection Fund (FOBAPROA), will also be responsible for helping to strengthen Mexico's fragile banking institutions. Other measures introduced in 1998 include the removal of restrictions on foreign ownership of Mexican banks and debt relief mechanisms for small businesses and agricultural producers. Greater independence was also given to the Central Bank, together with responsibility for oversight of monetary and exchange-rate policy and supervision of the banking system and the stock market.

Adverse conditions in many countries made it necessary to implement contingency measures. In 1998 and 1999, in an effort to offset the effects of tax evasion, the application of the tax on financial transactions was extended, even though the relevant business associations contend that this tax impairs the operation of the financial system. Nonetheless, the need to reduce fiscal imbalances prevailed over concerns in relation to the costs associated with this tax. Furthermore, since this particular tax is easy to apply and difficult to evade, it is an attractive fiscal policy instrument. Because of these characteristics, this tax may be made permanent, although all the countries which have adopted it (Brazil, Colombia, Ecuador, Venezuela) initially did so for a limited period.

There was a significant deterioration in the position of Colombia's financial sector, primarily because of the measures taken by the authorities to defend the exchange-rate band. Restrictive monetary policies led to soaring interest rates, which then translated into

losses for the financial sector. The Government had to declare a state of economic emergency so that it could adopt debt-relief measures for low-income home buyers and participants in savings cooperatives and introduce a tax on financial transactions to shore up the Financial Institutions Guarantee Fund.

Paraguay, Jamaica and Ecuador have been experiencing banking problems and/or crises for the past four years. For Paraguay and Jamaica, 1998 brought no significant worsening of the situation, although the existing trends remained unchanged. In Jamaica, the Financial Sector Adjustment Company (Finsac) purchased commercial banks' portfolios of non-performing loans for the equivalent of 3.6% of GDP. The situation in Ecuador, on the other hand, took a drastic turn for the worse in 1998 and especially in the first half of 1999. The production sector was hit hard by the repercussions of the external situation and the destruction caused by El Niño, thereby exacerbating the plight of a financial sector, which had already been weakened by the protracted banking crisis. As a result, the Government had to intervene in the case of eight financial institutions. The authorities adopted the Economic and Financial Restructuring Act to boost activity in the production sector and stabilize the banking system, and the Deposits Guarantee Agency was established in order to put faltering financial institutions back on their feet and provide insurance for savings deposits. In addition, steps were taken to introduce constitutional changes that would give the Central Bank greater autonomy while also assigning it sole responsibility for monetary and exchange-rate policy.

The events of 1998 gave added momentum to the existing trend towards the institutional consolidation of the region's financial systems. The privatization of State-owned banks, mergers and acquisitions, the steps taken by regulatory bodies to bail out institutions in financial straits and the entry of foreign banks into the market all had the effect of reducing the number of financial entities. This process was particularly intense in 1998 in Argentina, Colombia, Ecuador and Paraguay.

Other legislative measures in the region included the creation of the Macroeconomic Stabilization Fund in Venezuela to soften the domestic impact of swings in international oil prices. In late 1998 Mexico's first derivatives market began to operate, and in Chile legislation was passed to permit the establishment of an international stock exchange in the country that would be free of any capital or tax restrictions on foreign investors. In Bolivia a new law was passed to govern securities markets and another to open up the insurance

market to international companies. In May 1999 the Ibero-American Securities Markets Institute was founded in Spain to facilitate cooperation and ex-

changes among the regulatory bodies that supervise securities markets in Spain, Portugal and 15 Latin American countries, foster their development and promote legal harmonization in this area.

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#### **4. Labour reforms**

Labour reforms are probably the most difficult measures to implement because an inverse relationship exists between the short-term benefits to employers and the protection of workers' rights, and this leads to a major conflict of interest. It is therefore not surprising that, in comparison with other areas of reform, little has been achieved in the region in this respect.

Following protracted discussions and negotiations, the Argentine Congress passed a controversial labour reform bill in 1998 that seeks to lower the cost of hiring and firing personnel. This legislation also provides for the elimination of certain types of short-term labour contracts that do not provide social benefits and for the reduction of severance payments for new employees. In addition, contrary to the initial proposal made by the Government, under the new law the nego-

tiation of collective labour contracts with the trade union for each branch of activity at the national level remains mandatory.

Other legislative initiatives in 1998 included the passage of a compulsory arbitration law in Panama that stipulates the conditions under which a strike can be suspended. Changes in the labour code in Costa Rica, on the other hand, include the right to strike in the State sector, with the exception of railways, ports, airports and hospitals. In Brazil, constitutional reforms in the area of public administration increased the flexibility of rules and regulations governing labour contracts in the public sector. This makes way for new legislation which is expected to stipulate the conditions for dismissal or suspension of civil servants in the event of fiscal difficulties or unsatisfactory work performance.

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#### **5. Advances in the areas of trade reform and regional integration**

##### **(a) Trade reforms**

Liberalization programmes were carried forward in 1998, chiefly within the framework of regional integration schemes. However, the negative repercussions of the international financial crisis were felt more keenly in the area of trade reform than in other spheres. This was due to the way the crisis developed in the Asian countries, with steep real devaluations of those countries' currencies and, as a result, a considerable increase in the competitiveness of their exports. This, together with tumbling international commodity prices, sowed fears in the countries of the region that imports would spiral out of control and that exports would drop.

To prevent their trade deficits from rising, a number of countries announced tariff and non-tariff protectionist measures, but even so such methods were not widely used in 1998. Nonetheless, the currency crises that erupted in Brazil in January and in Ecuador in March 1999 brought about substantial changes in those two countries' external competitiveness in relation to the other countries of the region. As a result, the economic authorities were obliged to have recourse to the protectionist measures referred to above. After Brazil devalued its currency, Ecuador raised its tariffs by between two and ten percentage points in February in order to cut its trade deficit and finance its fiscal deficit. In March, Argentina applied non-tariff measures to pro-



tect more than 600 products, and in April it introduced minimum prices for steel imports. Meanwhile, Bolivia adopted a compulsory certification programme designed to restrict imports of agro-industrial products. Colombia placed limits on rice imports from Ecuador, and Venezuela imposed transport restrictions which affected trade with Colombia. The countries of the Andean Community announced temporary safeguards applying to any third-country imports affecting trade within the Community. Finally, motivated primarily by fiscal reasons, Mexico raised its tariff rates on products coming from countries with which it has not signed free trade agreements.

Despite the recent reappearance of protectionist measures, the overall direction of events during the decade remains unchanged. In the first place, these measures were clearly adopted in response to an exceptionally difficult situation, which suggests that they are likely to be in effect for a limited period of time. Furthermore, as will be discussed in more detail below, a number of countries continued on with their trade liberalization programmes in accordance with the timetables established in free trade agreements or regional integration schemes. In addition, several countries decided to continue opening up their markets unilaterally. For example, in January 1998 average tariffs in Panama were down to 8.25%, compared with 35% in 1995 (the tariff structure comprises six categories with rates ranging from 0% to 20%). Quantitative trade barriers were eliminated, and ad valorem taxes replaced specific duties. Chile, for its part, adopted a gradual tariff rollback programme which will lower its uniform tariff rate from 11% in 1998 to 6% by 2003, for a reduction of one percentage point per year.

The countries of the Caribbean, faced with imminent changes in the European Union's preferential treatment of their exports, took steps to restructure the banana industry and increase its competitiveness.

## **(b) The integration process**

Despite the unfavourable external situation affecting the region since early 1998, the regional integration process has continued to move forward, although more slowly than in previous years. On a number of occasions, the adoption of restrictive measures has created tension among the members of integration schemes, but thus far it has proved possible to resolve these potential conflicts through direct consultations among the countries concerned.

### *(i) The Southern Common Market (Mercosur)*

In December 1997 the Mercosur Council authorized a general 3% increase in the common external tariff (CET), partly to compensate Argentina for the elimination of its 3% statistical surcharge, but also to deal with growing deficits in Argentina and Brazil. At the same time, the Council adopted common rules on protective trade measures aimed at third-country imports. Also, under the Montevideo Protocol on Trade in Services in the Southern Common Market, a regime was established that is designed to liberalize trade in services among the Mercosur countries.

In April 1998 a framework agreement was signed in Buenos Aires for a free trade area between Mercosur and the Andean Community, which should come into force in the year 2000. However, the negotiations have proven to be lengthier and more complex than expected, and as of mid-1999 approximately half of all tariff items had not yet been covered.

At its meeting in May 1998, the Common Market Group examined a number of complaints by Argentina about Brazilian export subsidies and the failure of Brazil, Paraguay and Uruguay to comply with the obligation to incorporate certain resolutions previously adopted by the Group into their domestic legislation. These events underline the need to create a formal dispute settlement mechanism within Mercosur.

### *(ii) The Andean Community*

During the tenth session of the Andean Presidential Council in April 1998, the Governments of the member countries expressed their interest in harmonizing their macroeconomic policies. The relevant authorities were asked to prepare an agenda containing the policy harmonization objectives to be attained.

In June 1998, as was also done in the case of Mercosur, the Community adopted a framework agreement to liberalize trade in services within the Community. The agreement applies to trade in all service sectors, and its goal is to achieve free trade in services by the year 2005.

The eleventh session of the Presidential Council marked the thirtieth anniversary of the signing of the Cartagena Agreement. In their final declaration, the Presidents set forth the goal of completing the establishment of the Andean common market by the year 2005, thereby creating the conditions necessary for the free movement of services, capital and persons, as well as of goods, within the subregion. They also instructed the competent authorities to continue to work on devel-

opening a common foreign policy and defining criteria for a gradual convergence of macroeconomic policies.

*(iii) Central American Common Market (CACM)*

In 1998 the member States furthered their trade liberalization process by progressively lowering their common external tariff, although these cuts came somewhat late in terms of the existing tariff reduction schedule. The countries agreed on a five-year extension of the tariff rollback period, which is now due to end in 2005. The programme provides for zero tariff rates on raw materials and capital goods and for a 15% ceiling for final goods, with intermediate rates of 5% and 10%. Other events took place during the period which should also prove favourable for the development of intra-group and world trade: three countries implemented the new Central American Uniform Customs Code, and common regimes were instituted for rules of origin, unfair trade practices and safeguard measures. In addition, almost all tariffs applying to reciprocal trade in agricultural products were dismantled; the use of safeguard clauses was reduced and almost all limitations on currency exchange and on import payments were eliminated.

In April 1998, the Central American countries and the Dominican Republic signed an agreement establishing a reciprocal free trade zone. Ever since the third Central America-Mexico Summit, held in Tuxtla in July 1998, Mexico and the countries of the Northern Triangle of Central America (El Salvador, Guatemala and Honduras) have redoubled their efforts to conclude a free trade agreement.

*(iv) The Caribbean Community (CARICOM)*

The ultimate goal of the Caribbean Community is to set up a common market and a single economy among its 15 member countries. The first step towards the fulfilment of this goal was supposed to be the establishment of free trade in goods and services, free movement of persons and capital, and the harmonization of

the member countries' macroeconomic policies. The Community also has a programme for reducing its common external tariffs to rates of between 5% and 20% for non-agricultural goods. However, as of mid-1998, only Barbados, Saint Kitts and Nevis, and Saint Vincent and the Grenadines had implemented the final phase of the programme.

Efforts to establish and perfect the common market and single economy included the negotiation and application by the year 2000 of a series of protocols that provide for thorough-going changes in the Treaty of Chaguaramas, by which CARICOM was established. The first protocol, which proposes the restructuring of the Community's organs and institutions, came into force on a provisional basis on 1 July 1997. During the nineteenth Conference of Heads of Government (30 June-4 July 1998), the leaders of the member countries signed the third protocol, on industrial policy, and the fifth protocol, on common agricultural policy. The CARICOM countries have not yet succeeded in harmonizing their treatment of foreign investment, competition policy, or intellectual property rights. In April 1998 the CARICOM Bureau formulated a set of recommendations on how joint negotiations with third countries should be conducted. On 1 June 1998 the CARICOM Governments and Colombia signed a document extending the economic and trade agreement between them. In August 1998, joint negotiations were concluded with the Dominican Republic on a framework free trade agreement which should be fully implemented by the year 2005.

*(v) Other integration processes*

Bilateral negotiations in the region also continued. Mexico and Brazil, for example, agreed to work towards an agreement on tariff preferences. Guatemala, Honduras, El Salvador, Nicaragua and Costa Rica began negotiations with Chile and Panama on reciprocal trade liberalization programmes, and Mexico was negotiating a free trade agreement with the European Union.



## Chapter IV

### Level of activity and inflation

#### 1.

#### Level of activity

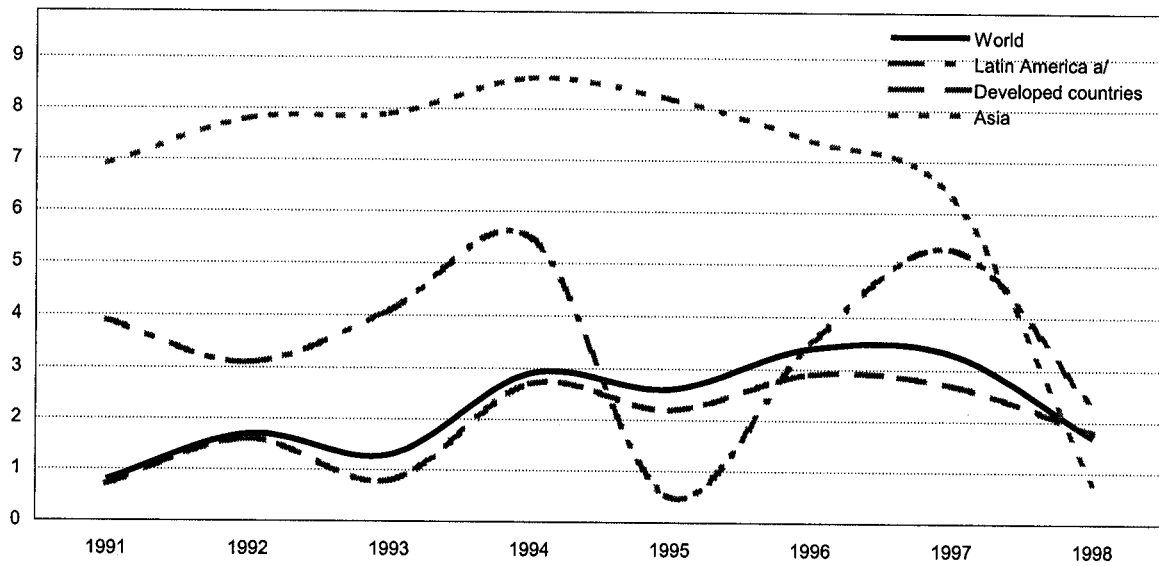
Economic activity in Latin America and the Caribbean slowed considerably in 1998, with the growth rate of regional GDP falling from 5.4% in 1997 to 2.3% in 1998. In the first two quarters, the regional economy continued to perform as strongly as in 1997, which had been one of the best years in the last quarter century, but it then began to falter and started showing signs of negative growth towards the end of the year. This disappointing performance continued into the first half of 1999, and total growth for 1999 will probably be around zero. At the same time, since demographic growth is still rapid in most of the countries of the region, per capita GDP rose by only 0.8% in 1998, for a total increase of 16% since the beginning of the decade.

**EVEN THIS MODEST** rate of economic growth in 1998 was higher than that of the world economy, which expanded by just 1.7% (versus 3.3% in 1997). Because of the economic slump that began in the region in the second half of the year, however, its performance has clearly become worse than that of the rest of the world since that time (see figure IV.1). During the 1990s the region has generally grown at a faster pace than the rest of the world, although not as rapidly as Asia was doing up to 1997. The crisis that broke out in

the Asian continent in 1998 led to a steep downturn in the growth of the Asian economies, which thus fell behind those of Latin America and the Caribbean despite the fact that they, too, were experiencing a major slowdown.

An acute deterioration was observed in the region's economy in the course of 1998. The first quarter of 1997 had seen one of the highest growth rates of recent years, but thereafter growth began tapering off and then dropped steeply in 1998. Quarterly figures for economic activity declined in both late 1998 and early 1999.

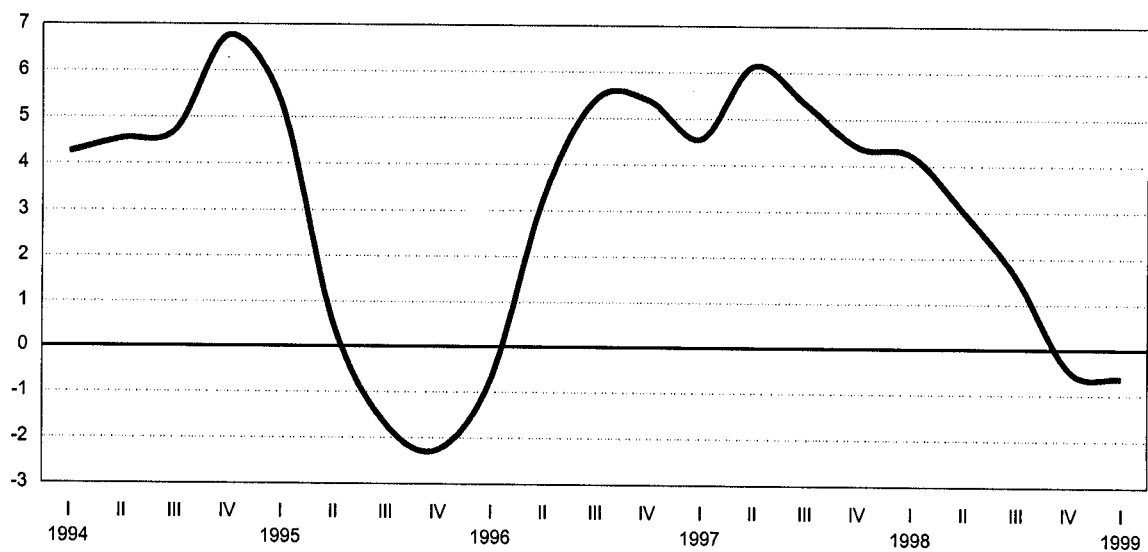
Figure IV.1  
**ECONOMIC GROWTH WORLDWIDE**  
*(Annual growth rates)*



Source: World Economic Situation and Prospects for 1999, United Nations (1999).

<sup>a</sup> ECLAC, on the basis of official figures.

Figure IV.2  
**LATIN AMERICA: REGIONAL GROSS DOMESTIC PRODUCT**  
*(Percentage change from same quarter of previous year)*



Source: ECLAC, on the basis of official figures.

Growth in the Caribbean subregion was similar to that of the region as a whole, with a growth rate of 2.0%, the same as in 1997. The increase in per capita GDP was fairly small (1.1%), but even so was higher than the regional average, owing to the Caribbean's very low rate of population growth. GDP fell in Guyana, in contrast to the strong upswing of 1996 and 1997. Jamaica saw its GDP shrink for the third consecutive year, with a contraction of 0.7%. The best results were achieved by Grenada and Saint Vincent and the Grenadines, with GDP growth of 5% or more.

The lower growth figures registered for the region in 1998 are attributable to the negative performances of 21 countries, and particularly of Argentina, Brazil, Chile, Guyana, Paraguay, Peru, Suriname and Venezuela, where GDP growth was between three and nine percentage points below its 1997 levels. Despite this sombre picture, only four countries (Guyana, Jamaica, Paraguay and Venezuela) experienced an actual contraction in economic activity, but in 1999 this poor performance spread to other countries, including some of the larger economies. The Costa Rican economy performed substantially better than in 1997, with GDP growth of 5.5%, and Costa Rica and the Dominican Republic were thus the two fastest-growing economies in the region in 1998. Seven other countries achieved GDP growth rates of between 4% and 5%; four economies grew by between 2% and 4%; and the remainder experienced little or no growth. Given the size of the Brazilian economy, its very low 1998 growth rate of 0.2% played a large part in the lacklustre growth figure recorded for the region as a whole.

A number of factors, of varying importance from country to country, explain the current economic situation in Latin America. The international crisis is among the most important of these elements, but several domestic economic and political factors—including adjustment policies implemented to deal with serious macroeconomic imbalances—also played a part, as did the considerable damage caused by weather conditions in the region in 1998.

The international financial crisis which began in Asia in mid-1997 and spread throughout the world in 1998 undermined economic activity in the region. Initially, its consequences were chiefly financial in nature and were particularly severe in Brazil, Colombia and Argentina; later on, the impact of the crisis began to be seen primarily in trade flows and in tumbling prices for many of the commodities produced in the region. The public external debt moratorium declared by the Russian Federation in August 1998 had serious repercussions for the region owing to fears that other countries

might follow suit, particularly Brazil, which in recent years has had a serious fiscal imbalance and a hefty balance-of-payments deficit. The macroeconomic measures taken in response to the crisis, which included fiscal policies and restrictive monetary policies based, in most cases, on high real interest rates, improved price and exchange-rate stability, but they also aggravated the impact of external events on economic activity in the region rather than cushioning these shocks (see chapter II).

Increasingly adverse weather conditions in 1998 led to heavy losses of human life and did serious damage to production capacity and infrastructure. First came El Niño, followed by the reverse phenomenon La Niña, which affected the entire region to varying degrees; then came the hurricanes that laid waste to several countries in the Caribbean (Hurricane Georges) and Central America (Hurricane Mitch). El Niño and La Niña caused floods and droughts whose effects were especially devastating in the Andean region, Brazil and the Southern Cone. The worst consequences were in the agricultural sector and in those countries that depend on hydroelectric power, which had to institute strict rationing of electricity and incurred higher costs for the use of thermal power generating plants. In Honduras and Nicaragua, enormous damage and loss of life were caused by Hurricane Mitch, which was one of the most devastating storms of the century.

Following the Brazilian devaluation in early 1999, many observers of the Latin American economy expected Brazil's GDP to contract sharply, which would have negative implications for Mercosur and the rest of the region; however, by mid-1999 it no longer seemed that Brazil's recession would be very deep. Nonetheless, in other countries, such as Argentina, Chile, Ecuador, Uruguay and Venezuela, economic activity has been growing much more slowly or, in some cases, has actually contracted. Based on figures for the first half of 1999, significant reductions in GDP growth are forecast for the year as a whole, with the 2.4% rate recorded in 1998 expected to be followed by zero growth in 1999.

Per capita GDP for the region increased by only 0.8%, with demographic growth still relatively high (1.5%). Per capita GDP growth was fairly rapid in the Dominican Republic, Uruguay, Argentina, Honduras and Costa Rica but was negative in Brazil, Colombia, Ecuador, Paraguay, Peru and Venezuela. In 1998 the average level of this major indicator of well-being was somewhat higher than it had been in 1980, having only recently regained and then surpassed (in 1996) the level reached in the early years of the preceding decade. In

Table IV.1  
**LATIN AMERICA AND THE CARIBBEAN: GROSS DOMESTIC PRODUCT**  
*(Annual growth rates)*

	1991	1992	1993	1994	1995	1996	1997	1998 <sup>a</sup>	1991-1998
<b>Latin America and the Caribbean<sup>b</sup></b>	<b>3.8</b>	<b>3.2</b>	<b>3.8</b>	<b>5.7</b>	<b>1.0</b>	<b>3.6</b>	<b>5.4</b>	<b>2.3</b>	<b>3.6</b>
<b>Subtotal (19 countries)<sup>b</sup></b>	<b>3.8</b>	<b>3.2</b>	<b>3.9</b>	<b>5.8</b>	<b>1.0</b>	<b>3.6</b>	<b>5.4</b>	<b>2.4</b>	<b>3.6</b>
Argentina	10.0	8.9	5.8	8.3	-3.1	4.4	8.0	4.9	5.8
Bolivia	5.4	1.7	4.2	4.8	4.7	4.5	4.1	4.6	4.2
Brazil	1.0	-0.3	4.5	6.2	4.2	2.9	3.8	0.2	2.8
Chile	7.3	11.0	6.6	5.1	9.1	6.9	7.0	3.1	7.0
Colombia	1.6	3.9	4.5	6.3	5.4	2.1	1.5	0.7	3.2
Costa Rica	2.2	7.1	5.8	4.3	2.2	-0.5	3.5	5.5	3.7
Ecuador	5.0	3.0	2.2	4.4	3.0	2.3	3.9	1.0	3.1
El Salvador	2.8	7.3	6.4	6.0	6.2	1.8	4.2	3.2	4.7
Guatemala	3.7	4.9	4.0	4.1	5.0	3.0	4.3	5.0	4.3
Haiti	0.1	-13.8	-2.2	-8.3	5.0	2.8	1.5	3.2	-1.7
Honduras	2.7	5.8	7.1	-1.9	3.7	3.8	5.0	3.9	3.7
Mexico	4.2	3.7	1.7	4.6	-6.2	5.2	6.8	4.9	3.0
Nicaragua	-0.3	0.8	-0.4	4.0	4.5	5.0	5.5	4.2	2.9
Panama	9.0	8.2	5.3	3.1	1.9	2.7	4.8	4.0	4.9
Paraguay	2.5	1.7	4.0	3.0	4.5	1.1	2.4	-0.6	2.3
Peru	2.5	-0.9	5.7	13.6	8.6	2.3	8.6	0.1	5.0
Dominican Republic	0.8	6.4	2.0	4.3	4.5	6.8	7.1	6.0	4.7
Uruguay	2.9	7.4	3.1	5.5	-2.0	5.0	5.0	4.6	3.9
Venezuela	10.5	7.0	-0.4	-3.7	5.9	-0.4	6.6	-0.2	3.1
<b>Subtotal Caribbean<sup>c</sup></b>	<b>1.8</b>	<b>0.9</b>	<b>0.5</b>	<b>3.3</b>	<b>2.5</b>	<b>3.2</b>	<b>2.0</b>	<b>2.0</b>	<b>2.0</b>
Antigua and Barbuda	4.1	1.0	3.5	4.8	-4.3	5.5	4.6	2.8	2.7
Barbados	-3.5	-5.4	1.0	3.6	2.5	5.1	3.0	4.4	1.3
Belize	3.4	8.9	4.0	1.6	3.5	1.0	4.0	1.6	3.5
Dominica	2.6	3.0	2.2	2.1	2.3	2.9	2.7	3.5	2.7
Grenada	3.7	1.0	-1.1	3.4	3.0	3.2	4.7	5.0	2.9
Guyana	10.2	11.2	3.1	17.7	2.4	9.2	6.1	-1.3	7.2
Jamaica	0.3	2.5	1.8	1.9	1.7	-0.5	-2.3	-0.7	0.6
Saint Kitts and Nevis	3.4	3.6	6.7	3.3	3.1	5.5	6.3	4.0	4.5
Saint Vincent and the Grenadines	1.6	6.7	2.4	-2.6	7.8	1.7	3.2	5.5	3.2
Saint Lucia	-2.0	7.3	0.4	1.9	0.7	0.5	0.9	2.9	1.6
Suriname	4.4	-1.9	-8.5	-4.0	-1.7	20.7	3.6	0.0	1.3
Trinidad and Tobago	3.5	-1.1	-1.2	4.2	4.1	4.0	4.2	3.6	2.6

Source: ECLAC, on the basis of official figures converted into dollars at constant 1995 prices.

<sup>a</sup> Preliminary figures. <sup>b</sup> Does not include Cuba. <sup>c</sup> Based on figures at factor cost.

some countries, including Chile, Colombia, the Dominican Republic and Uruguay, the figures were significantly higher than in 1980. However Haiti, Nicaragua and Venezuela were still far below their 1980 levels. In the remaining countries, per capita GDP was close to the levels registered in the early 1980s.

Per capita GDP showed a greater improvement in the Caribbean subregion than in the region as a whole. The best results were observed in Barbados, Trinidad and Tobago, and the small countries making up the Organization of Eastern Caribbean States (OECS), whereas Belize, Guyana, Jamaica and Suriname did poorly in this respect.

Table IV.2  
**LATIN AMERICA AND THE CARIBBEAN: PER CAPITA GROSS DOMESTIC PRODUCT**  
*(Annual growth rates)*

	1991	1992	1993	1994	1995	1996	1997	1998 <sup>a</sup>	1991-1998
<b>Latin America and the Caribbean<sup>b</sup></b>	<b>1.9</b>	<b>1.3</b>	<b>2.0</b>	<b>3.9</b>	<b>-0.7</b>	<b>1.9</b>	<b>3.7</b>	<b>0.8</b>	<b>1.8</b>
<b>Subtotal (19 countries)<sup>b</sup></b>	<b>1.9</b>	<b>1.4</b>	<b>2.1</b>	<b>3.9</b>	<b>-0.7</b>	<b>1.9</b>	<b>3.7</b>	<b>0.7</b>	<b>1.8</b>
Argentina	8.5	7.5	4.4	6.9	-4.4	3.0	6.6	3.6	4.4
Bolivia	2.9	-0.8	1.7	2.2	2.2	2.0	1.7	2.1	1.8
Brazil	-0.6	-1.8	3.0	4.7	2.7	1.4	2.4	-1.1	1.3
Chile	5.6	9.1	4.8	3.5	7.4	5.3	5.5	1.7	5.3
Colombia	-0.3	1.9	2.5	4.2	3.4	0.1	-0.4	-1.2	1.3
Costa Rica	-0.9	3.7	2.5	1.1	-0.6	-3.2	0.8	3.0	0.8
Ecuador	2.7	0.7	-0.1	2.1	0.8	0.2	1.8	-0.9	0.9
El Salvador	0.9	5.1	4.2	3.7	4.0	-0.3	2.0	1.1	2.6
Guatemala	1.1	2.2	1.3	1.4	2.2	0.3	1.6	2.3	1.6
Haiti	-2.0	-15.4	-4.0	-9.9	3.1	0.9	-0.4	1.3	-3.5
Honduras	-0.4	2.7	4.0	-4.7	0.7	0.9	2.1	1.1	0.8
Mexico	2.2	1.8	-0.1	2.8	-7.8	3.4	5.1	3.2	1.2
Nicaragua	-3.0	-2.1	-3.3	1.0	1.5	2.1	2.6	1.4	0.0
Panama	6.9	6.2	3.4	1.3	0.1	0.9	3.1	2.3	3.0
Paraguay	-0.4	-1.1	1.3	0.4	1.7	-1.6	-0.2	-3.2	-0.4
Peru	0.6	-2.6	4.0	11.6	6.8	0.5	6.7	-1.6	3.1
Dominican Republic	-1.2	4.3	0.0	2.4	2.7	4.9	5.3	4.2	2.8
Uruguay	2.2	6.6	2.4	4.7	-2.7	4.3	4.3	3.8	3.2
Venezuela	7.9	4.6	-2.7	-5.8	3.7	-2.5	4.4	-2.2	0.8
<b>Subtotal Caribbean<sup>c</sup></b>	<b>0.9</b>	<b>0.1</b>	<b>-0.4</b>	<b>2.4</b>	<b>1.6</b>	<b>2.3</b>	<b>1.2</b>	<b>1.1</b>	<b>1.2</b>
Antigua and Barbuda	2.5	-0.6	1.4	2.7	-5.7	4.0	3.6	2.8	1.3
Barbados	-3.8	-6.2	0.7	2.8	2.1	4.7	2.6	3.6	0.7
Belize	0.7	6.2	1.5	-1.3	1.1	-1.8	1.7	-1.1	0.8
Dominica	2.6	3.0	2.2	2.1	2.3	2.9	2.7	3.5	2.7
Grenada	3.5	0.8	-1.3	3.2	2.8	2.8	4.3	4.5	2.6
Guyana	9.5	10.4	2.1	16.5	1.5	8.2	5.0	-2.3	6.2
Jamaica	-0.5	1.6	0.9	1.0	0.8	-1.4	-3.2	-1.6	-0.3
Saint Kitts and Nevis	3.9	4.1	7.3	3.8	3.6	5.5	6.3	4.0	4.8
Saint Vincent and the Grenadines	0.7	5.8	1.5	-3.5	6.8	0.8	2.3	4.5	2.3
Saint Lucia	-3.3	5.9	-0.9	0.6	-0.6	-0.8	-0.5	1.5	0.2
Suriname	3.8	-2.0	-8.7	-4.3	-2.2	20.1	3.1	-0.7	0.8
Trinidad and Tobago	2.7	-1.9	-1.9	3.3	3.4	3.4	3.6	3.1	1.9

Source: ECLAC, on the basis of official figures converted into dollars at constant 1995 prices.

<sup>a</sup> Preliminary figures. <sup>b</sup> Does not include Cuba. <sup>c</sup> Based on figures at factor cost.

Mainly as a result of the deteriorating terms of trade for 12 of the 19 countries for which data are available, the region's gross national income grew only half as much as its GDP, although there were significant variations across countries. In the Dominican Republic, Guatemala, Honduras, Nicaragua and Uruguay, national income outperformed GDP by a wide margin. In the first four of these countries this was

due to increased inflows of current transfers, whereas in Uruguay it stemmed from an improvement in the terms of trade caused by sharply lower oil prices. In Chile, Ecuador and Venezuela, however, the performance of national income was weaker than that of GDP because of the considerable downswing in the prices of their principal exports.



## 2. Supply and demand

Unlike 1997, 1998 saw a slowdown in all components of supply and demand in Latin America and the Caribbean. The growth rate of aggregate supply was down to 3.3% but even so was higher than GDP growth thanks to the fact that the volume of imports continued to expand at a considerable pace (see table IV.3).

The expansion in aggregate demand outdistanced GDP growth due to the larger increase observed in export volumes. As for the components of domestic demand, the percentage increase in investment was considerably smaller, while consumption grew at a rate similar to that of GDP. The growth rate of private consumption decreased somewhat more sharply than that of total consumption, while public-sector consumption

continued to grow at a rate similar to that of 1997. Average growth of fixed investment for the region was 3.2%, with a notable influence in this respect being exerted by Bolivia, Costa Rica, Honduras and the Dominican Republic. Given this drastic decrease in the growth rate of investment in 1998, this factor was once again the most volatile component of demand (see figure IV.3).

There was a considerable increase in the volume of the region's imports (almost 8%), but this was nonetheless a sharp drop from the 20% growth rate posted in 1997. Generally speaking, the countries that were successful in maintaining relatively high levels of economic activity —namely Bolivia, Costa Rica, the

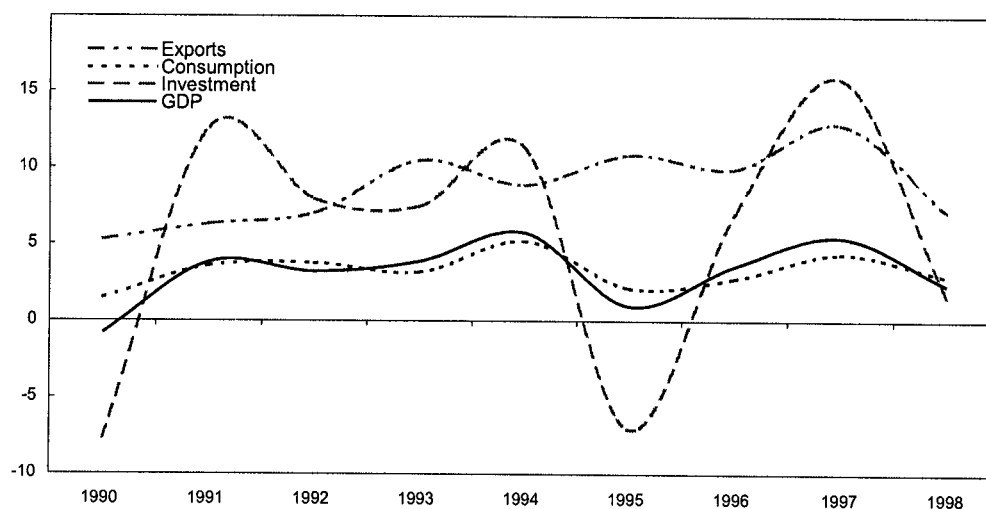
Table IV. 3  
LATIN AMERICA AND THE CARIBBEAN: PRINCIPAL COMPONENTS  
OF NATIONAL INCOME AND EXPENDITURE  
(Annual growth rates)

	1991	1992	1993	1994	1995	1996	1997	1998 <sup>a</sup>
1. Total supply (2+3)	5.4	4.9	4.8	6.8	1.4	4.5	7.7	3.3
2. Gross domestic product	3.8	3.2	3.9	5.8	1.0	3.6	5.4	2.4
3. Imports of goods and services	20.5	18.7	11.4	13.7	4.1	10.1	20.5	7.8
4. Exports of goods and services	6.3	7.0	10.5	8.9	10.8	9.9	12.8	7.1
5. Domestic availability of goods and services (2 + 3 - 4) = domestic demand (6 + 7)	5.3	4.6	4.1	6.5	0.1	3.7	6.8	2.6
6. Final consumption expenditure + change in stocks <sup>b</sup>	5.3	4.0	3.6	5.4	1.5	3.3	4.6	2.4
7. Gross fixed capital formation <sup>c</sup>	5.0	7.1	5.9	11.3	-5.8	5.0	16.3	3.2
8. Factor payments	-3.8	-2.7	15.4	2.2	5.2	5.9	12.5	12.7
9. Real gross national income <sup>d</sup>	3.9	3.3	3.4	6.4	1.2	3.7	5.2	1.2

Source: ECLAC, on the basis of official figures converted into dollars at constant 1995 prices.

<sup>a</sup> Preliminary figures. <sup>b</sup> For 1991-1996, does not include changes in stocks in Haiti; for 1997-1998, does not include changes in stocks in Haiti or Colombia. <sup>c</sup> For 1991-1996, includes changes in stocks in Haiti; for 1997-1998, includes changes in stock in Haiti and Colombia. <sup>d</sup> Includes factor payments, current external transfers and the terms-of-trade effect.

Figure IV.3  
**LATIN AMERICA AND THE CARIBBEAN: EXPORTS, CONSUMPTION,  
 INVESTMENT AND GROSS DOMESTIC PRODUCT**  
*(Annual growth rates)*



Source: ECLAC, on the basis of official figures.

Dominican Republic, Guatemala and Mexico— also registered sizeable increases in import volumes; nevertheless, some countries in which the growth of economic activity slowed its pace (including Argentina, Uruguay and Venezuela) also witnessed significant upturns in the volume of imports. In the remaining countries, import growth was negligible. Capital goods were one of the fastest-growing components of imports. The limited nature of many countries' industrial structures and the increase, however modest, in capital formation, together with the economic liberalization process,

made it increasingly necessary to purchase capital goods abroad (see chapter VII).

Export volume for the region grew at a rate of 7%, compared with 12.8% in 1997, and this overall decline was reflected in the national figures for most of the countries of the region (see chapter VIII). Exports were up by 10% or more for four countries (Costa Rica, Guatemala, Haiti and Mexico) and by between 6% and 9% for five others (Argentina, Brazil, Chile, Colombia and the Dominican Republic).

### 3. GDP growth

This section will analyse the relationship between the countries' GDP growth rates and the fundamental factors underlying the expansion of economic activity: consumption, investment and the external sector. It is not easy to identify factors common to the region as a

whole because of the considerable differences in size and economic structure that exist from country to country. For an initial approximation, the countries have been divided into three categories based on their levels of GDP growth: countries with high (5% or

Table IV.4  
**LATIN AMERICA AND THE CARIBBEAN: FACTORS OF ECONOMIC GROWTH IN 1998**  
*(Annual growth rates)*

	GDP	Consumption	Investment	Export volume	Import volume
<b>High GDP growth</b>					
Dominican Republic	6.0	8.6	27.7	8.7	21.6
Costa Rica	5.5	3.9	22.9	13.1	18.3
Guatemala	5.0	7.8	11.2	10.0	22.0
Simple average	5.5	6.8	20.6	10.6	20.6
Median	5.5	7.8	22.9	10.0	21.6
<b>Intermediate GDP growth</b>					
Mexico	4.9	4.9	11.4	10.2	14.7
Argentina	4.9	4.2	7.3	8.2	7.4
Uruguay	4.6	5.6	11.8	0.6	8.5
Bolivia	4.6	1.7	26.5	2.8	10.1
Nicaragua	4.2	11.0	6.2	- 6.0	7.8
Panama	4.0	7.6	13.7	- 4.1	1.7
Honduras	3.9	0.8	19.8	1.8	6.0
El Salvador	3.2	4.1	5.5	1.8	5.6
Haiti	3.2	3.3	7.4	21.9	13.9
Chile	3.1	1.2	2.1	6.1	0.9
Simple average	4.1	4.5	11.2	4.3	7.7
Median	4.1	4.2	9.4	2.3	7.6
<b>Low GDP growth</b>					
Ecuador	1.0	3.0	6.3	- 3.2	5.5
Colombia	0.7	1.0	- 6.2	8.8	0.4
Brazil	0.2	0.4	- 2.3	6.2	1.3
Peru	0.1	- 0.1	- 0.6	3.7	0.8
Venezuela	- 0.2	2.8	- 5.9	2.1	7.6
Paraguay	- 0.6	- 4.1	- 5.3	- 7.0	- 13.8
Simple average	0.2	0.5	- 2.3	1.8	0.3
Median	0.2	0.7	- 3.8	2.9	1.1

Source: ECLAC, on the basis of official figures.

The composition of these groups has changed a great deal from one year to another. Of the nine countries with high growth rates in 1997, only three were still in this category in 1998. The membership of the intermediate group grew from seven in 1997 to 10 in 1998. Lastly, the number of countries in the low-growth group doubled from three in 1997 to six in 1998. Among the countries involved in these changes, two of the most dramatic cases were those of Chile and Peru, which had been growing rapidly over the course of the preceding five years but suffered setbacks in 1998: Chile moved down into the intermediate group, and Peru, following the economic stagnation it experienced in 1998, ended the year in the low-growth group. Costa Rica and Guatemala, on the other hand, having previously shown only modest growth, performed better and moved up into a higher group in 1998.

The slackening pace of regional growth was reflected differently in the growth rates of the countries in these three groups. Average growth in the top group fell from 6.6% in 1997 to 5.5% in 1998. There was no variation in the intermediate group, and in the low-growth group the GDP growth rate fell from 1.8% in 1997 to 0.2% in 1998.

In the three countries with growth rates of 5% or more (Costa Rica, the Dominican Republic and Guatemala), both consumption and investment climbed steeply. The external sector, however, exerted a negative influence; with imports growing much faster than exports, part of the domestic buoyancy of these three economies was diverted abroad.

In the second group of countries —those with growth rates between 3% and 5%— the performance of domestic demand factors was less dynamic than in the

first group. The rates of expansion recorded for consumption were close to average levels of output growth, but investment increased by only 11%, compared with 21% for the high-growth countries. As for the external sector, both exports and imports rose more slowly than in the first group, and the difference between the growth rates for imports and exports was smaller as well; consequently, less of the momentum of these countries' domestic economies was diverted towards the outside world.

In the countries where GDP grew by less than 3% (Brazil, Colombia, Ecuador, Paraguay, Peru and Venezuela), consumption climbed by barely 0.3 percentage points over GDP, and investment declined. In contrast, the external sector had a positive effect, since in these countries, unlike the other two groups, the growth rate of exports was higher than that of imports.

Lastly, the current account deficit increased in all three groups; in fact, only three countries managed to improve their position in this respect.

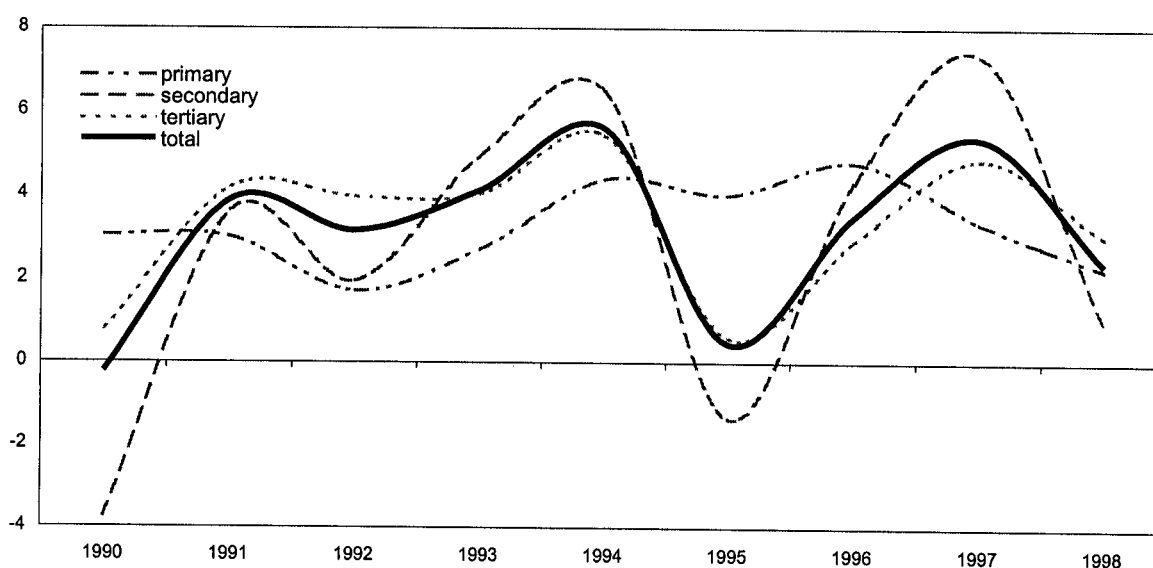
#### 4. Production sectors

The performance of the region's production sectors was very uneven in 1998. Generally speaking, there was a steep decline in the output of goods, particularly in manufacturing, which grew by only 0.6% compared with 6.2% in 1997. The expansion of the construction industry was down from 10.8% in 1997 to 2.2% in 1998. Agricultural output remained sluggish, and in mining the growth rate fell from 7.3% in 1997 to 3.3% in 1998. The commerce, restaurants and hotels

sector had a difficult year, with growth of 1.6% versus 7.5% in 1997. On the other hand, basic services maintained the buoyancy it had displayed the year before, as did the finance, insurance, real estate and business services sector. The growth rate for other services fell from 4.1% in 1997 to 2.1% in 1998.

The declining performance of the Caribbean sub-region was attributable to serious problems in agriculture and mining caused by the passage of Hurricane

Figure IV.4  
LATIN AMERICA: GROWTH OF PRODUCTION SECTORS



Source: ECLAC, on the basis of official figures.

Georges. Some of these losses were made up for by improved growth in other sectors, particularly manufacturing, construction, electric power, and the gas and water supply industries.

#### (a) Agriculture

The growth rate posted for the agricultural sector was similar to that of the previous year, but performance was very uneven. A strong recovery was observed in Argentina, Chile, Costa Rica, Haiti, Panama, Uruguay and, to a lesser extent, Colombia, and Guatemala and Mexico managed to maintain their previous growth rates. Considerable decreases were registered in Bolivia, Ecuador, El Salvador, Honduras, Paraguay, Peru and Venezuela, and somewhat smaller downturns occurred in Brazil and Nicaragua. Performance in the

Caribbean subregion was very poor for the second year running.

Many countries were troubled by adverse weather conditions. Hurricane Georges in the Caribbean and, above all, Hurricane Mitch in Central America caused heavy loss of human life and did severe damage to crops in a number of countries, particularly Honduras and Nicaragua. Further problems are expected in 1999 as a consequence of the destruction of installed capacity and major crop damage. Furthermore, the meagre harvests recorded in a number of South American countries were also chiefly a result of El Niño.

There were other countries, however, that performed exceptionally well in 1998. Argentina's agricultural sector achieved growth in excess of 10% thanks, in part, to decisions that had been made in relation to planting and input use when international prices

Table IV.5  
**LATIN AMERICA AND THE CARIBBEAN: GROSS DOMESTIC PRODUCT,  
BY BRANCH OF ECONOMIC ACTIVITY**  
(Annual growth rates)

	Agriculture		Mining and quarrying		Manufacturing		Construction		Subtotal: goods		Basic services		Other services	
	1997	1998	1997	1998	1997	1998	1997	1998	1997	1998	1997	1998	1997	1998
<b>Latin America and the Caribbean</b>	<b>1.9</b>	<b>1.6</b>	<b>7.3</b>	<b>3.3</b>	<b>6.2</b>	<b>0.6</b>	<b>10.8</b>	<b>2.2</b>	<b>6.2</b>	<b>1.3</b>	<b>7.0</b>	<b>6.9</b>	<b>4.1</b>	<b>2.1</b>
Argentina	3.3	10.5	8.0	3.2	9.2	2.2	23.5	4.9	10.8	4.0	6.9	6.3	6.3	4.9
Bolivia	4.1	-3.5	9.5	5.3	2.6	3.9	6.4	37.0	4.4	3.9	6.9	7.4	4.9	5.1
Brazil	2.7	0.2	6.9	9.2	3.7	-3.3	8.5	1.9	4.6	-1.1	4.5	5.8	1.6	0.0
Chile	-1.7	3.0	9.8	4.1	5.4	-1.5	7.8	-0.4	5.7	0.7	12.9	9.4	6.3	3.8
Colombia	-0.7	0.8	4.4	10.0	2.6	-0.5	0.1	-14.4	1.5	-1.1	5.0	3.1	3.6	-0.1
Costa Rica	-0.1	5.3	...	...	5.1	7.2	7.5	10.7	3.0	6.6	6.3	10.1	3.3	4.1
Ecuador	4.1	-1.4	1.8	-3.1	6.1	1.2	2.8	6.0	4.5	0.3	3.8	1.6	2.5	0.7
El Salvador	0.5	-1.9	6.5	5.5	8.0	8.0	5.1	4.4	5.1	4.3	7.5	6.4	3.2	1.8
Guatemala	2.8	3.2	25.1	20.5	2.7	3.5	9.3	9.9	3.7	4.2	7.2	7.3	4.1	5.1
Haiti	-1.2	2.2	9.9	6.7	0.7	1.8	10.1	9.4	1.7	3.9	-0.2	1.2	0.5	2.0
Honduras	5.5	-7.0	4.8	7.4	6.0	5.8	2.4	22.9	5.4	1.7	6.0	7.5	4.9	5.9
Mexico	0.2	0.5	4.5	3.4	10.0	7.4	9.3	4.6	8.0	5.8	9.4	9.6	6.0	3.5
Nicaragua	8.3	4.2	24.7	44.6	3.8	2.1	10.4	8.6	7.4	4.6	5.5	3.7	2.9	3.7
Panama	0.4	3.6	38.9	5.0	7.0	3.1	5.5	5.0	4.5	3.7	4.2	4.2	5.4	3.8
Paraguay	5.3	0.2	2.0	2.5	-0.2	1.0	1.0	1.0	2.9	0.6	3.7	2.2	1.6	-2.4
Peru	3.6	0.8	4.9	4.2	7.0	-2.3	20.4	1.3	9.8	-0.6	9.0	3.0	8.5	0.3
Dominican Rep.	3.4	1.0	3.1	-15.9	7.9	5.0	17.1	19.6	7.5	4.9	11.9	13.5	6.0	5.8
Uruguay	-1.2	5.6	2.9	13.1	5.8	2.3	2.9	13.9	3.4	4.8	5.2	8.2	4.8	4.0
Venezuela	2.5	-0.7	10.0	-1.0	5.2	-3.9	9.7	-1.1	7.2	-2.1	8.5	6.2	2.6	-0.6

Source: ECLAC, on the basis of official figures converted into dollars at constant 1995 prices.

<sup>a</sup> Included in manufacturing.

were still relatively favourable, as well as to the new techniques and management methods introduced in recent years. In Costa Rica agriculture rebounded (5.3%) following the previous year's decline (-0.1%). The various impacts of El Niño more or less balanced each other out, since in the first five months of 1998 its adverse effects were mainly felt in the livestock sector and basic grain crops but, at the same time, traditional export products (unlike non-traditional exports) benefited from improved weather conditions in the areas where they are produced as a result of this phenomenon. In October, Hurricane Mitch damaged coffee plantations, but this was offset by favourable conditions for banana and sugar-cane plantations. In Uruguay, growth of almost 6% in agricultural output more than compensated for the previous year's contraction, and record output levels were achieved. Taking the 1990s as a whole, agricultural output has increased by 40%. Both the livestock and crop-farming sectors contributed to the growth rate recorded in 1998, thanks to good weather and the recent introduction of new technologies in such areas as milk production.

#### (b) Mining

The rate of growth in the mining sector slowed, mainly owing to the international crisis, which led to a slump in demand and in the prices of a number of the region's mining products. Even so, the sector remained one of the major recipients of foreign direct investment. Gas production and use increased thanks to improved energy integration and interconnection among Argentina, Chile, Uruguay, Bolivia, Brazil and the Central American countries.

#### (c) Manufacturing

The manufacturing sector has undergone major changes in recent years as a consequence of liberalization programmes in the external sector, privatizations and market deregulation. As part of a sector-wide trend, the growth rate plummeted from 6.2% in 1997 to 0.6% in 1998, with the only exceptions being Bolivia, Costa Rica and El Salvador, which posted substantial improvements. The very low growth in manufacturing was due to a number of factors, including the constraints affecting domestic demand, lower external demand and the implementation of adjustment policies. Free trade zones and the *maquila* industry, which have become established in several countries in recent years, continued to show a healthy expansion.

#### (d) Construction

Growth in the construction industry plunged from 10.8% in 1997 to 2.2% in 1998; here too, performances were very uneven. Growth rates declined in Chile, Colombia and Venezuela and were down sharply in Argentina and Brazil, but remained steady in a number of other countries (El Salvador, Guatemala, Nicaragua, Panama and Paraguay). More rapid growth was seen in the remaining countries of the region, and especially in Bolivia, Costa Rica, Ecuador, Honduras and Uruguay. In some countries, the sector received an additional boost from the rebuilding of infrastructure following the destruction caused by El Niño. The overall negative figures were also partly due to adjustment processes in a number of countries which directly affected public-sector investment, particularly in construction, and had an indirect impact on private investment via higher interest rates.

#### (e) Services

Services as a whole showed growth rates close to that of GDP. Basic services turned in the best performance of all, with a rate of 7%, thanks to continuing strong expansion in the telecommunications sector. Trends in the energy sector were very uneven. In a number of countries, hydroelectric power generation was impaired by droughts, but elsewhere abundant rainfall had the opposite effect. This instability further strengthened the already widely-accepted argument for promoting the interconnection of electricity and gas supplies, towards which considerable progress has already been made. In point of fact, energy integration programmes involving Argentina, Uruguay, Bolivia, Chile and Brazil are already well under way. The energy crisis in Chile, caused by reduced hydroelectric power generation resulting from a prolonged drought, may encourage interconnections with countries having plentiful water resources, such as Argentina and Uruguay.

As for the rest of the services industry, there was a severe downturn in the commerce, restaurants and hotels sector. This decline was largely a result of the poor performance of such countries as Brazil (where the sector contracted by 3.4% in 1998 as compared to a 4% growth rate in 1997), Peru and Venezuela. However, in many countries the previous year's pace of growth was maintained or even surpassed. In the finance, insurance, real estate and business services sector, growth rates held steady at their 1997 levels.

## 5. Inflation

Inflation in Latin America and the Caribbean levelled off at about 10% in 1998, following the steep decreases of the previous four years. In 1993 inflation was running at almost 900%, but it then began to drop sharply thanks to rigorous stabilization plans in most of the countries of the region, and the rate of price increases for the biennium 1997-1998 was the lowest in 50 years. These low levels of inflation continued in the early months of 1999, even in Brazil, despite the deep devaluation of mid-January.

This successful performance was a widespread phenomenon, since 14 of the 22 countries studied had single-digit annual rates of inflation. Prices rose at rates of between 10% and 20% in six other countries; the inflation rate was well in excess of 20% in the remaining two countries, with Venezuela posting a rate of almost 30% and Ecuador one of over 40% (the 12-month inflation rate stood at 53% as of June 1999). Inflation rates fell in 11 countries and rose in the other 11, but only three of the latter (Ecuador, Nicaragua and Paraguay) turned in significantly worse results in 1998 than in 1997. Inflation in Ecuador was 13 percentage points higher than in 1997; in Nicaragua the rate was 18%, or more than double the previous year's; and prices in Paraguay rose by almost 15%, which was eight points higher than in 1997.

In addition to the low overall inflation rate, it is noteworthy that in the past four years there have been no rates of three figures or more except in Venezuela, which in 1996 saw prices of consumer goods rise by slightly more than 100%, although that figure subsequently fell considerably. These results contrast with the figures for the 1980s and the early 1990s, when persistently high (three- and four-digit) inflation rates were common.

The steep reduction in inflation achieved in the 1990s is mainly attributable to economic policy decisions implemented since the late 1980s. These policies have given top priority to fighting inflation, with strong emphasis on overcoming macroeconomic imbalances, and this has had a positive influence on the expectations of economic agents. The structural reforms of recent years have also helped to combat inflation. The positive trend of the world economy up to 1997 has been another factor, since it has been accompanied by low interest rates, plentiful inflows of financial resources to the emerging economies and favourable terms of trade

for the region. This situation helped to drive down real exchange rates, and this was reflected in considerably lower prices for tradable goods.

The financial turbulence which engulfed the world economy in the second half of 1997 and is still in evidence today has had no immediate effect on inflation figures, which remain stable at the regional level, but it has caused serious trouble for some countries' foreign exchange markets and has led to monetary and fiscal policy difficulties.

In 1998, a number of factors had varying effects on domestic price trends in the region's economies. Some of them have had positive consequences, such as the restrictive monetary policies adopted in most countries, which have helped to hold down price increases by counteracting the impacts of fiscal imbalances and of the considerable build-up of international reserves seen in the first half of the year.

Falling international prices for the region's commodity imports, particularly oil, have also helped to reduce inflation. In some countries, the reduction in external prices has not been fully passed on to domestic prices, but has instead been used as a source of windfall profits for certain public-sector enterprises; these profits have then been transferred to the government, thus helping to cut the fiscal deficit and hence inflation. In those cases where international prices of export commodities have dropped sharply, this has also helped to bring down domestic inflation, although its effect has not been as strong as that of lower import prices, either because the level of domestic consumption of such exportables is so low or because of the pricing policies followed by the authorities, who have been reluctant to pass on the decrease in international prices to the domestic market. On the other hand, the reductions in export prices have also affected foreign exchange inflows, leading to serious problems in terms of foreign exchange policy and therefore to renewed inflationary pressures.

In a number of countries, the stability of the nominal exchange rate has helped to keep inflation in check. This was made possible by the region's international liquidity position, which brought plentiful inflows of financial resources to the emerging countries and thus led to the accumulation of high levels of international reserves. The turnabout in these flows in the second half of 1998 had the opposite effect, upsetting foreign

exchange markets and making it difficult to maintain stability in nominal exchange rates because of the sharp decreases in international reserves, even though the latter had been at very high levels. However, in those countries where significant devaluations took place, there was no serious negative impact on domestic prices; this was because their impact was mitigated by other factors, such as the recessions that have been affecting those economies since the second half of 1998. This phenomenon is of great importance in the case of Brazil, where the increase of more than 40% that was registered in the exchange rate in early 1999 had no major repercussions on prices, since they rose by less than 4% between January and June.

On the other hand, the weather-related disasters which have struck the region since mid-1997 have indeed had a negative effect in terms of inflation. These include El Niño, whose worst effects were seen in Colombia, Ecuador, Peru and some Central American countries; Hurricane Mitch, which devastated Honduras and Nicaragua and caused significant damage in El Salvador and Guatemala; and Hurricane Georges, which hit a number of Caribbean countries, particularly the Dominican Republic. These disasters did a great deal of damage in terms of food production and infrastructure, thus leading to serious problems in relation to the supply of staples for the population. However, the impact on inflation was short-lived.

Despite the considerable progress made by stabilization programmes, inflation persists, although at low levels, and there is no clear sign that it will disappear altogether any time soon. After having fallen steeply, in many countries inflation has levelled off at rates higher than those of the developed countries, although they are quite low in comparison with the region's historical trend. Even in the countries that had very low inflation in 1998, recent foreign exchange fluctuations have given rise to doubts as to the solidity of their stabilization processes. A number of Governments have had to resort to a broader range of restrictive measures to prevent renewed inflationary outbreaks. Such fears have been fueled by the problems affecting the Venezuelan economy, the difficult situation in Ecuador and, more recently, Brazil's steep devaluation, since these developments clearly show that the region is still subject to internal and external disequilibria.

Furthermore, serious problems may yet arise, both on the external front (unfavourable terms of trade, rationing of capital flows, major increases in interest rates) and in the domestic sphere (worsening fiscal deficits, unwise monetary policies, large devaluations, fi-

nancial crises or natural disasters), which can have negative impacts on economic conditions and may trigger inflationary surges. Thus, if the worldwide financial crisis and the strong pressure on the region's foreign exchange markets were to persist, the relative price stability achieved recently in a number of countries might be endangered.

The continued use of indexing mechanisms is certainly one of the factors making it difficult to consolidate stabilization processes. Any external or domestic disturbance leading to short-term price increases could combine with difficulties in the fiscal or external sectors—where there are still problems—to set the stage for a reactivation of indexation systems, which are still in operation even though they currently maintain a low profile. This could result in the inclusion of trigger clauses based on past inflation in employment contracts, variable interest rates, and the incorporation of monetary correction mechanisms into a wide variety of contracts. This would push inflation up, and anti-inflation policies would again encounter serious difficulties owing to the renewed momentum of price increases.

While there was widespread success in holding down inflation, there were significant differences among the countries of the region, which can thus be divided into four groups—low-, moderate-, intermediate- and high-inflation countries—according to their rates of price increases in recent years. There are currently no cases of very high (three- or four-digit) inflation or of hyperinflation in the region.

The low-inflation group consists of countries where annual inflation rates have been below 5% in recent years. Argentina has been in this group for the past few years, thanks to the considerable advances made by its stabilization process since 1991, when it adopted its dollar convertibility system. In 1998, inflation in Argentina was once again close to zero, although slightly above the previous year's rate. Inflation has remained low in 1999, and there has even been some deflation owing to the recession affecting that economy since mid-1998. Barbados and Panama, both of which have traditionally been very stable, are also in this low-inflation group, with rates of less than 2%. Inflation in Barbados was over two percentage points lower than the year before, when prices had risen more sharply than usual following the introduction of a value added tax in January 1997. The case of Trinidad and Tobago is somewhat different, in that over the past five years its average annual inflation rate was 4.6%, but in 1998 the figure rose to 6.5%, possibly owing to factors of a temporary nature.



Table IV.6  
**LATIN AMERICA AND THE CARIBBEAN: CONSUMER PRICES**  
*(December-to-December percentage variation)*

	1991	1992	1993	1994	1995	1996	1997	1998	1999 <sup>a</sup>
<b>Latin America and the Caribbean</b>	<b>199</b>	<b>414</b>	<b>877</b>	<b>333.1</b>	<b>25.8</b>	<b>18.2</b>	<b>10.4</b>	<b>10.3</b>	<b>8.6</b>
Argentina	84.0	17.6	7.4	3.9	1.6	0.1	0.3	0.7	-1.3
Barbados	8.1	3.4	-1.0	0.5	3.4	1.8	3.6	1.4 <sup>b</sup>	...
Bolivia	14.5	10.5	9.3	8.5	12.6	7.9	6.7	4.4	1.5
Brazil	475.8	1 149.1	2 489.1	929.3	22.0	9.1	4.3	2.5	3.1
Chile	18.7	12.7	12.2	8.9	8.2	6.6	6.0	4.7	3.7
Colombia	26.8	25.1	22.6	22.6	19.7	21.6	17.7	16.7	9.0
Costa Rica	25.3	17.0	9.0	19.9	22.6	13.9	11.2	12.4	10.6
Ecuador	49.0	60.2	31.0	25.4	22.8	25.6	30.6	43.4	52.9
El Salvador	9.8	20.0	12.1	8.9	11.4	7.4	1.9	4.2	-1.3
Guatemala	10.2	14.2	11.6	11.6	8.6	10.9	7.1	7.5	3.7 <sup>e</sup>
Haiti	6.6	16.1	44.4	32.2	24.8	14.6	15.6	7.4	7.9 <sup>c</sup>
Honduras	21.4	6.5	13.0	28.9	26.8	25.3	12.7	15.7	10.6
Jamaica	80.2	40.2	30.1	26.9	25.5	15.8	9.2	7.9	7.5 <sup>c</sup>
Mexico	18.9	11.9	8.0	7.1	52.1	27.7	15.7	18.6	17.4
Nicaragua	865.6	3.5	19.5	14.4	11.1	12.1	7.3	18.5	8.1
Panama	1.6	1.6	1.0	1.3	0.8	2.3	-0.5	1.4	1.1 <sup>c</sup>
Paraguay	11.8	17.8	20.3	18.3	10.5	8.2	6.2	14.6	4.5
Peru	139.2	56.7	39.5	15.4	10.2	11.8	6.5	6.0	2.9
Dominican Republic	7.9	5.2	2.8	14.3	9.2	4.0	8.4	7.8	8.1 <sup>d</sup>
Trinidad and Tobago	2.3	8.5	13.4	5.5	3.8	4.3	3.5	6.5 <sup>b</sup>	...
Uruguay	81.3	59.0	52.9	44.1	35.4	24.3	15.2	8.7	6.0
Venezuela	31.0	31.9	45.9	70.8	56.6	103.2	37.6	29.9	23.5

Source: ECLAC, on the basis of information from official institutions of the countries.

<sup>a</sup> July 1998 - June 1999 variation.

<sup>b</sup> December 1997 - November 1998 variation.

<sup>c</sup> February 1998 - January 1999 variation.

<sup>d</sup> May 1998 - April 1999 variation.

<sup>e</sup> June 1998 - May 1999 variation.

Bolivia, Chile and El Salvador could also be classified as low-inflation countries, since their inflation rates were only slightly above 4% in 1998, but their average annual rates for the five-year period 1994-1998 were between 6.7% and 8%. In all three countries, however, inflation has been declining for a number of years, so they can be regarded as being in a relatively stable situation and can be expected to make continuing progress. Bolivia and Chile improved upon the previous year's figures, with inflation rates down by two points and one point, respectively. The lowering of inflation in Bolivia was due to the implementation of policies designed to rein in demand, but the rate was also affected by short-term factors such as falling international oil prices and the relative stability of food prices. If these goods are left out of the calculation, inflation stood at just above 6%. Inflation in Chile fell from 6% in 1997 to 4.7% in 1998 despite the fact that in the third quarter the real exchange rate broke away from the downward

trend it had followed since 1991. This positive development was the result of a significant slowdown in the prices of tradables, particularly in the fourth quarter, due in part to lower international inflation and the stability of the exchange rate during that period. The underlying inflation rate, which excludes variations in the prices of certain goods because of their essentially seasonal nature, was higher, however (6.3%). In El Salvador the rate was 4.2%, two points up on the 1997 figure; this was attributable to the rise in food prices (6.9%) prompted by the shortage of fruits and vegetables that occurred late in the year owing to the damage caused by Hurricane Mitch.

Inflation in Brazil has been below 5% for the past two years, but the average annual rate for the last five years stands at 70% because it includes the first half of 1994, when Brazil was still suffering from runaway inflation, with annual rates in the four-digit range. Since the remarkable progress made by the country is still so

recent, Brazil cannot yet be listed among the low-inflation countries, but must instead be regarded as being in a transitional stage. Inflation stood at only 2.5% in 1998, the lowest rate recorded by Brazil since the Second World War. This represented a major step forward in the consolidation of the downward trend in inflation which has been observed since the country's stabilization plan was introduced in 1994, although many doubts still remain in this regard. Fears have been heightened by the steep devaluation and radical change in the foreign exchange regime that occurred in mid-January 1999 and by the marked instability of the currency market in the following months. However, so far this new situation has not triggered any inflationary spikes; price rises accelerated somewhat for a few weeks, but then dropped back to their low levels of recent years.

Cuba should also be mentioned in the context of the low-inflation group. Thanks to a system of price controls and increasing amounts of family remittances from abroad, the Cuban authorities have succeeded in maintaining price stability in the various segments of the market. The consumer price index rose by 2.7% in 1998, with this being the net effect of an increase in the informal market and declines in both the agricultural sector and the State-run restaurant sector. Prices in the controlled market showed practically no change from their 1997 levels.

The group of countries having moderate inflation rates (annual price increases between 5% and 10%) includes Peru, where the rate stood at 6% in 1998. This was the lowest figure since 1972 even though the devaluation of the sol amounted to 15% for the year and despite the impact of El Niño, which pushed up the prices of agricultural and fishery products during the first two quarters. These factors were counteracted by others, such as falling domestic demand and lower prices for many imported goods, including oil. When the supply of agricultural and fishery products began to rebound in mid-1998, the inflationary pressures in those markets soon subsided. In the Dominican Republic, inflation stood at 7.8%. Price rises for the first eight months of the year totalled just under 2%, partly because of a decline in domestic demand caused by rising interest rates and restrictive monetary policy, and partly because of the establishment of a single exchange rate and lower fuel prices. However, after Hurricane Georges hit the country in the fourth quarter, the damage done to infrastructure and agriculture drove the annual inflation rate up by five percentage points. In Guatemala, the relative stability of the nominal exchange rate together with positive developments in import prices, particularly in

the case of oil, held the inflation rate down to 7.5%, which was only four tenths of a point more than the previous year, despite the surge in domestic prices in November (2.65%) caused by Hurricane Mitch. The domestic supply situation began to return to normal in December, and the inflation rate started falling rapidly.

Other countries are also moving towards moderate levels of inflation. These include Uruguay, which in recent years has achieved a considerable reduction in its inflation rate. The average annual rate for the past five years is relatively high (25%), but in 1998 inflation was down to the single-digit range for the first time since the mid-1950s, thanks to a further reduction in the public-sector deficit, a slower rate of devaluation and lower international prices, particularly for oil. In Haiti, the implementation of the financial austerity programme and a restrictive monetary policy eased the pressure on the exchange rate and on domestic prices, and this brought the annual inflation rate down from 15.6% in 1997 to 7.4% in 1998. Another positive factor was a 25% increase in the harvest, which helped to ensure a more consistent supply of consumer products. The drop in the prices of petroleum products also helped. Lastly, Jamaica succeeded in lowering its annual inflation rate by a little over one percentage point through the use of fiscal and monetary instruments.

There are six countries in the intermediate inflation group (annual rates between 10% and 25%), and all of them have been in this category for several years. Colombia is the only one of these countries which made some progress in lowering the inflation rate. Inflation rose slightly in Costa Rica, Honduras and Mexico, but in Paraguay and Nicaragua, which had posted single-digit inflation rates in 1997, the increases were sharper. Meanwhile Colombia's stabilization process continued slowly but surely. In the first half of 1998, damage caused by El Niño drove up food prices, thereby generating an inflationary upsurge which temporarily pushed the annual rate above 20%. Even so, favourable weather conditions in the second half of the year, together with the effects of a restrictive monetary policy and a recession in the production sector, helped to dampen price increases considerably. The country ended the year with an inflation rate of 16.7%, and the downward trend strengthened in early 1999; as a result, by May the 12-month inflation rate was only 10%.

Consumer prices in Costa Rica rose slightly faster than in 1997 and accelerated somewhat in the third and fourth quarters owing to pressure from the demand created by the rapid growth of economic activity, plentiful liquidity in the economy and easy access to consumer credit. Food prices were affected by weather conditions

and their impact on the harvests of some agricultural commodities. The price rises would have been sharper, however, had it not been for certain compensatory factors, including the fall in oil prices. In Honduras, inflation rose slightly in 1998, having fallen considerably the previous year. This small increase was due to price rises in the fourth quarter attributable to Hurricane Mitch, which damaged infrastructure and affected domestic supply, particularly of foodstuffs. Inflation remained at this increased level in early 1999, but then began to wane. In Mexico, where inflation had been trending downward, it began to climb again in the third quarter of 1998, and the cumulative rate for the year thus amounted to 18.6%, which was higher than both the government target of 12% and the 1997 figure (15.7%). This was mainly attributable to the faster downward slippage of the peso against the dollar. Falling oil prices and international financial volatility made it necessary to adjust monetary and fiscal policy and created instability in the foreign exchange market; the peso depreciated more than expected, and this in turn caused inflation to rebound.

The inflation rate rose sharply in Nicaragua in 1998 owing to food supply problems caused by natural phenomena such as El Niño and Hurricane Mitch, which mostly affected agricultural goods. Adjustments of charges for basic services also contributed to the problem. Paraguay, which had succeeded in bringing down inflation over the previous five years, suffered a setback, with its inflation rate climbing to almost 15%, compared with the 1997 figure of only 6%, owing to various external and domestic factors. The depreciation of the guaraní by almost 25% pushed up the prices of imported goods, which make up a large proportion of the consumer basket. Adverse weather conditions also led to higher prices

for some foodstuffs, particularly meat and dairy products. Adjustments in charges for public utilities and services such as electric power, drinking water, education and transport also added to the problem, as did higher taxes on luxury goods. Inflation declined in 1999 in both Nicaragua and Paraguay, and by June the 12-month rates were single figures in both countries.

Ecuador and Venezuela were both in the high-inflation group but exhibited differing trends in 1998, as inflation rose in Ecuador but fell in Venezuela. The consumer price index in Venezuela stood at almost 30%; although high, this compares favourably with the 1997 figure of 38%. The authorities responded to the impact of the downturn in the prices for oil (the country's main source of income), of the international financial crisis and of the rising cost of money resulting from the defence of the exchange rate by adopting adjustment policies and cutting public spending, and this policy response helped to hold down the rate of inflation. In early 1998 the downward trend in the monthly inflation rate was reversed, with January's 2% figure giving way to a rate of 3.4% in April, but it then turned downward again and ended the year below the 2% mark. The rate increased in January 1999, but then dipped down to just over 1%. Ecuador had the region's highest inflation rate in 1998 (43.4%), and this was also the country's highest rate of the decade. Disastrous weather conditions early in the year pushed up prices for many agricultural products and for transport. There was another upward surge in the consumer price index in October following the discontinuation of a number of subsidies. In the first quarter of 1999, the steep depreciation of the sucre and rising petrol prices had a strong impact on inflation, with the rate for the 12-month period to June standing at 53%.

## Chapter V

# Investment and saving<sup>1</sup>

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### 1. General overview

The sharp economic downswing seen in Latin America and the Caribbean in 1998 had particularly severe effects on investment and saving. The international crisis dampened investment growth significantly in most of the countries, with the rate for the region as a whole standing at less than 2% in 1998, compared with over 15% in 1997, although results varied widely from one country to another. Not surprisingly, the impact on investment and saving was most severe in countries where economic growth faltered, and investment levels actually fell in some of these cases. In the countries where economic growth remained at medium or high levels, investment growth outpaced GDP growth by a substantial margin. The abrupt economic slowdown in the region and the fact that the investment ratio remained close to the previous year's level were reflected in a considerable decrease in the production capacity utilization rate.

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<sup>1</sup> It should be noted that the analyses presented in this edition of the *Economic Survey of Latin America and the Caribbean* are based on official figures converted into dollars at 1995 prices, whereas the previous edition used figures in 1990 dollars. The results detailed in the two documents are therefore not fully comparable. For example, the aggregate level of gross capital formation is somewhat lower when 1995 is used as the base year (23.9%), whereas the figure is 24.6% when the base year is 1990. This change is particularly significant in the cases of Argentina, Chile, the Dominican Republic, Nicaragua, Peru and Uruguay.

External saving represented a greatly increased proportion of investment financing. In 1998 this proportion amounted to 38%, or two and a half times higher than the 1996 level, following its remarkable upswing in 1997 (79%). As a result, the external savings ratio was up from 2.2% of GDP in 1996 to 5% in 1998. This increase made up for the decrease in national saving, which fell by 1.5% of GDP owing to the considerable deterioration in the terms of trade. In some of the countries of the region, the international financial crisis had a serious effect on flows of external financing. In addition, given the region's limited capacity to produce capital goods, considerable quantities of such products have to be purchased from other countries, which raises the issue as to how these imports are to be financed. Lastly, domestic saving, which is the mainstay for investment, fell to 21.4% in 1998 compared with 21.8% in 1997.

Viewed from a dynamic perspective, saving and investment may be regarded as the "bridge" between the short term and the medium and long terms.<sup>2</sup> The region's growth pattern in recent years has been a highly investment-intensive one, and this characteristic was particularly prominent in 1998, especially owing to short-term factors; hence, even with gross capital formation standing at almost 24% of GDP, a growth rate of only 2.4% was achieved. Consequently, domestic saving was insufficient to finance the level of real investment needed to give a stronger boost to economic activity. External saving has therefore become an essential component of investment financing, as evidenced by the strong rate of growth mentioned above, and is approaching levels which are unlikely to be sustainable in the longer term. In 1998, more than 20% of investment in the region was financed with external resources (see chapter VII).

## 2. Investment<sup>3</sup>

In 1998 total investment in the region (including changes in stocks) dipped to 23.7% of GDP, compared with 23.9% in 1997. However, at 21.5% of GDP, fixed investment was two tenths of a point higher than the previous year. This difference was due to a considerable drop in inventory levels. As might be expected, the behaviour of investment in 1998 was highly uneven from country to country, compared with the previous year's more uniform performance. In contrast to the situation in 1997, when only Haiti had recorded a decrease, in 1998 fixed investment declined as a percentage of GDP in six countries (Brazil, Chile, Colombia, Paraguay, Peru and Venezuela) (see table V.1).

The after-effects of the crisis of the 1980s had included a downward trend in public investment. In some cases, this has been due to external constraints and in others to the effects of structural reforms; the latter factors include privatizations, which, since they reduce the

State's participation in production, also lead to a decline in public investment. The trend of recent years continued in 1998, and in the great majority of the countries for which data are available, the share of private investment expanded. Bolivia is a good example of this, since, until very recently, public investment made up the greater part of the total but has now been displaced by private investment. This change has gone hand in hand with the privatization of State-owned enterprises and a significant increase in foreign direct investment (FDI).

In fact, public investment rose significantly more than private investment in only three countries (out of a total of nine for which data are available). In Ecuador and Honduras, this was mostly due to the need to rebuild infrastructure following the damage done by El Niño and by hurricanes. In Panama, much of the increase in public investment was channelled into road construction and social infrastructure in the health care sector.

2 Data series at constant 1995 prices differ from the series at current prices used in the summary of this edition of the *Economic Survey*. The saving/investment balance at current prices is a better indicator for use in flow analyses, particularly in the case of financial flows (providing, of course, that it can be used at all, since the inflation rate needs to be very low, like those currently seen in the region), whereas investment at constant prices is a better measurement of the expansion of production capacity and of potential economic growth.

3 The data needed for the statistical breakdowns used in this study (public and private investment, on the one hand, and investment in construction and machinery and equipment, on the other) are relatively hard to come by, as can be seen in tables V.2 and V.3. In both cases, data are available only for just over half of the countries.

Table V.1  
**LATIN AMERICA AND THE CARIBBEAN: GROSS FIXED CAPITAL FORMATION**  
*(As percentages of GDP)*

Country	1990	1991	1992	1993	1994	1995	1996	1997	1998 <sup>a</sup>
<b>Latin America and the Caribbean<sup>b</sup></b>	<b>18.2</b>	<b>18.4</b>	<b>19.1</b>	<b>19.4</b>	<b>20.5</b>	<b>19.1</b>	<b>19.3</b>	<b>21.3</b>	<b>21.5</b>
Argentina	11.9	14.1	17.1	18.7	20.8	18.0	18.8	22.0	22.5
Bolivia	13.2	15.0	16.6	16.3	14.2	15.5	16.6	20.9	25.3
Brazil	21.3	20.2	18.9	19.2	20.3	20.5	20.3	21.3	20.8
Chile	19.2	17.7	19.5	21.7	21.6	23.9	24.5	25.4	25.1
Colombia <sup>c</sup>	13.7	12.9	13.9	17.0	19.8	19.8	18.1	23.2	21.6
Costa Rica	20.1	17.3	19.4	22.5	20.0	19.1	18.0	20.4	23.7
Ecuador	17.7	18.5	18.9	18.6	18.5	18.6	18.5	18.5	19.4
El Salvador	12.5	14.1	15.3	16.6	17.6	18.7	16.3	16.8	17.2
Guatemala	11.6	11.7	14.4	15.0	14.1	14.5	13.7	15.9	16.8
Haiti <sup>d</sup>	12.0	11.5	8.0	7.6	7.7	13.8	13.2	12.8	13.4
Honduras	19.2	18.7	22.5	28.5	29.0	24.0	23.9	26.0	30.0
Mexico	19.0	20.3	21.9	20.8	21.6	16.2	18.0	20.6	21.8
Nicaragua	20.9	19.5	22.4	21.2	24.3	26.1	30.8	31.6	32.2
Panama	7.8	13.6	17.9	24.0	24.6	26.0	24.6	28.0	30.6
Paraguay	23.2	24.0	22.2	22.1	22.4	23.1	22.8	22.0	20.9
Peru	17.0	17.0	17.7	18.8	21.7	23.8	22.3	24.1	24.0
Dominican Republic	19.0	16.8	19.7	23.0	22.2	22.1	22.7	25.2	30.4
Uruguay	8.1	9.7	10.6	12.0	11.6	11.0	11.4	11.6	12.4
Venezuela	14.3	17.7	21.4	20.2	17.1	16.5	15.3	17.5	16.5

Source: ECLAC, on the basis of official figures converted into dollars at constant 1995 prices.

<sup>a</sup> Preliminary figures.

<sup>b</sup> Includes changes in stocks in Haiti; for 1997 and 1998, includes changes in stocks in Colombia.

<sup>c</sup> For 1997 and 1998, includes changes in stocks.

<sup>d</sup> Includes changes in stocks.

Table V.2  
**LATIN AMERICA AND THE CARIBBEAN: COMPOSITION OF GROSS  
 FIXED CAPITAL FORMATION, BY SECTOR**

	Percentages of GDP				Growth rates, 1997/1998		
	Public		Private		Public	Private	Gross fixed capital formation
	1990	1998 <sup>a</sup>	1990	1998 <sup>a</sup>			
Costa Rica	4.4	6.2	15.7	17.6	14.8	26.1	22.9
Ecuador	4.2	3.5	13.5	16.0	7.3	6.1	6.3
El Salvador	2.5	3.3	10.0	13.9	1.3	6.6	5.5
Honduras	6.9	6.1	12.2	23.5	0.3	0.1	19.8
Mexico	4.4	2.8	14.5	19.0	- 20.4	18.4	11.4
Panama	1.1	5.9	6.7	24.6	51.0	7.3	13.7
Dominican Republic	5.1	6.5	13.9	23.9	8.3	34.3	27.7
Uruguay	2.6	3.3	5.5	9.1	6.4	13.9	11.8
Venezuela	9.5	8.7	4.8	7.8	- 11.1	0.6	- 5.9

Source: ECLAC, based on official figures converted into dollars at constant 1995 prices.

<sup>a</sup> Preliminary figures.

The breakdown of fixed investment by use showed a change in 1998. The trend in recent years had been away from construction and towards machinery and equipment, but in more than half of the 11 countries considered, investment in construction was the component showing the strongest growth, and investment in machinery and equipment actually contracted in three of them. This occurred in countries that saw a significant downturn in the growth of economic activity (Peru and Venezuela) or that had a very low growth rate (Brazil). In Guatemala, Nicaragua and Uruguay, investment expanded in both areas but more so in construction. In the countries where investment in machinery and equipment climbed substantially (Bolivia, Costa Rica, Dominican Republic), a strong increase in FDI was observed at the same time.

The existence of external constraints or the lack thereof have a direct effect on the composition of investment and especially on investment in machinery and equipment, since a large portion of these goods are imported. The strong upswings seen in imports of capital goods and in FDI in a number of countries corroborate this observation.

The close link between economic growth and increased investment in machinery and equipment was

again confirmed in 1998. In the three countries in which economic activity grew the most in 1998 (Costa Rica, the Dominican Republic and Guatemala), investment in machinery and equipment expanded very swiftly; the same thing occurred in Argentina and Mexico, where the rate of economic growth was somewhat lower.

There are many investment projects under way which could not be suspended because they would have been very difficult to postpone or were part of long-term industrial strategies. This was especially the case in the mining sector, in which large-scale investments were planned in many countries despite low international price levels for most metals. In the energy sector, major integration projects are being developed whose main objective is to form a grid of gas pipelines linking the countries of the region; these projects will benefit Argentina, Bolivia, Brazil, Chile, Colombia, Ecuador, Peru and Uruguay. A number of transnational corporations are involved in these projects, and work on the gas pipeline between Bolivia and Brazil is currently being completed. The strength of private investment in Bolivia has been closely linked to this project and to the exploration and development of new deposits as part of an effort to increase natural gas exports.

Table V.3  
LATIN AMERICA AND THE CARIBBEAN: COMPOSITION OF GROSS FIXED  
CAPITAL FORMATION, BY USE

	Percentages of GDP				Growth rates, 1997/1998		
	Construction		Machinery and equipment		Con- struc- tion	Machinery and equipment	Gross fixed capital formation
	1990	1998 <sup>a</sup>	1990	1998 <sup>a</sup>			
Brazil	15.2	13.2	6.1	7.6	1.3	-7.9	-2.3
Costa Rica	7.9	8.5	12.2	15.1	10.6	29.9	22.9
El Salvador	7.2	8.5	5.3	8.6	3.3	7.9	5.5
Guatemala	3.6	5.0	8.0	11.7	14.4	9.8	11.2
Mexico	9.6	9.3	9.4	12.6	4.6	17.0	11.4
Nicaragua	6.4	9.8	14.5	22.5	8.6	5.1	6.2
Panama	3.2	13.9	4.6	16.7	3.5	23.8	13.7
Peru	13.1	18.9	3.9	5.0	1.0	-6.2	-0.6
Dominican Republic	15.5	16.7	3.5	13.7	6.5	68.5	27.7
Uruguay	5.8	7.2	2.4	5.3	16.5	5.9	11.8
Venezuela	7.9	8.7	6.4	7.8	-1.6	-10.2	-5.9

Source: ECLAC, on the basis of official figures converted into dollars at constant 1995 prices.

<sup>a</sup> Preliminary figures.

### 3. Saving

The region's domestic savings rates remained fairly stable but at relatively low levels. As a result of this situation, along with the performance of investment and the rate of economic growth, investment financing has become more and more dependent on external saving.

One of the highly important issues in the region in relation to policies for the promotion of domestic saving revolves around reforms in the financial sector (see chapter III) and the linkage between public and private saving. The empirical evidence suggests that public saving can be a powerful tool for boosting national saving.

An upward trend in net factor payments raised this variable to 2.9% of GDP in 1998; this tendency is expected to strengthen in the coming years, in view of the high levels of FDI flowing into the region in recent years. Net factor payments were up by US\$ 6 billion at constant 1995 prices, with particularly large increases in outflows under this heading being posted by Argentina, Brazil, Costa Rica, the Dominican Republic, Ecuador and Panama. However, the levels of such payments decreased in Bolivia, Chile, Guatemala, Honduras and Mexico. Current transfers remained steady at about 1% of GDP.

#### (a) Domestic saving and national saving

In 1998 national saving fell to 18.6% of GDP compared with 20.1% in 1997, while gross domestic saving remained close to 1997 levels. The difference between the results for the two variables was mostly due to the negative impact of the terms of trade, which deteriorated significantly in most of the countries of the region, and particularly in Chile, Ecuador and Venezuela.

#### (b) External saving<sup>4</sup>

External saving, as measured in constant prices, has risen to record levels in the 1990s. The 1998 figure (5% of GDP) was one of the highest of recent decades, being surpassed only by the 5.1% level recorded in 1981. This provided financing for more than 20% of gross capital formation,<sup>5</sup> which made external saving the fastest-growing component of this variable, as had

Table V.4  
LATIN AMERICA AND THE CARIBBEAN: FINANCING OF  
GROSS CAPITAL FORMATION<sup>a</sup>  
(As percentages of GDP)

	1990	1991	1992	1993	1994	1995	1996	1997	1998 <sup>b</sup>
1. Gross domestic saving	20.5	20.7	20.3	20.8	21.3	20.3	21.0	21.8	21.4
2. Factor income	- 2.5	- 2.3	- 2.2	- 2.4	- 2.3	- 2.4	- 2.5	- 2.6	- 2.9
3. Current transfers	0.7	0.7	0.8	0.8	0.8	0.9	0.8	0.8	0.9
4. Terms-of-trade effect	- 0.3	- 0.4	- 0.6	- 0.7	- 0.3	-	0.2	0.2	- 0.7
5. Gross national saving (1 + 2 + 3 + 4)	18.4	18.7	18.3	18.5	19.5	18.8	19.5	20.1	18.6
6. External saving	0.1	1.4	2.7	3.3	3.4	2.2	2.2	3.7	5.0
7. Gross capital formation (5+ 6)	18.5	20.1	21.0	21.7	22.9	21.0	21.7	23.9	23.7

Source: ECLAC, on the basis of official figures converted into dollars at constant 1995 prices.

<sup>a</sup> In the calculations of domestic saving and national saving, in the case of Argentina it was assumed that gross capital formation was equal to gross fixed capital formation. The same assumption was also applied in the case of Brazil for 1997-1998.

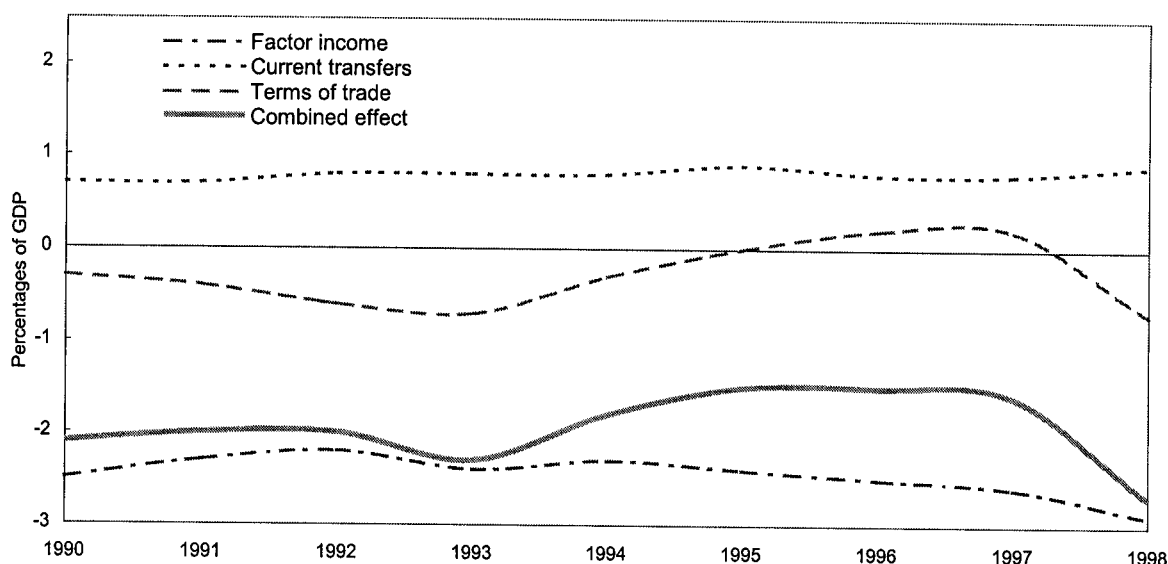
<sup>b</sup> Preliminary figures.

4 External saving is the sum of FDI, portfolio capital, other capital flows and changes in reserves. When calculated at constant prices, this variable has to be adjusted at current prices for, among other factors, the effect of changes in the terms of trade and the exchange rate for the base year.

5 See chapter VII, section 2, for an analysis of the various components of capital flows.



Figure V.1  
**LATIN AMERICA AND THE CARIBBEAN: VARIABLES ASSOCIATED WITH THE DIFFERENTIAL  
 BETWEEN DOMESTIC AND NATIONAL SAVING**



Source: ECLAC, on the basis of official figures converted into dollars at constant 1995 prices.

also been the case in 1997. FDI flows, which made up a considerable proportion of external savings, are the most directly linked factor to the expansion of production capacity. External saving increased in 1998 in the great majority of the countries of the region, with the exceptions being Colombia, Honduras and Paraguay.

### (c) Foreign direct investment <sup>6</sup>

As a result of events on the international scene, the exponential growth of FDI in recent years declined in the final quarter of 1997. It continued to grow in 1998, but at a lower rate, and the pace at which its share of external saving had been growing therefore slowed as well.

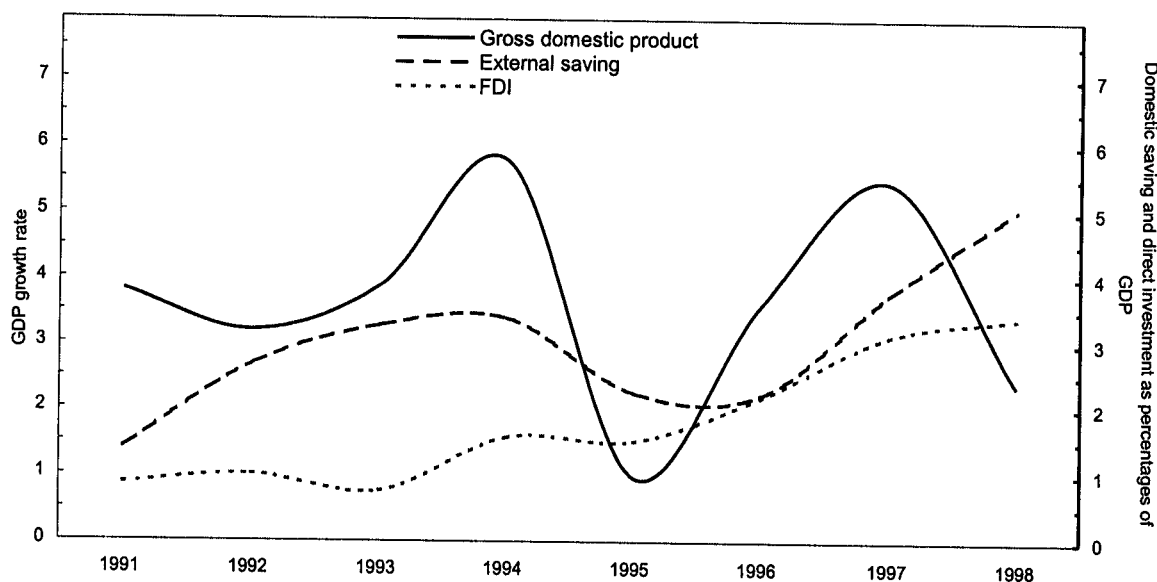
In the first half of the 1990s, inflows of FDI into the region were strongly influenced by the privatization programmes being pursued by various countries in the

region. Subsequently, Latin American Governments' revenues from privatization operations have gradually been supplemented by sizeable new direct investments in the modernization of firms which have changed hands, and such investments have become a clearly predominant source of inflows. Furthermore, in 1998 and early 1999 acquisitions of private assets came to play a more significant role than purchases of State assets. As a result, FDI has been the source of considerable increases in the region's pool of productive capital.

FDI in 1998 amounted to 3.4% of GDP, equivalent to more than 15% of total investment. A considerable increase was seen in flows to Bolivia, Brazil, Costa Rica, the Dominican Republic, Ecuador, Guatemala and Uruguay. In other countries (Argentina, Chile, Colombia, Mexico and Venezuela), FDI inflows diminished after having reached very high levels the previous year.

<sup>6</sup> FDI is discussed here because it is one of the sources of international financing for the balance of payments. It should be noted that the figures for this variable do not always correspond to the increase in production capacity because they also include transfers of ownership of existing assets.

Figure V. 2  
**LATIN AMERICA AND THE CARIBBEAN: FOREIGN DIRECT INVESTMENT (FDI)  
 AND GDP GROWTH**



Source: ECLAC, on the basis of official figures.

The bulk of foreign capital inflows have been invested in services, mainly in energy, telecommunications and finance. There has also been increasing investment in extractive industries formerly under

State control, such as those connected with mining and oil; manufacturing, particularly the automotive industry; and export activities, including *maquila* industries.<sup>7</sup>

<sup>7</sup> See ECLAC, *Foreign Investment in Latin America and the Caribbean, 1998* (LC/G.2042-P), Santiago, Chile, December 1998. United Nations publication, Sales No. E.98.II.G.14.



## Chapter VI

# Employment and wages

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### 1. Main trends

The slowdown in economic growth was reflected throughout the region in a deteriorating situation in the labour market which thus stalled the improvement observed the previous year. In specific terms, the unemployment rate climbed from 7.3% to 8.0% —its highest level in 15 years— as a result of the rapid expansion of the labour supply (an increase in the overall participation rate) and a fairly sluggish rate of job creation (a decrease in the employment rate). This regional figure is, however, largely attributable to the unfavourable situation in Brazil, since in a number of other countries the main indicators did not start to decline until late in the year; in a third group —mainly Mexico and the Central American and Caribbean countries— employment strengthened in comparison with the previous year. Against this background, average real wages showed a slight improvement and, contrary to the tendency in the preceding years, the growth rate for real minimum wages surpassed this increase by a small margin.

**THE UPSWING** in the economy in 1997 had given a fairly strong boost to the demand for labour and had brought unemployment figures down slightly. At the regional level, this trend was checked in 1998 when

growth slowed in a majority of the countries, since in many cases this had a negative impact on labour indicators, especially towards the end of the year. The rate of job creation, particularly with respect to salaried or

wage-based jobs, fell sharply in comparison with the year before, which meant that most of the new jobs that were created were in the informal sector. In terms of specific sectors, employment contracted in agriculture once again and expanded very little in manufacturing. New jobs were concentrated in construction and, above all, in tertiary activities, especially financial, real estate and business services, which expanded at a rapid pace, and commerce and social, community and personal services, which also made a significant contribution to the increase in employment.

Beyond these broad regional trends, labour statistics varied widely from one country to another. Almost all the countries in the southern part of the continent experienced rising unemployment, sluggish job creation, a sharp increase in the role of the informal sector within the employment structure, and flat or declining real wage levels. In some cases the labour situation worsened, especially in late 1998 and early 1999, while in Brazil, employment and unemployment variables, which had started to deteriorate in late 1997, continued to trend downwards.

In contrast, Mexico and the Central American and Caribbean countries performed fairly well in this respect. Less affected by the erosion of economic conditions outside the region and buoyed by the strength of

the United States economy, these countries recorded growth rates above the regional average, which enabled them to reduce unemployment, boost job creation and make some improvements in job quality. In most of these economies, the increase in real wages was also above the average for the region. In addition, thanks to the stronger demand for labour, in most cases salaried employment accounted for a higher percentage of new jobs and, as part of another trend that set these nations apart from the South American countries, the rate of job creation in the manufacturing sector was fairly high.

At the country level, Costa Rica, Dominican Republic, Honduras,<sup>1</sup> Mexico, Panama and Uruguay (the only South American country on the list) were the most successful in lowering unemployment, creating jobs<sup>2</sup> and improving real wages; Brazil, Ecuador and Colombia turned in the worst performances in these respects as a consequence of negative economic trends throughout the year; elsewhere in the region, meanwhile, the situation did not start to deteriorate until the fourth quarter.

As economic activity weakened, the labour situation deteriorated even further in the first few months of 1999, especially in the Southern Cone countries, Colombia, Ecuador and Venezuela.

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## 2. Unemployment

The weighted average rate of unemployment rose sharply, climbing from 7.3% in 1997 to 8.0% in 1998, its highest level since 1984. National unemployment trends were quite mixed, however (see table VI.1). In fact, of the 21 countries for which information was available, only four saw a rise in unemployment amounting to half a percentage point or more, 10 recorded declines of a comparable magnitude, and the remaining seven countries' rates varied by smaller amounts. Thus, the weighted average reflects, first and foremost, the sharp rise in unemployment in Brazil, the

largest economy in the region. By contrast, the simple average for these 21 countries actually declined slightly, from 10.1% to 9.9%.

Unemployment increased by approximately two percentage points or more in Brazil, Colombia and Ecuador. In these countries, the cooling of the economy due to the international crisis and domestic factors depressed the demand for labour. This showed through in a downswing in the employment rate in Brazil and Ecuador and, in all three cases, in a very slow growth rate for salaried and other wage-based employment. In

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1 Until it was struck by Hurricane Mitch.

2 The job creation rate used here takes into account the employment rate and the relative proportion of wage employment in the total number of new jobs created.

Table VI.1  
**LATIN AMERICA AND THE CARIBBEAN: URBAN UNEMPLOYMENT**  
*(Average annual rates)*

	1980	1985	1990	1992	1993	1994	1995	1996	1997	1998 <sup>a</sup>
<b>Latin America and the Caribbean</b>	<b>6.2</b>	<b>7.3</b>	<b>5.9</b>	<b>6.2</b>	<b>6.2</b>	<b>6.3</b>	<b>7.2</b>	<b>7.7</b>	<b>7.3</b>	<b>8.0</b>
Argentina										
Urban areas <sup>b</sup>	2.6	6.1	7.4	7.0	9.6	11.5	17.5	17.2	14.9	12.9
Barbados										
Total nationwide <sup>c</sup>	...	...	14.7	23.0	24.3	21.9	19.7	14.3	12.2	11.8
Bolivia										
Departmental capitals	...	5.8	7.3	5.4	5.8	3.1	3.6	3.8	4.4	...
Brazil										
Six metropolitan areas	6.3	5.3	4.3	5.8	5.4	5.1	4.6	5.4	5.7	7.6
Chile										
Total nationwide <sup>d</sup>	10.4	15.3	7.8	6.7	6.5	7.8	7.4	6.4	6.1	6.4
Colombia <sup>c</sup>										
Seven metropolitan areas	10.0	13.9	10.5	10.2	8.6	8.9	8.8	11.2	12.4	15.3
Costa Rica										
Total urban	6.0	6.7	5.4	4.3	4.0	4.3	5.7	6.6	5.9	5.4
Cuba										
Total nationwide	...	...	...	6.1	6.2	6.7	7.9	7.6	6.8	6.5
Ecuador <sup>c</sup>										
Total urban	5.7	10.4	6.1	8.9	8.9	7.8	7.7	10.4	9.3	11.5
El Salvador										
Total urban	...	...	10.0	8.2	8.1	7.0	7.0	7.5	7.5	7.9
Guatemala <sup>e</sup>										
Total nationwide	2.2	12.1	6.0	1.5	2.5	3.3	3.7	3.7	5.0	5.9
Honduras										
Total urban	8.8	11.7	7.8	6.0	7.0	4.0	5.6	6.5	6.4	5.2
Jamaica <sup>c</sup>										
Total nationwide	...	...	15.3	15.7	16.3	15.4	16.2	16.0	16.5	15.5
Mexico										
Urban areas <sup>b</sup>	4.5	4.4	2.7	2.8	3.4	3.7	6.2	5.5	3.7	3.2
Nicaragua										
Total nationwide	...	3.2	7.6	14.4	17.8	17.1	16.9	16.0	14.3	12.2
Panama <sup>c</sup>										
Metropolitan region	9.9	15.6	20.0	17.5	15.6	16.0	16.6	16.9	15.4	15.0
Paraguay										
Asunción metropolitan area	4.1	5.2	6.6	5.3	5.1	4.4	5.3	8.2	6.9	7.2
Peru										
Lima metropolitan area	7.1	10.1	8.3	9.4	9.9	8.8	8.2	8.0	9.2	8.4
Dominican Republic <sup>c</sup>										
Total nationwide	...	...	...	20.3	19.9	16.0	15.8	16.5	15.9	14.3
Trinidad and Tobago										
Total nationwide <sup>e</sup>	...	...	20.1	19.7	19.8	18.4	17.2	16.3	15.0	14.2
Uruguay										
Total urban <sup>g</sup>	...	...	8.5	9.0	8.3	9.2	10.3	11.9	11.5	10.1
Venezuela										
Total nationwide	6.0	13.1	10.4	7.8	6.6	8.7	10.3	11.8	11.4	11.2

Source: ECLAC, on the basis of official figures.

<sup>a</sup> Preliminary figures.

<sup>b</sup> Represents a large and increasing number of urban areas.

<sup>c</sup> Includes hidden unemployment.

<sup>d</sup> The figure entered for 1985 actually relates to 1984.

<sup>e</sup> Official estimates.

<sup>f</sup> From 1994 on, figures refer to total urban unemployment.

<sup>g</sup> Figures for 1980 and 1985 refer to unemployment in Montevideo.

Colombia, the labour force participation rate rose steeply owing to the need of many households for additional income, but because of the slump in labour demand, this increase was reflected in sharply higher informal employment and unemployment figures. In Chile and Peru, the unemployment level changed very little in terms of the annual average but was starting to climb towards the end of the year.

By contrast, in Argentina, the Dominican Republic, Nicaragua and Uruguay, unemployment fell by one

percentage point or more, generally because of an increase in employment rather than because of any reduction in the labour supply. In all these countries, however, unemployment was still at double-digit levels.

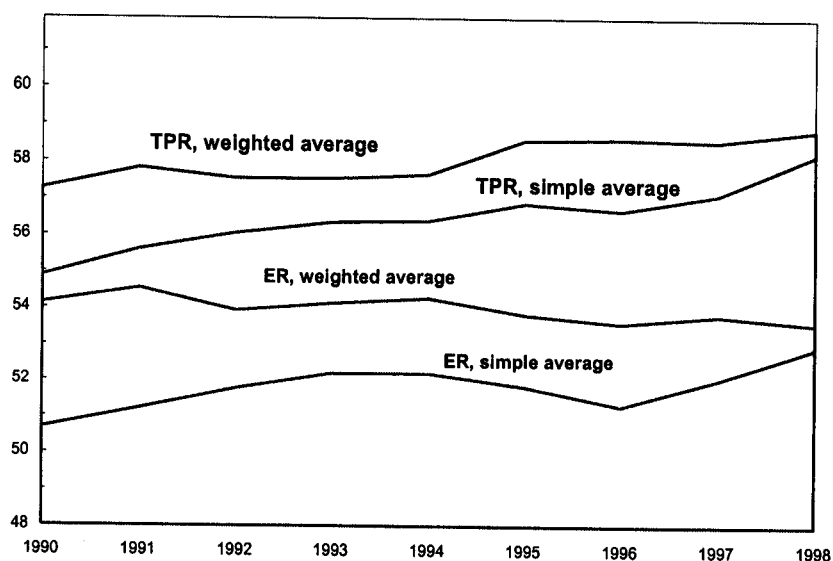
The unemployment rate is a function of the variation in the number of persons seeking work (the labour supply) and the number of jobs created. The behaviour of these two variables in 1998 is described in the following sections.

### 3. Labour supply

The growth of the labour supply accelerated in 1998. Apart from the demographic increase in the working-age population (i.e., persons 15 years and over), which grows by approximately 2.3% per year, a steep increase was recorded in the percentage of people in this age group who are either working or seeking em-

ployment (total participation rate). The weighted average participation rate for 12 countries went up from 58.5% to 58.9%, while the simple average climbed from 57.1% to 58.2%; these increases are a reflection of the swift expansion of the labour supply, particularly in some of the smaller countries (see figure VI.1).

Figure VI.1  
LATIN AMERICA AND THE CARIBBEAN (12 COUNTRIES): TOTAL PARTICIPATION RATE (TPR)  
AND EMPLOYMENT RATE (ER)<sup>a</sup>



Source: ECLAC, on the basis of official figures.

<sup>a</sup> The TPR and ER are expressed as percentages of the working-age population, as is the weighted average regional open unemployment rate (shaded area).

Table VI.2  
LATIN AMERICA AND THE CARIBBEAN: PARTICIPATION RATES<sup>a</sup>

	Total participation rate			Male participation rate			Female participation rate		
	1991	1997	1998 <sup>b</sup>	1991	1997	1998 <sup>b</sup>	1991	1997	1998 <sup>b</sup>
Simple average	54.6	55.9	56.8	73.6	73.0	73.4	36.9	40.1	41.4
Argentina <sup>c</sup>	40.9	45.1	45.5	54.9	56.5	56.4	28.1	34.4	35.4
Brazil <sup>d</sup>	61.1	58.5	58.2	80.0	74.7	73.7	44.3	44.3	44.5
Chile <sup>e</sup>	52.7	54.2	54.4	75.7	74.7	74.7	30.8	34.6	35.0
Colombia <sup>f</sup>	59.3	61.5	62.7	75.0	74.0	74.1	46.3	51.0	52.9
Costa Rica <sup>g</sup>	52.2	53.8	55.3	74.9	74.5	75.6	30.6	33.5	35.6
Ecuador <sup>h</sup>	56.8	56.6	58.4	71.3	70.9	71.8	43.2	43.1	46.1
El Salvador <sup>e</sup>	...	50.9	53.4	...	68.5	69.3	...	35.3	39.4
Honduras <sup>i</sup>	48.6	53.1	51.9	71.9	72.6	72.5	26.6	35.0	32.8
Mexico <sup>j</sup>	53.3	56.2	56.5	73.9	75.0	75.5	34.5	39.3	39.4
Panama <sup>k</sup>	57.5	61.6	62.2	77.3	80.7	80.6	38.1	43.1	44.1
Dominican Republic <sup>f</sup>	55.0	54.2	54.4	72.9	72.5	...	37.5	36.2	...
Uruguay <sup>j</sup>	57.4	57.7	60.4	73.3	71.4	73.4	43.8	45.8	49.2
Venezuela <sup>l</sup>	60.2	63.9	65.2	81.5	82.6	83.1	38.9	45.1	47.2

Source: ECLAC, on the basis of official figures.

<sup>a</sup> The participation rate is calculated as a percentage of the working-age population, except in the case of Argentina, where it is calculated as a percentage of the total population. The data are not always comparable, since the definitions used for the working-age population and geographic coverage may vary. <sup>b</sup> Preliminary figures. <sup>c</sup> Greater Buenos Aires, average for April-May and October. <sup>d</sup> Six metropolitan areas, annual average. <sup>e</sup> Total nationwide, annual average. <sup>f</sup> Seven metropolitan areas, December. <sup>g</sup> Total nationwide, July. <sup>h</sup> National urban figure, November. <sup>i</sup> Total nationwide, September. <sup>j</sup> National urban figure, annual average. <sup>k</sup> National urban figure, August. <sup>l</sup> Total nationwide, second half of the year.

Consequently, the economically active population grew by 3%, which was well above the trend rate for the decade of 2.75%.<sup>3</sup> As shown in table VI.2, the increase in the labour supply was mainly due to a very strong upturn in the female labour force participation rate, whereas in most cases the increase in the male labour force participation rate was quite small.

This marked rise in the labour supply took place within two quite different types of economic contexts. In some cases, the need for additional sources of income during a time of slack economic activity prompted a large number of men and, above all, women to join the labour force. This occurred, for example, in

Colombia, Ecuador and Venezuela. In these cases, where the rise in labour force participation may be interpreted as the result of supply-side pressure, a substantial proportion of these new entrants into the labour force were able to find employment only in informal activities or remained jobless. In other countries, such as Costa Rica, El Salvador and Panama, rising levels of economic activity bolstered businesses' demand for labour, inducing a larger number of economically inactive persons to enter the job market. Under these circumstances, a significant proportion of the additional labour supply was able to find salaried employment.

<sup>3</sup> This is a simple average for 14 countries. In terms of weighted averages, the economically active population has tended to grow at a rate of about 2.5% in the 1990s.



#### 4. Employment trends

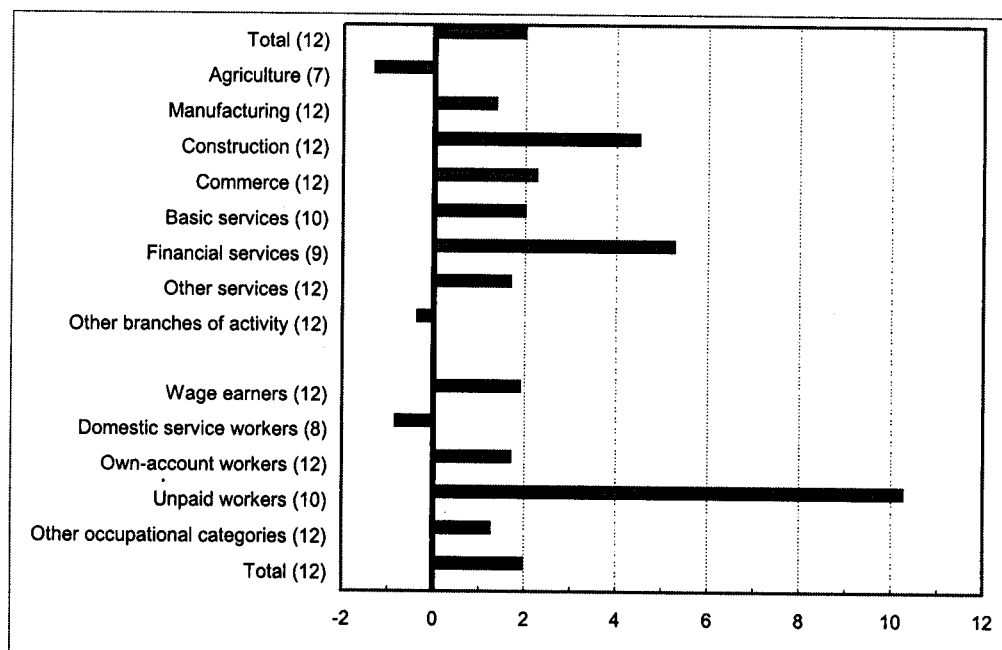
Flagging economic growth was coupled with a slower rate of job creation in 1998. In fact, employment expanded by only 2.0% at the regional level compared with 3.0% in 1997, thus slipping back to the relatively low rates of 1995 and 1996. This was largely a result of the slight contraction, in absolute terms, recorded in Brazil, since for the rest of the region, employment rose by 3.6%. Nonetheless, the decline in the rate of job creation was quite widespread, as in 10 out of the 12 countries for which data were available, the rate was lower than it had been the year before.

Despite this overall decline, job creation was fairly buoyant in a number of countries. This was particularly the case in Costa Rica, El Salvador, Mexico and Panama, where the rate for this variable outstripped the growth rate of the working-age population by a wide margin. The same was true for Uruguay, which contin-

ued to experience an upswing in the employment level following steep losses in the years from 1995 to 1997, and in Venezuela. Hence, the simple average rate of employment rose from 52.0% to 52.9%. The weighted average, on the other hand, fell as a consequence of Brazil's mediocre performance, which nudged the regional employment rate down from 53.8% to 53.6% (see figure VI.1).

At the regional level, slack labour demand showed through in the meagre increase seen in salaried and other wage-based employment (1.9%), which expanded by a slightly lower rate than total employment (see figure VI.2). At this level, however, trends were once again highly uneven, since in such countries as Costa Rica, El Salvador, Honduras, Mexico and Panama, wage earners accounted for a larger share of total employment than before. By contrast, in Brazil, Chile,

Figure VI.2  
LATIN AMERICA AND THE CARIBBEAN: NET VARIATION IN EMPLOYMENT, 1998  
(Percentages)<sup>a</sup>



Source: ECLAC, on the basis of official figures.

<sup>a</sup> The variations shown refer to weighted national rates for the population aged 10 and over based on the relative size of each branch of activity and occupational category. The figures in brackets indicate the number of countries for which information was available.

Table VI.3  
**LATIN AMERICA AND THE CARIBBEAN: CONTRIBUTION  
 TO NET JOB CREATION, 1998**  
 (Percentages)

Contribution of each branch of activity to increase in non-agricultural employment		Contribution of each occupational category to increase in total employment	
Total (12 countries)	100	Total (12 countries)	100
Manufacturing	13	Wage earners (including domestic service workers)	58
Construction	15	Own-account workers	17
Commerce	23	Unpaid workers	21
Basic services	8	Other	4
Other services (includes social, community and personal services, and finance, insurance, real estate and business services)	42		
Other	-1		

Source: ECLAC, on the basis of official figures.

Colombia, Ecuador and Venezuela, the cooling of economic activity restrained the demand for labour, and this was reflected in modest and, in some cases, negative growth rates for salaried employment.

The pressure exerted by the labour supply in these countries was reflected in a steeper increase in self-employment, which expanded by 1.7% at the regional level. In contrast with the previous year, the number of unpaid workers also climbed sharply (10.3%), with particularly marked increases in Colombia, Ecuador and Venezuela. Thus, the two main employment categories which, for the most part, correspond to informal activities contributed 38% of all new jobs (see table VI.3).

Newly-created salaried or wage-based positions (including domestic service) accounted for 58% of all new jobs but, in line with the trend observed throughout the decade, these jobs were concentrated in small businesses and microenterprises. According to figures compiled by the International Labour Organization (ILO), formal non-agricultural employment stagnated as the net result of an increase in public-sector employment and a contraction of a similar magnitude in formal

employment within the private sector. Hence, any new jobs had to come from informal activities, and the number of own-account workers, unpaid workers and wage earners employed in non-agricultural small businesses and microenterprises grew by 4.5%. These statistics indicate that the trend towards an increasing proportion of informal employment that has been observed during the 1980s and 1990s strengthened further in 1998.

As in previous years, employment in the agricultural sector contracted, and this time it did so quite markedly (1.3%). This figure does not take into account the sharp decline in agricultural labour demand in Brazil (estimated at 11.5% based on manpower requirements during the planting and harvesting seasons) caused by the drought which ravaged the country, especially in the north-east. The steepest declines in the amount of land under cultivation and in labour demand were in the staple grain (corn, beans and rice) and cassava crops.<sup>4</sup> The critical situation in Brazilian agriculture resulted in a 5.7% reduction in formal agricultural employment, thereby considerably speeding the decline in agricultural employment in the country as a whole.

<sup>4</sup> See the Data Analysis System Foundation of the State of São Paulo (SEADE), *Sensor Agrícola*, São Paulo, November 1998. For 1999, a strong recovery in the amount of land under cultivation and in production is expected, and this should lead to an upturn in employment (*Boletim de conjuntura*, No. 4/99).

After two years of declines, employment in manufacturing in Latin America had expanded by 1.8% in 1997, but this was followed by a growth rate of just 1.3% in 1998. This indicates that the percentage of total employment accounted for by the manufacturing sector slipped further, thus reinforcing a trend observed throughout the decade. In 1998, the manufacturing sector contributed only 13% of newly-created non-agricultural jobs. The sector's share of employment declined in almost all the South American countries —Argentina, Brazil, Chile and Ecuador actually recorded losses of manufacturing jobs in absolute terms— but in Costa Rica, El Salvador, Honduras and Mexico, the number of jobs in this sector increased faster than employment as a whole.<sup>5</sup> Consequently, at the regional level employment trends in the manufacturing sector continue to be very uneven. Job growth in this sector has been greater in the meso-American countries, whose geographical proximity to North America and the privileged access enjoyed by some of their industries (especially *maquila* activities) to its markets stimulate investment and job creation in the sector; on the other hand, in the South American countries, trade liberalization has forced companies to make numerous labour-saving adjustments, and no new labour-intensive industries have arisen to take up the slack.

Following setbacks at the regional level in 1995 and 1996 and a somewhat halting recovery in 1997, the construction industry made a positive contribution to job creation in 1998. In fact, the number of jobs in the sector increased by 4.5%, and by even more in Honduras, Mexico, Panama and Uruguay, where this industry regained its former buoyancy. In the Caribbean countries as well, the rapid growth of the construction sector played an influential role in the relatively favourable performance of the labour market. By contrast, employment in construction was sluggish in Brazil and actually shrank in Colombia. At the regional level, construction accounted for 15% of all new non-agricultural jobs in 1998.

As in previous years, employment in financial services, insurance, real estate and business services (a sector which has undergone sweeping changes in the

1990s) expanded by a robust 52%. However, in basic services (electricity, gas and water; transport, storage and communications), where employment levels had burgeoned in earlier years as a result of these sectors' liberalization and modernization, the rate of job creation fell to 2.0% (close to the overall average) in 1998.

In the case of the main tertiary activities —commerce, restaurants and hotels, and social, community and personal services— job growth was down slightly from the preceding year, falling to 2.2% and 1.7%, respectively. Even so, tertiary activities continued to generate the bulk of new jobs, with commerce accounting for 23%, basic services for 8% and other services for 42%.

Job losses in the formal sector were very steep in Brazil. According to data from the Ministry of Labour, 582,000 formal-sector jobs were lost in Brazil between December 1997 and December 1998 (a decrease of 2.8%). Most of the cutbacks occurred in manufacturing (301,000 jobs, or a drop of 5.9%), construction (64,000 jobs, or 4.9%), basic services (75,000, or 4%), commerce (58,000, or 1.4%), financial services (36,000, or 5.7%) and agriculture (52,000, or 5.7%).

Job-quality indicators for 1998 underscore the fact that the open unemployment rate does not provide a complete picture of the problems existing in the labour market. The corresponding indicators point to the existence of high degrees of informality and job insecurity (see table VI.4). In 1998, the variation in these indicators reflected the differences observed in job creation patterns. Thus, where labour demand was relatively strong, there were some improvements, as was the case in Costa Rica, El Salvador, Honduras, Mexico, Peru and Uruguay. By contrast, in Colombia, Brazil, Ecuador and Venezuela, the weak demand for labour as compared with the needs of the economically active population meant that a large proportion of new jobs fell short of job-quality standards in one way or another. In 1998, underemployment rose sharply in Colombia, as did the proportion of jobs paying less than the minimum wage. In Brazil, a lack of job security was a growing problem in connection with salaried positions, while in Ecuador and Venezuela, the occupational structure became increasingly informal.

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5 This was also true of Guatemala and Nicaragua (for which no sample information was available for 1998), where the number of formal jobs (i.e., those affording social security coverage) grew faster in the manufacturing industry than in the economy as a whole.

Table VI.4  
**LATIN AMERICA AND THE CARIBBEAN: EMPLOYMENT  
 QUALITY INDICATORS**  
*(Index: 1995 = 100)*

	Insufficient volume of work							
	1991	1992	1993	1994	1995	1996	1997	1998 <sup>a</sup>
Argentina	60.7	60.7	69.0	80.0	100.0	109.7	106.9	106.9
Bolivia	...	...	...	...	100.0	132.9	70.0	...
Chile <sup>b</sup>	90.0	75.0	110.0	100.0	100.0	205.0	280.0	215.0
Colombia	117.1	121.4	101.7	102.6	100.0	128.9	131.6	157.3
Costa Rica	109.2	77.3	75.6	88.3	100.0	120.8	106.7	112.5
Honduras	165.7	119.3	196.7	92.2	100.0	176.7	182.9	129.8
Mexico	79.8	83.8	91.9	87.3	100.0	98.3	86.1	76.3
Paraguay	...	...	...	82.8	100.0	133.7	...	97.8
Peru	...	...	...	...	100.0	114.3	114.3	102.5
Dominican Republic	92.1	101.6	100.0	86.9	100.0	81.0	92.1	...
Uruguay	91.2	66.7	59.6	71.9	100.0	119.3	103.5	89.5
<b>Insufficient income</b>								
Bolivia	...	...	...	...	100.0	88.9	92.7	...
Brazil	136.9	178.9	181.6	185.3	100.0	112.0	105.4	114.0
Colombia	100.5	125.7	119.4	131.9	100.0	116.8	106.3	135.6
Costa Rica	138.3	193.1	133.3	122.2	100.0	156.8	171.6	139.5
Honduras	156.3	136.9	144.0	116.2	100.0	111.4	101.8	91.5
Mexico	86.2	76.1	86.2	73.4	100.0	116.5	122.0	100.9
Paraguay	...	...	...	96.5	100.0	124.9	...	109.1
Peru	...	...	...	...	100.0	91.3	90.4	104.5
Dominican Republic	126.5	110.8	98.9	79.5	100.0	98.9	64.9	...
<b>Other indicators of insufficient quality</b>								
Brazil <sup>c</sup>	84.1	91.3	93.7	97.6	100.0	104.2	104.5	107.2
Colombia <sup>d</sup>	95.3	115.7	91.1	90.6	100.0	111.5	109.9	135.6
Ecuador <sup>e</sup>	103.3	108.3	107.8	103.1	100.0	99.7	92.5	98.4
El Salvador <sup>f</sup>	...	...	...	95.9	100.0	100.8	99.5	94.8
Mexico <sup>g</sup>	88.2	90.0	93.1	94.7	100.0	101.2	101.2	99.0
Uruguay <sup>h</sup>	100.0	104.0	100.7	101.3	100.0	98.7	103.3	100.0
Venezuela <sup>i</sup>	84.0	82.2	84.2	101.2	100.0	101.0	99.0	102.9

Source: ECLAC, on the basis of official figures.

Note: The indices reflect the number of employed persons with jobs of substandard quality as a percentage of the total number of job-holders. The volume of work is defined as being insufficient when employed persons work fewer hours per week than the normal or desired number. Income levels are defined as insufficient when employed persons who work what is considered to be a normal working day earn less than the established minimum wage. The other indicators of insufficient job quality refer to job security and coverage by labour laws. For all three groups of indicators, the definitions used vary from one country to another. For definitions and corresponding percentages, see the full version of the table in the Statistical Appendix.

<sup>a</sup> Preliminary figures. <sup>b</sup> The figures shown for the years up to and including 1995 are not directly comparable with those for 1996 and thereafter owing to changes in the sample used. <sup>c</sup> Wage earners not covered by labour and social laws as a percentage of total wage earners. <sup>d</sup> Temporary workers. <sup>e</sup> Gross underemployment. <sup>f</sup> Employed persons not covered by the Salvadoran Social Security Institute. <sup>g</sup> Employed persons who receive no benefits. <sup>h</sup> Private-sector wage earners not covered by labour laws and employed persons who are seeking other employment because of a lack of job security or because they are unpaid family workers. <sup>i</sup> Employed persons in the informal sector; nationwide total.

## 5. Wages

At the regional level, real average wages in the formal sector made a strong recovery between 1992 and 1994, but this trend was then broken by the "tequila" crisis in 1995; in the following years, real wages in most countries exhibited fairly small fluctuations in both directions, except in Brazil, Chile, Ecuador and Guatemala, where they rose substantially, and Mexico, Peru and Venezuela, where steep losses were recorded.

In 1998, as in 1997, the pattern of real wages was quite uniform in the different countries of the region. On the one hand, the dominant trend towards a slow-down in economic growth—accompanied, in some cases, by higher levels of unemployment—restrained wage increases. On the other, the relative stability of price levels and the fact that most countries did not experience a serious deterioration in their employment or unemployment situations forestalled any steep downturn in real wages.

In 8 of the 14 countries for which information was available, real wages varied between -2% and +3% (see

table VI.5). Larger increases were recorded in Bolivia (thanks to a marked drop in inflation in the second half of the year), Costa Rica (where economic growth accelerated), Nicaragua (owing to a strong rise in public-sector wages) and Venezuela (where wages have been slowing working their way back up following sharp decreases between 1992 and 1996). Declines in excess of this range were seen in Ecuador (as a consequence of a surge in inflation) and in Guatemala. As a result, regional indicators revealed modest wage rises, with a weighted average of 0.7%, a simple average of 1.5% and a median increase of 2%.

This fairly even pattern of variations within a relatively narrow range notwithstanding, wages have also been influenced by the countries' differing rates of economic growth. For example, economic stagnation in Brazil has put an end to the substantial wage increases (in absolute terms) that were being made under the *Real Plan*. In Mexico, on the other hand, after a three-year downturn, real wages in the manufacturing sector at

Table VI.5  
**LATIN AMERICA AND THE CARIBBEAN: REAL AVERAGE WAGES**  
(Indices of annual averages: 1995 = 100)

	1980	1990	1991	1992	1993	1994	1995	1996	1997	1998 <sup>a</sup>
Argentina <sup>b</sup>	128.8	99.1	100.4	101.7	100.4	101.1	100.0	99.8	99.3	98.2
Bolivia <sup>c</sup>	57.6	88.8	82.9	86.2	92.0	99.3	100.0	101.1	109.3	113.2
Brazil <sup>d</sup>	94.6	104.5	89.0	87.0	95.6	96.3	100.0	107.9	110.8	110.9
Chile <sup>e</sup>	77.2	80.9	84.9	88.7	91.8	96.1	100.0	104.1	106.6	109.5
Colombia <sup>f</sup>	80.7	94.9	92.4	93.5	97.9	98.8	100.0	101.5	104.2	102.8
Costa Rica <sup>g</sup>	104.0	89.8	85.6	89.2	98.3	102.0	100.0	97.9	98.7	103.3
Ecuador <sup>h</sup>	88.3	65.4	68.4	74.2	83.5	90.9	100.0	105.4	103.0	98.9
Guatemala <sup>i</sup>	109.7	77.0	72.1	82.9	88.7	89.3	100.0	112.6	112.8	108.5
Mexico <sup>j</sup>	113.1	88.1	93.8	100.7	109.7	114.9	100.0	90.1	89.1	91.5
Nicaragua <sup>k</sup>	390.8	81.8	84.5	100.5	93.3	98.2	100.0	97.9	97.7	105.0
Paraguay <sup>l</sup>	89.5	87.7	91.8	90.9	91.7	93.0	100.0	103.1	102.6	100.7
Peru <sup>m</sup>	265.0	85.7	98.7	95.2	94.4	109.2	100.0	95.2	94.5	92.7
Uruguay <sup>n</sup>	99.5	91.7	95.2	97.3	102.0	102.9	100.0	100.6	100.8	102.7
Venezuela <sup>o</sup>	302.4	138.1	130.1	136.5	124.4	104.8	100.0	76.7	96.3	101.5

Source: ECLAC, on the basis of official figures.

<sup>a</sup> Preliminary figures. <sup>b</sup> Manufacturing. <sup>c</sup> Private sector in La Paz. The figure shown in the column for 1980 refers to 1985. <sup>d</sup> Workers covered by social and labour legislation in six metropolitan areas. Average for 1980 for Rio de Janeiro and São Paulo. <sup>e</sup> Until April 1993, non-agricultural wage earners. Since May 1993, the general hourly wage index is used. <sup>f</sup> Workers in the manufacturing sector. <sup>g</sup> Average declared wages of workers covered by the social security system. <sup>h</sup> Non-agricultural enterprises with 10 or more employees. The figure shown in the 1980 column refers to 1985. <sup>i</sup> Average wages, not including payment in kind or other benefits. <sup>j</sup> Asunción. <sup>k</sup> Private-sector manual workers in the Lima metropolitan area. <sup>l</sup> Urban non-manual and manual workers; second half of each year. The figure shown in the 1980 column refers to 1982.

Table VI.6  
**LATIN AMERICA AND THE CARIBBEAN: REAL URBAN MINIMUM WAGE**  
*(Indices of annual average: 1995= 100)*

	1980	1990	1992	1993	1994	1995	1996	1997	1998 <sup>a</sup>
Argentina	132.4	28.4	57.9	74.9	103.4	100.0	99.8	99.3	98.4
Bolivia	...	50.9	84.0	92.3	101.8	100.0	96.0	98.1	113.5
Brazil	121.5	87.8	90.0	99.2	94.8	100.0	104.3	106.9	111.2
Chile	87.9	76.9	87.9	92.2	95.6	100.0	104.2	107.9	114.1
Colombia	97.4	104.6	99.4	102.1	100.4	100.0	99.3	101.2	99.5
Costa Rica	83.7	101.2	95.4	99.5	102.2	100.0	101.9	105.7	109.3
Ecuador <sup>b</sup>	209.8	72.8	63.4	72.8	84.4	100.0	109.7	105.8	98.3
El Salvador <sup>c</sup>	278.6	97.0	101.5	101.5	99.6	100.0	96.4	92.2	95.3
Guatemala	409.2	197.2	142.9	123.8	109.5	100.0	99.0	90.7	95.3
Haiti	157.5	115.6	96.1	74.0	53.2	100.0	82.9	71.3	63.4
Honduras	131.3	111.6	121.3	123.0	105.8	100.0	96.0	102.0	106.0
Mexico <sup>d</sup>	323.9	128.0	116.4	114.5	114.7	100.0	91.0	90.0	90.7
Panama	94.5	93.8	91.3	102.0	100.6	100.0	104.3	103.1	105.9
Paraguay <sup>e</sup>	87.5	114.5	99.8	96.0	98.5	100.0	102.4	107.4	105.8
Peru <sup>f</sup>	676.1	158.0	107.4	75.5	97.8	100.0	103.2	181.2	200.9
Dominican Republic	109.8	83.4	98.4	93.5	99.5	100.0	100.6	102.0	106.3
Uruguay	233.9	161.3	141.0	122.3	108.5	100.0	96.6	94.8	98.1
Venezuela <sup>g</sup>	184.6	88.3	108.8	95.3	106.8	100.0	94.6	80.7	80.5

Source: ECLAC, on the basis of official figures.

<sup>a</sup> Preliminary figures. <sup>b</sup> Minimum living wage including supplementary allowances. <sup>c</sup> Minimum wage for manufacturing and services sector in San Salvador. <sup>d</sup> Minimum wage deflated by the consumer price index (CPI) for Mexico City. Since 1996, the figures are deflated by the CPI for low-income groups. <sup>e</sup> Minimum wage for Asunción. <sup>f</sup> Minimum wage in the Lima metropolitan area for non-agricultural activities. <sup>g</sup> Nationwide minimum wage for non-agricultural activities; from 1992 onward, includes meal and transport allowances.

last showed a small increase. However, even with this increase they were only slightly above their 1990 level and considerably lower than they had been in 1980.

The differences across countries in terms of fluctuations in real minimum wages were greater than in the case of average wages, since not all countries adjust the minimum wage on an annual basis and some of them awarded sizeable increases to compensate for steep losses in earlier years. Thus, the minimum wage fell sharply in Haiti while considerable increases were made in Bolivia and Peru.<sup>6</sup> Real minimum wages also

rose, although not by as much, in Brazil, Chile, Costa Rica, Dominican Republic and Uruguay (see table VI.6).

At the regional level, the increase in real minimum wages was slightly greater than in previous years, with the weighted average rising by 1.9%, the simple average by 2.3% and the median by 3.4%. In contrast to the situation in 1996 and 1997, the minimum wage climbed more than average wages did, which suggests that the gap between wage earners at the bottom of the scale and those at other levels in the wage structure narrowed slightly in 1998.

6 In the case of Peru, as well as that of the Dominican Republic, this was a statistical phenomenon resulting from the sharp increases in the minimum wage awarded in 1997, since no further adjustments were made in 1998.

## 6. Employment trends in early 1999

The critical economic situation prevailing in 1999 has been having a very strong negative impact on labour indicators. In the first few months of the year, the persistent economic slowdown in the region—with negative growth figures being recorded in some countries—adversely affected job creation and employment. In Chile, Colombia, Ecuador, Uruguay and Venezuela, unemployment levels were in some cases much higher than they had been during the same period of the preceding year as the result of flat or falling employment rates (see table VI.7). In some countries, such as Argentina, Brazil, Chile and Peru, a large number of jobs were

lost in the formal sector of the economy, especially in construction and manufacturing. Among the larger economies in the region for which information was available, in 1999 Mexico was the only one whose first-quarter unemployment rate was not higher than it had been the year before, but even in this case the employment rate had slipped back slightly and job creation in the formal sector was slowing down.

Within this economic context, real wages in the formal sector showed year-on-year declines in Brazil and Colombia, while in Chile and Uruguay, they were slightly higher.

Table VI. 7  
LATIN AMERICA AND THE CARIBBEAN: QUARTERLY LABOUR INDICATORS


	1997				1998				1999 <sup>a</sup>	
	I	II	III	IV	I	II	III	IV	I	II
<b>Unemployment rate</b>										
Argentina										
Urban areas <sup>b</sup>	...	16.1	...	13.7	...	13.2	13.2	12.4	...	14.5
Brazil										
Six metropolitan areas	5.6	6.0	5.9	5.3	7.6	8.0	7.8	6.9	7.8	7.9
Chile										
Total nationwide	5.8	6.6	6.7	5.3	5.3	6.1	6.8	7.2	8.2	10.8
Colombia										
Seven metropolitan areas	12.3	13.3	12.1	12.0	14.4	15.9	15.0	15.6	19.5	19.8
Ecuador										
Cuenca, Guayaquil and Quito	...	...	...	...	9.2	8.7	10.5	11.4	13.0	15.5
Mexico										
Urban areas <sup>b</sup>	4.3	3.9	3.7	3.1	3.5	3.2	3.2	2.8	2.9	2.6
Panama										
Total nationwide	14.1	13.1	13.2	11.8	13.7	12.0	13.4	11.2	13.1	...
Uruguay										
Urban total	11.7	12.0	11.9	10.3	10.0	9.8	10.2	10.3	11.2	11.7 <sup>c</sup>
Venezuela										
Total nationwide <sup>e</sup>	...	12.1	...	10.6	...	11.3	...	11.0	15.6	...
<b>Real average wage (index: 1995=100)</b>										
Argentina <sup>f</sup>	99.2	99.6	99.2	99.3	98.5	98.2	97.9	98.3	98.5	98.8 <sup>d</sup>
Brazil <sup>g</sup>	105.9	107.7	112.3	117.3	110.4	107.4	108.5	117.3	107.1	104.2 <sup>d</sup>
Chile <sup>h</sup>	107.0	106.8	106.6	106.1	109.2	109.7	109.5	109.5	112.1	111.8 <sup>d</sup>
Colombia <sup>i</sup>	101.8	106.4	104.4	104.0	103.6	102.9	103.0	101.6	100.6	...
Mexico <sup>f</sup>	85.1	87.7	86.9	96.6	88.1	90.0	89.6	98.4	87.8	90.9 <sup>d</sup>
Peru <sup>j</sup>	96.1	94.1	94.0	94.0	93.5	92.6	92.3	92.3	...	...
Uruguay	100.5	100.6	100.8	101.4	102.6	102.9	102.7	102.5	104.3	104.0 <sup>d</sup>

Source: ECLAC, on the basis of official figures from national sources.

<sup>a</sup> Preliminary figures. <sup>b</sup> Represents a large and increasing number of urban areas. <sup>c</sup> Average for April and May. <sup>d</sup> Average for March and May. <sup>e</sup> Refers to the first and second semesters. <sup>f</sup> Manufacturing. <sup>g</sup> April. <sup>h</sup> Workers covered by social and labour laws. <sup>i</sup> General index of hourly wages. <sup>j</sup> Manual workers in the manufacturing sector. <sup>k</sup> Private-sector manual workers in the Lima metropolitan area.

## Chapter VII

### The external sector



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The shock waves from the crisis that erupted in Asia in 1997 were transmitted to Latin America and the Caribbean through the external sector, where both merchandise trade and capital flows were adversely affected. The main trade effects were a steep decline in the prices of commodities, which make up the bulk of the region's exports, and a weakening of external demand in many of the countries. The first of these factors led to a drop in unit values for exports, and the second to a slowdown in the growth of export volumes –compounded, in some countries, by the destruction of export crops as a result of weather-related natural disasters. The end result was that the region's export earnings fell for the first time since 1986 and the growth of the purchasing power of exports slowed considerably.

**THIS LAST IMPACT** was aggravated by a shortage of external financing, forcing many Governments to take steps to curb the growth of imports, which in any event was already proving difficult to sustain. The upward trend in the value of imports did, in fact, slacken a great deal, although the adjustment did not have to be so drastic in terms of volumes since imports were becoming cheaper. The adjustment was achieved primarily through the control of domestic spending and the depreciation of a number of countries' currencies, which was in its turn linked to the retreat of foreign capital.

The changes observed in economic conditions in 1998 pushed the region's external trade activity into a slump, although the downturn was somewhat relative, since trade flows had reached extremely high levels in 1997, when trade had grown at one of the fastest rates recorded in recent decades. Nonetheless, this did not alter the upward trend of the region's trade deficit, which climbed to 4.4% of GDP in 1998. The difference lay in the fact that, in previous years, the widening gap between imports and exports had been caused by booming imports, whereas in 1998 it was mainly due to the weakness of exports.



Table VII.1  
**LATIN AMERICA AND THE CARIBBEAN: EXPORTS AND IMPORTS OF GOODS<sup>a</sup>**  
*(Indices: 1995 = 100)*

	Exports <sup>b</sup>			Imports <sup>b</sup>		
	Value	Unit value	Volume	Value	Unit value	Volume
1985	42.5	93.0	45.7	28.0	77.8	36.0
1986	36.4	78.8	46.2	28.7	78.0	36.8
1987	41.9	83.8	50.0	32.6	84.5	38.6
1988	48.6	84.4	57.6	38.0	87.4	43.5
1989	53.9	85.7	62.9	41.2	91.8	44.9
1990	59.3	90.5	65.5	46.6	95.1	49.0
1991	59.7	87.3	68.4	54.8	90.4	60.6
1992	64.5	87.9	73.4	67.3	92.4	72.8
1993	70.9	86.0	82.4	75.1	90.6	82.9
1994	82.5	91.9	89.8	89.3	92.6	96.4
1995	100.0	100.0	100.0	100.0	100.0	100.0
1996	111.6	101.1	110.4	110.9	99.2	111.8
1997	124.3	99.7	124.7	131.8	95.8	137.6
1998 <sup>c</sup>	122.2	91.1	134.2	138.6	92.4	150.0

Source: ECLAC, on the basis of figures from the International Monetary Fund and national sources.

<sup>a</sup> Covers 17 Spanish-speaking countries plus Brazil and Haiti.

<sup>b</sup> The indices shown here for unit values f.o.b. and volumes do not necessarily coincide with the corresponding indices calculated on the basis of the countries' national accounts owing to differences in methodologies and coverage.

<sup>c</sup> Preliminary figures.

As a result of the international financial crisis, the countries of the region could not count on the external financing needed to fully cover their larger current account deficits. Net capital inflows retreated from their record 1997 level of US\$ 85 billion, dropping to US\$ 68 billion in 1998—a figure more in line with those of earlier years. Capital inflows would have declined even further, however, had it not been for a renewed expansion of foreign direct investment (FDI), which, al-

though it was concentrated in the purchase of existing assets, nonetheless helped to mitigate the shortage of external financing. Resources provided specifically for this purpose by the International Monetary Fund (IMF) also helped but, even so, the countries of the region were obliged to use a substantial proportion (around US\$ 10 billion) of the reserves they had built up in previous years.

## 1. External trade

Although external trade results in the region varied from country to country, two contrasting patterns stood out. First and foremost, there was the negative performance of the South American countries, Nicaragua and

Panama, which were hurt in varying ways by the international crisis and weather-related natural disasters. Merchandise export earnings were down in all of these countries except Uruguay, which managed to

Table VII. 2  
**LATIN AMERICA AND THE CARIBBEAN: INTRAREGIONAL AND TOTAL EXPORTS**  
*(In billions of dollars and percentage shares)*

	1992	1993	1994	1995	1996	1997	1998 <sup>a</sup>
<b>Mercosur</b>							
Within Mercosur	7.2	10.0	12.0	14.4	17.1	20.5	20.3
World	50.5	54.2	62.1	70.3	74.4	82.6	80.5
Mercosur / world (%)	14.3	18.5	19.3	20.5	23.0	24.8	25.2
<b>Andean Group</b>							
Within Andean Group	2.2	2.9	3.5	4.8	4.5	5.1	4.8
World	28.3	29.8	34.8	40.2	43.6	44.4	42.7
Andean Group / world (%)	7.8	9.7	10.1	11.9	10.2	11.4	11.2
<b>LAIA</b>							
Whithin LAIA	19.4	23.7	28.4	34.8	43.2	50.4	47.4
World	134.9	145.2	170.3	206.3	229.5	254.3	249.2
LAIA / world (%)	14.4	16.3	16.7	16.9	18.8	19.8	19.0
<b>CACM</b>							
Within CACM	1.0	1.1	1.2	1.5	1.2	1.4	1.5
World	4.6	5.1	5.5	6.9	4.6	5.4	6.2
CACM / world (%)	21.7	21.6	21.8	21.9	26.1	26.1	25.1
<b>Caricom<sup>b</sup></b>							
Within Caricom	0.2	0.3	0.5	0.7	0.8	0.9	...
World	3.7	3.7	3.7	4.5	4.5	4.6	...
Caricom / world (%)	6.1	7.9	13.5	15.6	17.8	18.5	...
<b>Latin America and the Caribbean<sup>c</sup></b>							
Intraregional	24.5	29.3	35.2	42.8	45.1	52.8	49.8
World	146.1	156.4	177.3	216.1	238.6	264.4	260.1
Region / world (%)	16.8	18.7	19.9	19.8	18.9	20.0	19.1

Source: ECLAC, on the basis of official figures.

<sup>a</sup> Preliminary estimates.

<sup>b</sup> Includes Barbados, Guyana, Jamaica and Trinidad and Tobago.

<sup>c</sup> Includes LAIA, CACM, Barbados, Guyana, Jamaica, Trinidad and Tobago, Bahamas, Belize, Dominican Republic, Haiti, Panama and Suriname.

maintain them at the previous year's level; the purchasing power of exports also declined in most of these cases and, where it did not, the increase was very slight. The import-side adjustment was more severe in this group of countries, and in several of them the value of external purchases actually fell.

These results stand in contrast to the strong performance of a second group of countries, which includes the rest of the Central American nations, those of the Caribbean and, to some extent, Mexico. These countries saw a continuation of the upward trend in such variables as the terms of trade (except in El Salvador and Guatemala, where they deteriorated very slightly, and in Mexico), export volumes, the purchasing power

of exports and imports. A decisive factor in these countries' performance was their ability to capitalize upon the relative strength of the United States market, thanks mainly to the growth of their assembly (or *maquila*) industries, which range from the large and well-established apparel industry to the microprocessor plant recently set up in Costa Rica. In combination with tourism, the growth of the *maquila* sector, whose products enjoy preferential access to the United States market, has enabled the countries of this subregion to break away from their traditional role as enclave suppliers of commodities such as bananas, coffee and metal ore.

Given the differing relative weights of these two groups of countries in the regional total, this aggregate

weakened in both volume and value terms, with the value of merchandise exports falling by nearly 2%. Despite clear differences between the two groups in terms of their trade performance, however, they both witnessed a general deterioration in their trade balances. In fact, at the end of the year, only one country (Venezuela) had sufficient export earnings to finance all its imports of both goods and services.

The reduction in export values at the regional level was in large part due to the downturn seen in intraregional transactions, which has generally been the most buoyant component of the region's trade flows. The value of exports within the Latin American Integration Association (LAIA) area slid by 6%, thereby interrupting an expansionary trend that had lasted for 12 years. Trade among the countries of the Southern Common Market (Mercosur) decreased much less (0.5%), thereby underscoring the sound position of this subregional grouping. After having rebounded in 1997, trade among the countries of the Andean Community contracted by 6%, mainly because of reduced Venezuelan exports to Colombia. All the other trade flows within the LAIA grouping declined in varying proportions.

On the other hand, exports among the countries of the Central American Common Market (CACM) were

up by 9%, in line with the general growth trend characterizing trade in those countries, although this was less than the 14% growth rate posted for their total sales. Consequently, the share of intra-CACM trade in this grouping's total export trade receded from 21% in 1997 to 20% in 1998.

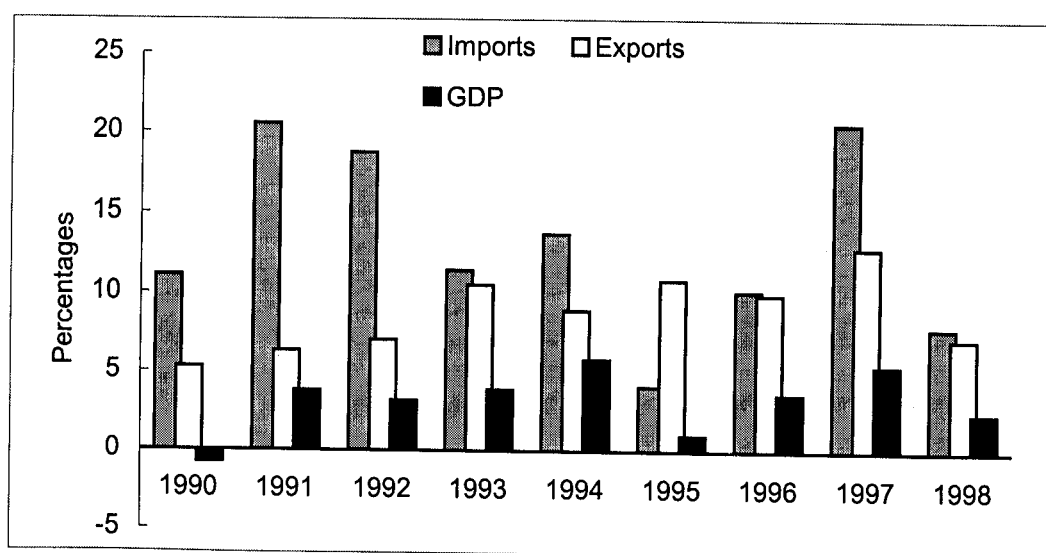
#### (a) The volume of merchandise trade

##### (i) A slowdown in exports

Although the growth of export volumes lost momentum in most of the countries of the region, volumes actually declined in only a few of them, and aggregate regional export growth came in at slightly under 8%. Although this was below the rates achieved in the five preceding years, and especially lower than the figure for 1997, it is quite high in comparison to the performance of other developing regions in 1998, with the exception of the transition economies. In fact, external sales by Latin American and Caribbean countries grew by much more than world trade as a whole, which expanded by 4.5%.

This pattern was the outcome of differing combinations of external and internal influences on the individual countries concerned.

Figure VII.1  
LATIN AMERICA: GROWTH OF TRADE VOLUMES (GOODS AND SERVICES)



Source: ECLAC, on the basis of official figures.

Table VII. 3  
**LATIN AMERICA AND THE CARIBBEAN: MERCHANDISE EXPORTS<sup>a</sup>**  
*(Rate of change in index: 1995=100)*

	Value			Unit value			Volume		
	1996	1997	1998 <sup>b</sup>	1996	1997	1998 <sup>b</sup>	1996	1997	1998 <sup>b</sup>
<b>Latin America and the Caribbean</b>	<b>11.6</b>	<b>11.4</b>	<b>-1.7</b>	<b>1.1</b>	<b>-1.4</b>	<b>-8.6</b>	<b>10.4</b>	<b>13.0</b>	<b>7.6</b>
Argentina	13.6	9.9	-0.8	6.0	-5.6	-9.0	7.2	16.4	9.0
Bolivia	8.7	3.0	-5.4	10.0	-1.1	-9.2	-1.2	4.1	4.3
Brazil	2.7	10.9	-3.5	3.0	1.5	-8.1	-0.3	9.2	5.0
Chile	-3.9	9.9	-11.9	-16.4	-0.7	-17.6	14.9	10.7	6.8
Colombia	4.0	10.2	-5.8	0.6	1.5	-12.0	3.4	8.5	7.0
Costa Rica	8.4	15.2	27.5	-5.4	3.9	-1.9	14.6	10.9	30.1
Ecuador	11.1	7.4	-20.1	8.1	1.5	-15.5	2.8	5.8	-5.5
El Salvador	7.8	35.0	1.5	-4.4	5.9	-5.9	12.8	27.5	7.9
Guatemala	3.5	16.3	9.0	-9.0	6.0	-2.6	13.7	9.8	11.9
Haiti	11.2	21.0	45.7	-4.0	6.0	-2.1	15.8	14.1	48.8
Honduras	11.4	13.1	8.8	-9.9	19.3	-2.9	23.7	-5.2	12.0
Mexico	20.7	15.0	6.4	0.6	-2.1	-4.0	20.0	17.4	10.9
Nicaragua	27.1	5.2	-12.9	-6.8	2.5	-0.9	36.4	2.6	-12.1
Panama	-4.3	14.6	-4.7	-1.9	2.1	0.0	-2.4	12.3	-4.7
Paraguay	-9.7	-11.6	-9.4	10.1	2.1	-9.9	-18.0	-13.4	0.6
Peru	5.5	15.5	-16.0	-2.2	1.6	-17.1	7.9	13.7	1.4
Dominican Republic	7.2	13.9	8.1	-0.8	1.3	-4.0	8.1	12.4	12.6
Uruguay	14.0	14.1	1.4	-2.2	-1.9	0.2	16.6	16.3	1.2
Venezuela	24.2	0.0	-26.0	12.5	-8.0	-27.0	10.4	8.7	1.4

Source: ECLAC, on the basis of figures from the International Monetary Fund and national sources.

<sup>a</sup> The indices shown here for unit values f.o.b. and volumes do not necessarily coincide with the corresponding indices calculated on the basis of the countries' national accounts owing to differences in methodologies and coverage.

<sup>b</sup> Preliminary figures.

The first of these influences stemmed from economic growth in destination markets. According to United Nations estimates, the world economy as a whole expanded by just 1.7% in 1998, only half the rate recorded in 1997. The growth figures for the different regions of the world are actually more relevant to an examination of these patterns, however, for while the United States economy maintained a healthy growth rate of almost 4%, the economies of South-East Asia registered a negative growth rate of 2% and the Japanese economy shrank by nearly 3%. This led to a contraction of the Asian market and, according to estimates by the World Trade Organization (WTO), imports into this region dropped by nearly 9%. Japanese imports fell by nearly 6% and those of the seven economies of South-East Asia (the Chinese Province of Taiwan, the Special Administrative Region of Hong Kong, China, Malaysia, Republic of Korea, Singapore and Thailand) plummeted 16%. In contrast, imports into the United

States and Canada grew by at least 10%, and European imports expanded by nearly 8%.

Thus, the countries that were hit hardest by the crisis were the ones that rely the most on the Asian market (including Chile, Ecuador, Peru and Uruguay). These countries were consequently forced to seek new outlets for their products; thanks to such initiatives, Chilean exports, for example, still managed to grow by over 6%, with the volume of that country's exports to Asia falling by 10%, but its sales to the rest of the world climbing by 18%.

At the other end of the continent and at the opposite extreme of the export spectrum, the relative solidity of the North American market made it possible for many Central American and Caribbean countries to increase their exports by more than the regional average. Countries in this group included Costa Rica, the Dominican Republic, Guatemala, Haiti and Honduras, along with Mexico, each of which registered export growth of over

10%. In nearly all these countries, a continuing upward trend has been seen in exports from the *maquila* sector, which is becoming an increasingly important part of this subregion's economy. In the case of Mexico, the North American Free Trade Agreement (NAFTA) has provided a framework conducive to an expansion of trade with this country's neighbours to the north.

Demand-side factors also hurt sales to the regional market, in line with the deceleration of economic growth seen in Latin America and the Caribbean. This adverse impact was particularly noticeable in Paraguay, which in many respects is a tributary of the Brazilian market. Other factors included a 5% drop in Panamanian exports, which was partly attributable to labour strikes in the banana industry.

Other export activities, chiefly fishing and agriculture, suffered setbacks due to the weather-related natural disasters that ravaged Latin America and the Caribbean. Exports from the countries of the Pacific basin, such as Ecuador and Peru, and the Caribbean, especially Cuba, the Dominican Republic and Nicaragua, were particularly hard hit by El Niño and Hurricanes Georges and Mitch. In fact, Nicaragua and Ecuador posted the region's worst export performances, with volumes plunging by 12% and 6%, respectively. These countries were followed by Peru, where external sales grew by just over 1%, or a scant one tenth of the previous year's rate. The after-effects of the damage done to certain crops, such as coffee, will last beyond the 1998 harvests.

Lastly, movements in real exchange rates are likely to have influenced export volumes, but this effect is difficult to determine and varies from one product and country to another. Generally speaking, commodities (especially perishable ones) are less sensitive to short-run price variations, so exchange-rate movements tend to have a delayed effect on exports, whereas they have a more immediate impact on imports.

In Paraguay, the effect of the currency's depreciation was probably greater on unregistered exports, as this category declined by less than registered exports. In Colombia it may have helped to boost exports of manufactured goods in particular but, in general, considering the moderate scale of the depreciation, the effects were probably limited, especially in view of the fact that prior to that time these currencies had been appreciating on a sustained basis. In Brazil, for example, the 1998 depreciation does not seem to have stimulated exports to any significant degree, although the much more drastic exchange-rate adjustment in 1999 does appear to have had an effect.

## (ii) *Slow adjustment of imports*

In most of the countries, import growth weakened in volume terms, after having been lifted to inordinately high levels in 1997 by a steady upward trend that had begun in the early 1990s. In 1998, regional imports grew by just 9% compared to nearly 25% the previous year. This slackening of import growth was in some cases more apparent than real, however, as the lower figure for the region as a whole was strongly influenced by the virtual stagnation of Brazilian imports, which account for one fifth of the regional total. In fact, in more than half of the countries, imports continued to expand at rates ranging from 10% to over 30%.

Given that 1998 was a year of moderate economic growth, this result is a further sign of the region's high propensity to import; for each percentage point of GDP growth, imports grew by 4% in 1998, the same ratio as in 1997. In the earlier years of the decade, it had been variable, although never falling below 3%; furthermore, in general, the lower the rate of GDP growth, the higher this ratio has tended to be.

Of course, other factors also influence this parameter, including, in particular, exchange-rate movements. The significant import growth seen in the 1990s has been accompanied by a widespread trend towards the real appreciation of local currencies, and the break in this trend seen in several of the region's major economies largely accounts for their import performance in 1998. In general, imports were flat or even declined in the South American countries whose currencies depreciated, such as Brazil, Chile, Colombia, Peru and Paraguay, while in countries whose currencies appreciated, the pace of import growth tended to be faster. Mexico is not in either of these two categories, since the real value of the peso was virtually unchanged, but that did not prevent this country's imports from expanding by a further 16%, following two years of appreciation and considerably higher import growth. In the Central American countries, the effect of exchange-rate movements was far less noticeable.

In most cases, these two forces – changes in the level of domestic economic activity and exchange-rate movements – had parallel effects on imports, since both were facets of the same domestic-expenditure adjustment process being undertaken by the major economies of the region. This was not the only mechanism through which imports were linked to economic activity, however, and such linkages sometimes exerted pressure in opposing directions.

In the Central American and Caribbean countries that have *maquila* industries, foreign purchases and

Table VII.4  
**LATIN AMERICA AND THE CARIBBEAN: MERCHANDISE IMPORTS<sup>a</sup>**  
*(Rate of change in index: 1995=100)*

	Value			Unit value			Volume		
	1996	1997	1998 <sup>b</sup>	1996	1997	1998 <sup>b</sup>	1996	1997	1998 <sup>b</sup>
<b>Latin america and the caribbean</b>	<b>10.9</b>	<b>18.8</b>	<b>5.2</b>	<b>-0.8</b>	<b>-3.4</b>	<b>-3.5</b>	<b>11.8</b>	<b>23.1</b>	<b>9.0</b>
Argentina	18.5	28.2	3.1	-2.3	-5.9	-4.6	21.3	36.2	8.1
Bolivia	11.8	20.2	7.0	-1.5	-4.4	-4.5	13.5	25.7	12.1
Brazil	7.3	15.1	-6.2	2.0	-4.1	-6.0	5.2	20.0	-0.2
Chile	12.6	10.4	-4.5	0.3	-4.5	-4.5	12.3	15.6	0.0
Colombia	-0.6	12.9	-5.0	-3.1	-7.5	-4.5	2.6	22.0	-0.6
Costa Rica	5.8	13.9	27.3	-0.3	-2.0	-5.0	6.1	16.2	34.1
Ecuador	-9.3	26.8	10.3	-1.4	-0.6	-5.0	-8.0	27.6	16.0
El Salvador	-4.8	16.3	5.5	0.3	-4.9	-5.1	-5.1	22.2	11.2
Guatemala	-5.0	22.9	19.8	1.8	-2.0	-2.0	-6.7	25.5	22.2
Haiti	-3.6	2.7	25.2	2.8	-2.0	-5.9	-6.2	4.8	33.1
Honduras	12.0	15.9	14.6	-2.9	-4.1	-4.9	15.4	20.8	20.6
Mexico	23.5	22.8	14.1	-2.1	-1.3	-1.6	26.1	24.4	15.9
Nicaragua	17.0	30.7	1.4	1.4	-2.7	-5.5	15.4	34.3	7.3
Panama	-3.0	13.8	4.3	-2.0	-5.9	-0.1	-1.0	20.9	4.4
Paraguay	-2.4	-4.4	-18.8	-0.3	-4.5	-5.6	-2.1	0.1	-14.0
Peru	1.6	8.5	-4.1	1.3	-5.0	-4.6	0.3	14.2	0.5
Dominican Republic	10.8	15.3	14.9	1.6	-3.1	-6.5	9.1	19.0	22.9
Uruguay	15.7	11.5	2.8	1.1	-1.7	-6.3	14.4	13.4	9.7
Venezuela	-17.7	30.3	7.8	-2.7	-5.0	-1.5	-15.4	37.1	9.5

Source: ECLAC, on the basis of figures from the International Monetary Fund and national sources.

<sup>a</sup> The indices shown here for unit values f.o.b. and volumes do not necessarily coincide with the corresponding indices calculated on the basis of the countries' national accounts owing to differences in methodologies and coverage.

<sup>b</sup> Preliminary figures.

economic activity, particularly in export-oriented sectors, exerted the same sort of influence. As the *maquila* industry is engaged in assembling imported components, the expansion of sales in 1998 also entailed higher imports. Although they were concentrated in intermediate products, they also included capital goods; a case in point was that of Costa Rica, where such purchases were associated with the expansion of the sector itself. The merchandise exports and imports involved in Paraguay's transit trade flows also moved in tandem, with a downturn in the former also pulling down the latter.

Production activity was inversely related to purchases of certain types of products in countries that were hit by weather-related natural disasters. In these countries, the loss of harvests of food crops grown for domestic consumption had to be made up for by using supplies from abroad, which in some cases were fi-

nanced with international aid. This explains the expansion in imports of consumer goods recorded in those countries, as well as the increase in imports of capital goods for the refurbishment of damaged production infrastructure in countries such as the Dominican Republic.

#### (b) The value of merchandise trade

The expansion of the physical volumes of both exports and imports in 1998 contrasts sharply with the plummeting price levels of tradable goods. This steep downturn had an especially serious impact on exports and produced a twin result: a severe deterioration in the terms of trade and lower regional export earnings. The result was a larger merchandise trade deficit for the region, since while exports slipped to below US\$ 325 billion, imports continued their upward climb to top US\$ 379 billion.

(i) *Deterioration in the terms of trade*

The deflationary climate prevailing on world goods markets in the wake of the Asian crisis showed through as a decrease in the unit values of tradables—especially among exports—of a magnitude not seen in the region since the mid-1980s. The mean price of Latin America's exports dropped by nearly 9%, while import prices slipped by 3.5%, resulting in a deterioration in the merchandise terms of trade of over 5%.

This loss of value was chiefly due to the tumbling price levels of commodities, the region's most important source of export earnings. The last four months of 1998 marked the culmination of a protracted downward trend in the prices of the region's main export products, such as oil, coffee, copper, sugar, cotton, aluminium and nickel, that brought them down to levels from 40% to 60% lower than their previous peaks. This process was driven by a number of variables that combined in differing ways depending on the product in question. These factors included: slackening demand from Asian countries, in particular for copper, oil, wheat and aluminium, as a result of the crisis that began in 1997; the more competitive price levels of the raw material exports from those countries stemming from the devaluation of their currencies (although the products that were most affected—tropical woods, natural rubber and rice—account for a negligible share of the total external sales of Latin America and the Caribbean); and increases in supply of a cyclical nature that had nothing to do with the crisis but were instead triggered by the high price levels that had existed previously, together with other factors such as weather and technological progress.

In the case of oil, supply cutbacks agreed upon in March and June 1998 by the members of the Organization of Petroleum Exporting Countries (OPEC), which includes Venezuela, failed to sustain prices, and between 1997 and 1998 the average price for the year that was paid for a mix of crudes plunged from US\$ 19.2 to US\$ 13.1 per barrel. A further production cutback was needed in March 1999 in order to force prices back up by 50%, and this time the decision was supported by producers not belonging to the organization as well, including Mexico. The trend in oil prices accounts for the 27% slump in the mean unit value of Venezuelan exports (the steepest decline in the region) and for much of the 16% drop in Ecuador, although in this country the effect was softened by much smaller price reductions for shrimp and banana exports.

The price of copper plummeted on the London Metal Exchange from an average of US\$ 2,276 to US\$

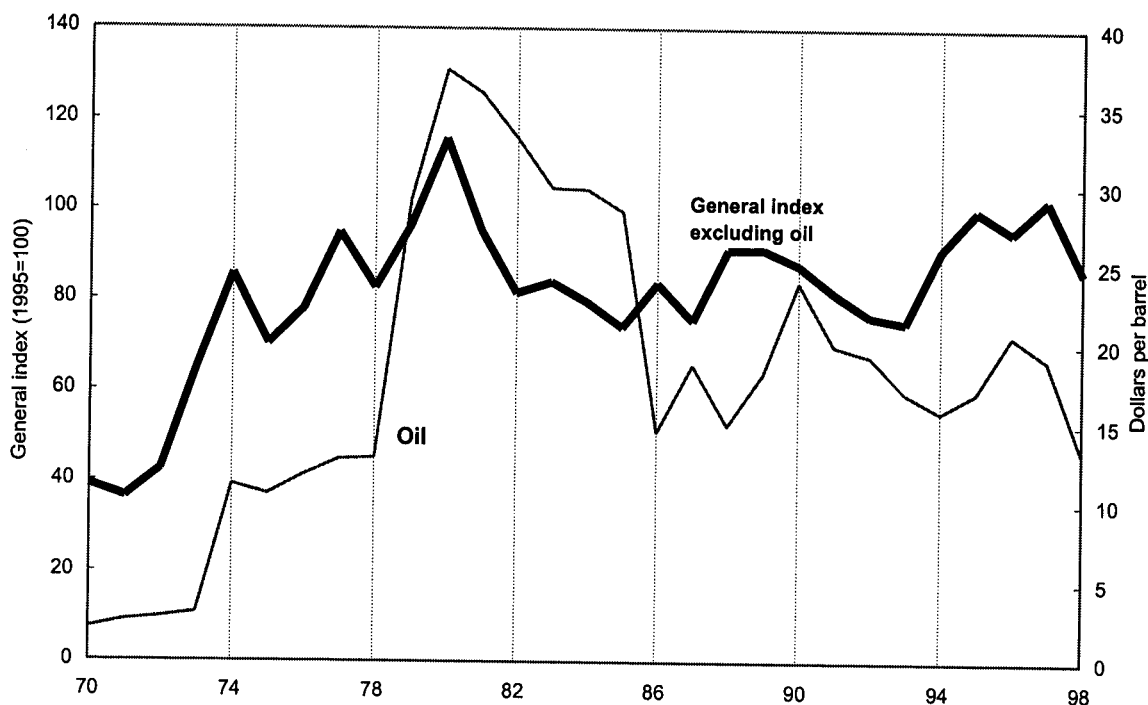
1,654 per ton as a result of the Asian crisis and a considerable increase in output stemmed from prior expansions of mining production capacity. Codelco-Chile, for example, the largest copper company in the world, expanded its ore output by 13% in 1998, and there was an increase of a similar magnitude in Peru. The slump in copper prices was a decisive factor in the overall decrease in export unit values in these two countries (over 17%), where the prices of other important products, such as timber in the case of Chile and other ores in that of Peru, also fell.

The price of arabica coffee was affected by good harvests, and the price quotation for the "other milds" category on the North American market fell on average from US\$ 1.85 to US\$ 1.32 per pound. This decrease deepened further in 1999 due to the sharp devaluation of the Brazilian *real*, which more than counterbalanced the effects of damage caused to Central American harvests by Hurricane Mitch. In 1998, overall unit values for exports declined in the Central American and Caribbean coffee-producing countries (Costa Rica, El Salvador, Guatemala, Haiti and Nicaragua). The average reduction was only a modest 2%, however, thanks partly to the limited degree to which the slide in world coffee prices was passed on through export contracts and partly to price trends in other products, especially bananas and *maquila* goods. In Brazil and Colombia, the two largest coffee exporters, unit values of exports fell by 8% and 12%, respectively, although these figures were also influenced by unfavorable price trends in oil (Colombia) and manufactured goods (Brazil).

In Argentina, the unit value of exports fell by 9%, as the average price of wheat slid from US\$ 152 to US\$ 119 per ton and average meat prices weakened from US\$ 0.84 to US\$ 0.78 per pound between 1997 and 1998. In Paraguay, lower prices for cotton and soybeans played a part in the 10% decline in the unit values of this country's exports, while lower nickel and sugar prices affected Cuba and the Dominican Republic.

The prices of internationally traded manufactures fell by an average of 4%, and the unit value of Mexico's exports, which are in large part made up of manufactures, decreased by the same percentage. Since most of the region's imports are also manufactures, the average unit values of imports dropped by similar proportions in all the countries, with the steepest decreases at the country level occurring in nations where oil makes up a large share of total foreign purchases. Thus, the drop in import prices, although it was an across-the-board phenomenon, varied between about 2% (in Mexico and Venezuela) and nearly 7% (in the Dominican Republic and Uruguay).

Figure VII.2  
PRICES ON COMMODITIES EXPORTED BY LATIN AMERICA



Source: ECLAC and UNCTAD.

The net effect of the slide in trade prices produced more losers than winners in the region. The terms of trade deteriorated most severely in countries that export oil and/or mining products, such as copper, as may be seen from the fact that this indicator plunged by 26% in Venezuela, by over 13% in Chile and Peru, and by 11% in Ecuador. In contrast, Uruguay headed up a group of countries whose terms of trade actually improved, as a 7% improvement in that country was accompanied by increases of between 2% and 5% in several other Latin American and Caribbean countries.

(ii) *A further increase in the merchandise trade deficit*

The slackening of external demand together with the fall in trade prices produced two results: a decline in

the region's export dollar earnings and a sharp slowdown in the rate of growth of the purchasing power of exports.

With the single exception of Uruguay, export earnings fell throughout the South American continent. In all of the countries to the north of the Isthmus of Panama except Nicaragua, on the other hand, export earnings rose thanks, in particular, to *maquila* activities. In the first group of countries there were decreases of over 20% in Ecuador and Venezuela and of more than 10% in Chile, Nicaragua and Peru. In the second group, Haiti and Costa Rica posted especially large gains and were the only countries in the region where export earnings climbed more sharply in 1998 than the year before; in Paraguay, however, earnings did decline less than they had in 1997.



The purchasing power of exports measures the physical quantity of goods that can be bought with the income generated by foreign sales, and this measurement is therefore a function of both their physical volume and the terms of trade. In about half of the countries, this indicator declined with respect to the previous year, with the steepest falls (between 10% and 25%) occurring in Ecuador, Venezuela and Peru. However, since the purchasing power of exports increased in the largest economies (Brazil and Mexico), although by much less than the average for the decade, the aggregate regional figure improved by just 2% — the lowest growth rate recorded in the 1990s.

The slower growth or decline in export earnings was accompanied by a similar trend in import expenditure. Import growth in value terms slackened or turned negative in the vast majority of countries; the only exceptions were Costa Rica and Haiti, where foreign purchases increased by approximately one fourth. Export earnings actually fell in five countries: Brazil, Chile, Colombia, Paraguay and Peru.

Although exports and imports both trended in the same direction, the magnitude of the change was greater in the case of exports, and a widespread deterioration in the merchandise trade balance was consequently seen in the region. In 1998, only one country (Venezuela) was still earning enough from its foreign sales to finance all of its imports, as the trade balances of Ecuador and Mexico also slipped into the red. In fact, Mexico's deficit, at over US\$ 7.7 billion, was the region's highest, followed by Brazil's, which at nearly US\$ 6.4 billion was down by US\$ 2 billion from the 1997 figure. The deficits in these two countries alone accounted for 44% of the regional total, which, at nearly US\$ 32.5 billion, represented a multiple of the preceding year's figure. This massive deficit was also partly the result of Venezuela's much smaller surplus, which plummeted from over US\$ 7 billion to less than US\$ 3.6 billion.

### (c) Trade in services

Services posted more favourable trade results than merchandise trade. Regional earnings in this category expanded by approximately 6% within a context of stable average prices, while outlays grew by less than 4% thanks to a slight reduction in the prices of imported services. In most of the countries, however, trade in services is of relatively minor importance.

Earnings in this category rose by a fairly moderate yet still significant amount in most of the countries, falling only in Colombia, Ecuador, El Salvador,

Paraguay and Uruguay. On the other hand, Brazil, Costa Rica, Honduras, Nicaragua and Peru all posted exceptionally large increases. In most cases, the changes in this variable were mainly generated by tourism, which is the region's principal source of export earnings in the services sector. When viewed relative to the size of the economy, tourism is particularly important in the Caribbean countries, Central America and Uruguay.

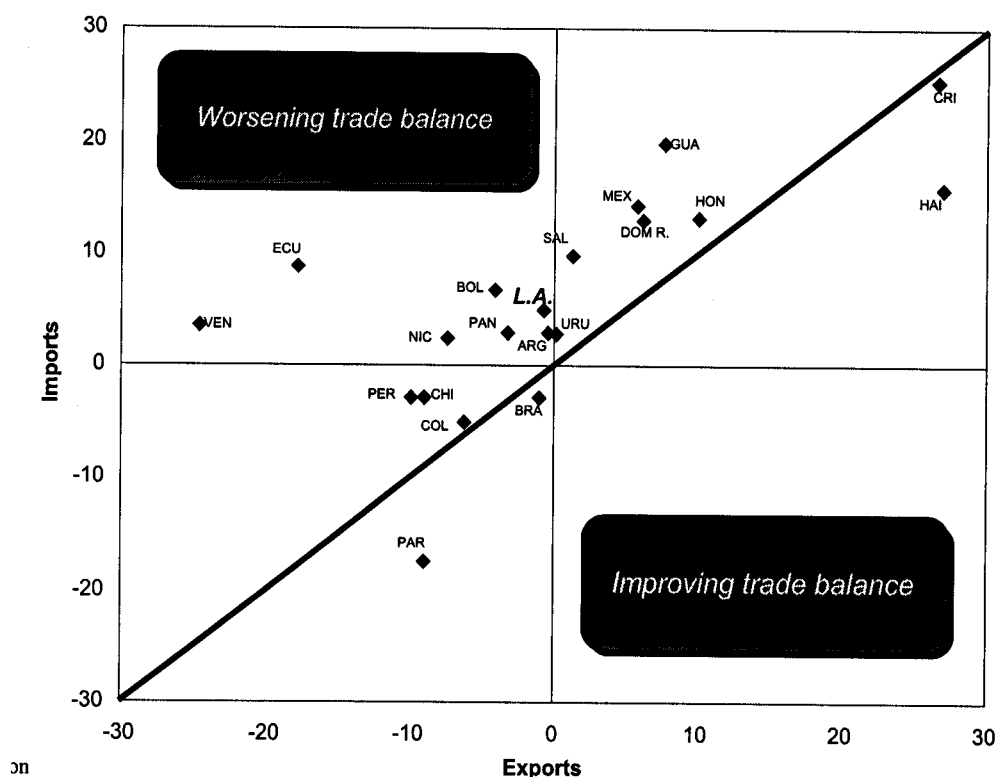
World tourism flows continued to grow in 1998 despite the global economic slowdown, but results were greatly influenced by uneven economic performances in the different regions. According to figures from the World Tourism Organization, the number of tourists throughout the world rose by 2.4% and tourism earnings climbed by 2%. As in the case of merchandise trade, the region's countries benefited especially from the robust performance of the North American economies and, to a lesser degree, some of the European countries.

Accordingly, the number of tourists in the region rose the most in Central America, with increases of 37% in El Salvador, 18% in Honduras and 9% in Panama. Clearly, the more stable political climate prevailing in these countries has contributed to this growth, which contrasts with the modest 1.7% expansion in tourism to Caribbean destinations. It should be noted in this connection that the tourism industry in the Caribbean is much more developed than in Central America, where the expansion in the sector has started from a comparatively much lower level. Costa Rica is the exception to this rule inasmuch as tourism, which generates earnings in excess of US\$ 900 million, has become the country's leading traditional export product.

Other destinations receiving a higher number of visitors included Brazil (up by 10%), Peru and Bolivia (9%) and Argentina (7%). Uruguay, on the other hand, was hurt by the economic difficulties of its two main Mercosur neighbours and saw its tourism income fall by over 8%. Stricter controls on border trade with Brazil cut the number of visitors to Paraguay, which explains the 12% drop in its tourism earnings. Political instability was probably the cause of the decline of tourism in Colombia.

The performance of transport services was another factor in the drop in Colombia's earnings, since the cargo shipped by the country's merchant fleet is an especially important source of income. This service category, which is closely linked to merchandise trade, also declined in other countries of the region, including Ecuador, Paraguay and Uruguay. In Panama, on the other hand, the revenue from Canal tolls rose thanks to rate

Figure VII.3  
**VARIATIONS IN THE VALUE OF TRADE IN GOODS AND SERVICES, 1997-1998**  
 (Percentages)



Source: ECLAC, on the basis of official figures.

increases. These revenues, together with income from offshore banking activities and the Colón Free Zone, are the mainstay of Panama's large services sector, which generates more than 70% of its GDP.

Shipping insurance and freight charges also account for a major share of the region's outlays for services, so the overall performance of the services sector generally reflects that of merchandise trade in each country. This explains the increase in payments for services in many countries, especially in Central America and the Caribbean (including Costa Rica, the Dominican Republic, El Salvador, Guatemala, Honduras and Haiti), along with Ecuador and Mexico. This factor was also behind the reduction in such outlays in countries

where foreign trade stagnated or declined, such as Brazil, Chile, Colombia, Panama, Paraguay and Peru. In nearly all cases, however, any increase in payments for transport services was mitigated by a reduction in freight rates on the international market.

The net outcome of these different influences on the services trade balance varied from country to country. The aggregate regional balance improved slightly, as the deficit edged down to below US\$ 21.7 billion in 1998 from its 1997 level of just over US\$ 21.8 billion, but over half of this sum corresponded to Brazil, with Argentina and Venezuela trailing far behind. Only Costa Rica, the Dominican Republic, Panama and Uruguay maintained their customary surpluses in 1998.

## 2. The current account balance and its financing

In a continuation of the preceding year's pattern, the deficit on the current account of the balance of payments for Latin America and the Caribbean as a whole again widened substantially in 1998, topping US\$ 89 billion. Measured in relative terms, it climbed from 3.4% to 4.5% of GDP (see table VII.5), a ratio not seen since the early 1980s. Capital inflows were insufficient to finance this shortfall, and the region therefore ended 1998 with an overall deficit of US\$ 21 billion, half of which was covered with reserve assets and half with IMF loans plus exceptional financing.

The current account worsened in all of the region's countries except Paraguay, although in Nicaragua the balance on this account was virtually unchanged. No Latin American country recorded a surplus—not even

El Salvador or Venezuela, which had done so in 1997. Almost all of the deterioration in the regional current account in 1998 was attributable to the poor performance reflected on the trade balance for goods and services (a deficit of US\$ 22 billion), since the negative influence of the factor income account was quite limited, although it did have a significant impact in some individual countries in Latin America.

In early 1998, the economic authorities of a number of countries in the region made it known that they could neither finance their current account deficit nor sustain it over the long run. Consequently, economic policies were introduced in the first half of the year in an effort to narrow the external gap (see the chapter on macroeconomic policy). The serious difficulties in

Table VII. 5  
LATIN AMERICA AND THE CARIBBEAN: BALANCE OF PAYMENTS  
(As percentages of gross domestic product)<sup>a</sup>

	Trade balance (goods and services)		Balance on current account		Balance on capital and financial accounts <sup>b</sup>		Overall balance	
	1997	1998	1997	1998 <sup>c</sup>	1997	1998 <sup>c</sup>	1997	1998 <sup>c</sup>
<b>Latin America and the Caribbean</b>	<b>-1.7</b>	<b>-2.7</b>	<b>-3.4</b>	<b>-4.5</b>	<b>4.3</b>	<b>3.5</b>	<b>0.9</b>	<b>-1.1</b>
Argentina	-1.9	-2.3	-3.7	-4.5	4.7	5.7	1.0	1.2
Bolivia	-8.1	-9.9	-6.9	-7.9	8.4	7.6	1.4	-0.3
Brazil	-2.4	-2.3	-4.2	-4.5	3.2	2.3	-1.0	-2.3
Chile	-2.1	-3.9	-5.4	-6.2	9.6	3.3	4.2	-2.9
Colombia	-4.4	-4.6	-6.2	-6.6	6.5	5.0	0.2	-1.6
Costa Rica	-1.4	-0.9	-2.2	-2.8	4.4	1.4	2.2	-1.4
Ecuador	1.6	-6.5	-3.6	-10.7	3.9	8.7	0.3	-2.1
El Salvador	-10.5	-12.9	0.9	-0.7	2.4	3.3	3.2	2.6
Guatemala	-5.7	-8.5	-3.1	-4.9	4.7	6.2	1.6	1.3
Haiti	-16.0	-15.1	-1.9	-2.2	2.9	3.2	1.0	1.0
Honduras	-5.9	-7.1	-3.9	-2.9	8.4	5.9	4.6	2.9
Mexico	-0.1	-2.1	-1.9	-3.8	5.3	4.3	3.5	0.5
Nicaragua	-36.7	-39.8	-40.3	-37.8	40.6	29.5	0.3	-8.4
Panama	-3.8	-9.2	-6.8	-13.5	10.7	8.4	3.9	-5.0
Paraguay	-9.0	-4.5	-8.0	-3.3	5.9	3.8	-2.0	0.6
Peru	-3.8	-4.8	-5.3	-6.1	6.3	2.7	1.1	-3.4
Dominican Republic	-4.8	-9.0	-1.1	-2.4	1.7	2.7	0.6	0.2
Uruguay	-0.8	-1.4	-1.4	-1.9	3.4	3.6	2.0	1.7
Venezuela	7.7	0.0	5.3	-1.8	-1.6	-1.9	3.7	-3.7

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

<sup>a</sup> Estimates based on figures expressed in dollars at current prices.

<sup>b</sup> Includes errors and omissions.

<sup>c</sup> Preliminary figures.

gaining access to foreign financing that the countries began to encounter in August 1998 made it all the more urgent to check the deterioration of the current account, and in some countries this gap began to narrow in the final months of the year. Another significant event to occur in 1998 in this connection was that the authorities of Honduras and Nicaragua drew attention to the problems that their Governments were having in servicing their debts in the aftermath of Hurricane Mitch and asked to be included in the debt reduction initiative devised for heavily indebted poor countries (HIPC) (see box VII.1 at the end of this chapter). In early 1999 Ecuador also announced that it wished to restructure its external debt.

#### (a) Factor income and current transfers

As in the previous five-year period, outlays under the headings of interest payments and profit remittances were equivalent to 2.5% of regional GDP (in the 1980s the average had been 4.3%). Although this ratio has remained quite stable in recent years, it has remained above 3% of GDP in some Latin American countries (e.g., Chile, Costa Rica, the Dominican Republic and Mexico), and in Ecuador it was 8%. Despite a rise in external debt, the increase in the region's interest payments was moderate, thanks to lower international rates (see table VII.6). Measured in relation to

exports of goods and services, however, such payments climbed from 15.1% to 16.3%, partly because of the decline in external sales. Profit remittances, meanwhile, continued on their upward trend of recent years, reaching the equivalent of 7% of the value of exports, or nearly twice as much as in the early 1990s. In Chile, Colombia and the Dominican Republic, profit remittances were equivalent to more than 10% of goods and services exports, although part of this sum was reinvested.

Current transfers continued to rise, climbing to over US\$ 16 billion, as the virtually unbroken expansionary trend of the 1990s continued. This inflow has traditionally been of major importance in the Central American and Caribbean countries. The Dominican Republic received an exceptionally high level of transfers in 1998 (nearly US\$ 2 billion) in absolute terms. When measured in relation to exports, transfers were also very significant in Bolivia, Nicaragua and, especially, El Salvador and Haiti; they were also considerable, although somewhat less so, in Ecuador, Guatemala and Honduras.

The importance of this source of income for Latin America is evidenced by the fact that, in its absence, the current account deficit would have amounted to between 12% and 16% of GDP in Bolivia, Ecuador, El Salvador, Haiti, Panama and the Dominican Republic and would have come to 5.1% for the region as a whole.

Table VII.6  
LATIN AMERICA: CAPITAL ACCOUNT INDICATORS

	1991	1992	1993	1994	1995	1996	1997	1998
	Percentages of GDP <sup>a</sup>							
Current account balance	-1.5	-2.7	-3.3	-3.3	-2.2	-2.1	-3.4	-4.5
Capital account balance <sup>b</sup>	1.9	3.8	4.3	2.6	1.7	3.6	4.3	3.5
Overall balance	0.4	1.1	1.1	-0.6	-0.5	1.5	0.9	-1.1
	Percentages							
Capital inflows to Latin America/ capital inflows to developing countries <sup>c</sup>	18.9	32.9	28.6	18.9	11.7	22.5	23.8	22.7
LIBOR (nominal)	6.0	3.9	3.4	5.1	6.1	5.6	5.8	5.5
LIBOR (real)	1.3	0.8	0.6	2.7	3.5	3.2	3.7	4.0
Yield on United States government bonds	7.9	7.0	5.8	7.1	6.6	6.5	6.4	5.3

Source: ECLAC, on the basis of official figures from the International Monetary Fund and the World Bank.

<sup>a</sup> Coefficients have been estimated on the basis of figures expressed in dollars at current prices.

<sup>b</sup> The figures on capital inflows include errors and omissions.

<sup>c</sup> Net flow of long-term resources.

## (b) Capital flows and international reserves

### (i) General features

The impact of the international financial crisis on capital flows had already become noticeable in some of the region's countries in the fourth quarter of 1997 and continued to be apparent in 1998. Unlike the 1994-1995 crisis, this time the effects were quite widespread, particularly with regard to the more volatile types of capital flows; this was especially true from August 1998 onward, when the impacts of the devaluation and the moratorium declared by the Russian Federation made themselves felt. By the end of 1998, capital flows to the region had fallen to US\$ 68 billion from their record 1997 level of US\$ 85 billion, thereby interrupting the recovery from the 1995 financial crisis in Mexico that had begun in 1996.

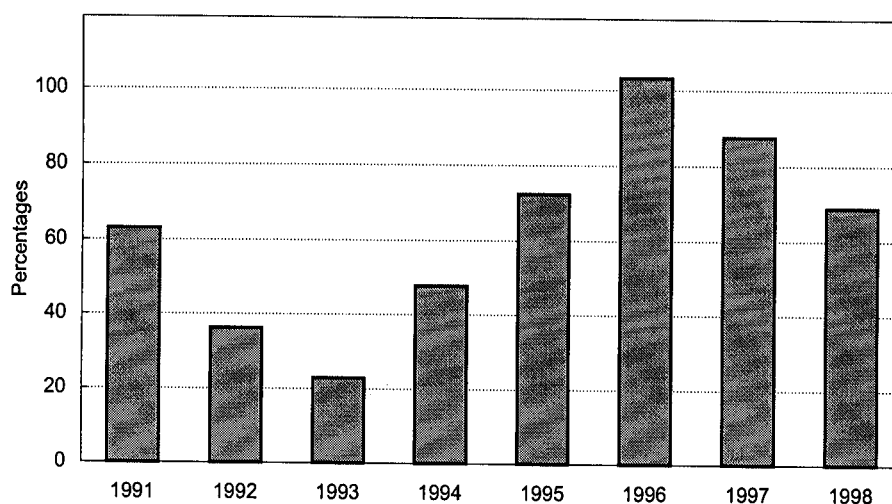
Towards the end of 1998, Brazil (one of the Latin American countries that was hit the hardest by the crisis) had to seek loans from IMF in addition to US\$ 9.3 billion in exceptional financing. This formed part of an overall financial assistance package totalling US\$ 41 billion that was put together with the help of the World Bank, the Inter-American Development Bank (IDB), the Bank for International Settlements (BIS) and developed-country Governments. These funds are to be disbursed over a three-year period.

One remarkable aspect of the region's external financing operations in 1998 was that foreign direct investment (FDI) continued to arrive in abundance, as it has done consistently in recent years; in fact, thanks to its robust expansion in Brazil, it actually surpassed the exceptionally high level recorded in 1997, although it should also be noted that a substantial proportion of this flow involved sales of existing assets. FDI flows thus continued to finance a large part of the current account deficits of many of the region's countries (see figure VII.4). Meanwhile, however, inflows of other types of capital, including bonds, commercial bank loans and portfolio equity investment, decreased sharply, especially in the South American countries.

In 1996 and in 1997 up until September, the region had received plentiful capital inflows, with loans being taken out under quite favourable terms and conditions. When the Asian crisis began to deepen in October 1997, however, the region entered a cycle of more limited and increasingly expensive external financing. This cycle can be divided into three phases.

During the first phase, which corresponds to the fourth quarter of 1997, short-term capital inflows dwindled and the cost of external financing increased by a moderate amount; this trend was observed in only some of the region's countries. The second phase, between January and July 1998, saw a recovery of capital in-

Figure VII-4  
LATIN AMERICA AND THE CARIBBEAN: CONTRIBUTION OF FOREIGN DIRECT INVESTMENT FLOWS IN FINANCING THE BALANCE-OF-PAYMENTS CURRENT ACCOUNT



Source: ECLAC, on the basis of official figures.

Table VII. 7  
**LATIN AMERICA AND THE CARIBBEAN: NET FOREIGN DIRECT INVESTMENT**<sup>a b</sup>  
 (Millions of dollars)

	1991	1992	1993	1994	1995	1996	1997	1998 <sup>c</sup>
<b>Latin America and the Caribbean</b>	<b>10 997</b>	<b>12 484</b>	<b>10 327</b>	<b>23 657</b>	<b>24 922</b>	<b>37 827</b>	<b>55 603</b>	<b>59 991</b>
Argentina	2 439	3 218	2 059	2 480	3 756	4 937	4 924	3 740
Bolivia	50	91	121	147	391	472	728	870
Brazil	89	1 924	801	2 035	3 475	11 667	18 610	29 171
Chile	697	538	600	1 672	2 220	3 561	3 467	1 994
Colombia	433	679	719	1 296	704	2 743	4 804	2 982
Costa Rica	172	222	243	292	331	422	475	532
Ecuador	160	178	469	531	470	491	695	830
El Salvador <sup>d</sup>	25	15	16	...	38	...	...	875
Guatemala	91	94	143	65	75	77	85	673
Haiti	14	-2	-2	-3	7	4	4	11
Honduras	52	48	52	42	69	90	128	99
Mexico	4 742	4 393	4 389	10 972	9 526	7 619	12 830	10 238
Nicaragua	42	40	40	40	75	97	173	184
Panama	41	139	156	410	289	330	1 275	1 186
Paraguay	84	118	74	97	156	246	230	186
Peru	-7	136	670	3 083	2 083	3 242	2 030	1 968
Dominican Republic	145	180	189	207	414	97	421	691
Uruguay	...	...	102	155	157	137	113	164
Venezuela	1 728	473	-514	136	686	1 595	4 611	3 597

Source: ECLAC, on the basis of figures from the International Monetary Fund and national sources.

<sup>a</sup> Refers to direct investment in the reporting economy minus direct investment abroad by its residents. This information is not available for some countries. <sup>b</sup> In accordance with the fifth edition of the IMF *Balance of Payments Manual*, all transactions between non-financial enterprises undertaking direct investments and their parent companies and subsidiaries are included in direct investment. <sup>c</sup> Preliminary figures. <sup>d</sup> The Central Reserve Bank of El Salvador has been keeping a systematic record of foreign direct investment since 1998.

flows and a slight improvement in financing terms. In the third phase, which began in August 1998 and lasted until about February the following year, a considerable number of Latin American countries were rocked by the shock waves from the Russian moratorium. This period was marked by an acute shortage of capital, mainly of the more volatile types, and a substantial rise in the cost of external financing. From March onward these flows began to pick up again, however, especially in the case of bonds.

## (ii) Composition of capital flows

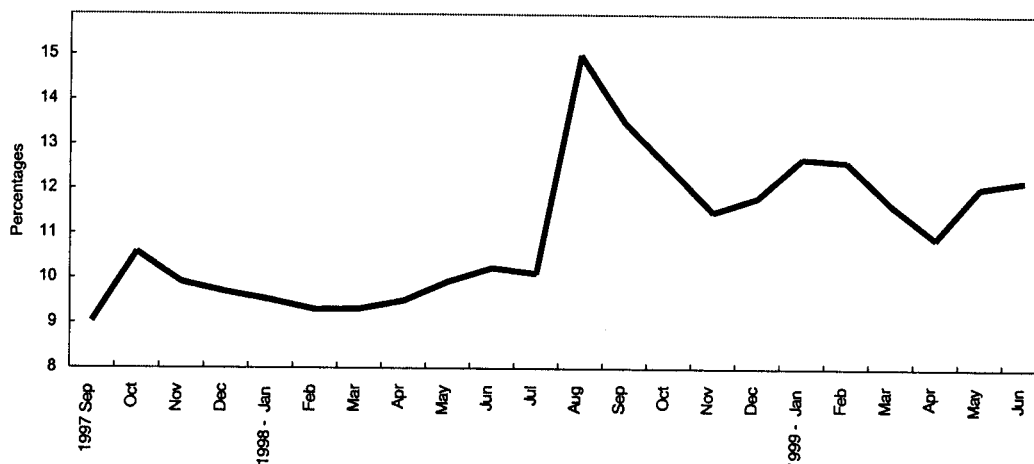
### - Foreign direct investment (FDI)

Unlike other capital flows, in 1998 FDI moving into Latin America and the Caribbean surpassed the record (US\$ 60 billion) achieved a year earlier. Some-

what paradoxically, this was due to a considerable expansion of FDI flows to Brazil, which had suffered the steepest reduction in other types of capital inflows. One of the factors underlying this trend is that FDI investors look for projects whose returns are determined by longer-range trends rather than hinging on short-run economic conditions.

Economies that have enjoyed a continuous increase in direct investment flows in recent years include Costa Rica, Ecuador, the Dominican Republic and especially Bolivia, where over the last five years FDI inflows have gone up year after year. By contrast, direct investment was scaled back in other countries of the region, although in Colombia, Mexico and Venezuela the retreat started from the exceptionally high levels attained in 1997 (see table VII.7). However unlike the situation in that year, during which the three modalities of FDI in the region—acquisition of private

Figure VII-5  
**LATIN AMERICA: BOND YIELDS ON THE SECONDARY MARKET<sup>a</sup>**



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

<sup>a</sup> Weighted average yield of eurobonds on the secondary market.

assets, privatizations and investment in new assets—all reached similar levels,<sup>1</sup> in 1998 and the early months of 1999 the acquisition of private assets appeared to be taking on a more important role than the purchase of State assets. Privatizations involving considerable sums were carried out in El Salvador, Guatemala and Panama because of the sale of electrical utilities in these countries, but in the main recipient country (Brazil), only slightly more than 20% of total FDI inflows were accounted for by privatizations.

Outgoing FDI, mainly in the Mercosur area, grew to nearly US\$ 8 billion. As in 1997, Chilean residents and, to a lesser extent, residents of Brazil and Argentina were the most active investors. In 1998, the inflow of FDI to Argentina amounted to US\$ 5.7 billion, while outward FDI totalled US\$ 2 billion; in Chile, the corresponding amounts were US\$ 4.8 billion and US\$ 2.8 billion, respectively.

#### *- International bond issues*

The placement of securities on international financial markets declined appreciably in 1998, falling to

just US\$ 38 billion, which was the lowest level in the last three years. Total net bond flows, excluding amortization payments, amounted to US\$ 13 billion, with most placements being made in the first half of the year in the public sector. Up to July 1998, the cost of external financing had not increased significantly (see figure VII.5). In August, however, it rose sharply on the secondary market, reaching nearly 15% per annum before gradually dropping back to 12% by year's end.

Due to this rise in the cost of finance, the region's Governments and firms issued no new bonds between August and October 1998, and it was not until November that the first bond issue since the turmoil of August was launched by the Government of Argentina; this was followed by an issue from Petróleos Mexicanos (Pemex).

A further significant impact on borrowing conditions was that the average term of international bond issues shortened from 15 years in 1997 to eight in 1998, and this situation continued into the first quarter of 1999; it should be remembered, however, that the terms prevailing prior to September 1997 had been extremely favourable (see table VII.8).

1 See ECLAC, *Foreign Investment in Latin America and the Caribbean, 1998* (LC/G. 2042-P), Santiago, Chile, December 1998. United Nations publication, Sales No. E.98.II.G.14.

Table VII. 8  
LATIN AMERICA: INTERNATIONAL BOND ISSUES<sup>a</sup>

BANK OF MEXICO									
	1996	1997	1998	1998				1999	
				I quarter	II quarter	III quarter <sup>c</sup>	IV quarter	I quarter	April
<b>A. Maturity of new issues (years)</b>									
<b>Region</b>	<b>7.8</b>	<b>15.4</b>	<b>8.5</b>	<b>7.6</b>	<b>10.1</b>	<b>8.4</b>	<b>7.7</b>	<b>8.8</b>	<b>7.8</b>
Argentina <sup>d</sup>	9.2	13.5	10.6	9.3	14.4	9.1	8.2	11.6	9.3
Brazil <sup>e</sup>	6.5	16.5	7.9	7.1	9.0	8.1	6.2	4.2 <sup>f</sup>	5.0
Chile	7.3	35.6	11.0	-	11.0	-	-	9.4	10.0
Colombia	6.9	15.0	7.9	6.5	10.0	7.0	-	5.0	10.0
Costa Rica	-	-	...	-	...	-	-	-	10.0
Ecuador	-	5.0	-	-	-	-	-	-	-
Mexico	7.4	9.4	9.1	8.7	11.0	7.0	10.0	8.5	10.0
Panama	-	19.6	-	-	-	-	-	30.0 <sup>g</sup>	-
Uruguay	-	30.0	5.0	-	-	-	5.0	-	10.0
Venezuela	7.0	30.0	20.0	-	-	20.0	...	...	-
<b>B. Spread</b>									
(Differential between the yield on the bonds issued and the yield on United States Treasury bonds) <sup>h</sup>									
<b>Region</b>	<b>370</b>	<b>285</b>	<b>500</b>	<b>432</b>	<b>505</b>	<b>512</b>	<b>611</b>	<b>567</b>	<b>550</b>
Argentina	383	298	441	415	379	356	669	681	585
Brazil <sup>e</sup>	358	327	541	464	571	532	779	604 <sup>f</sup>	675
Chile	86	96	235	-	235	-	-	353	191
Colombia	188	140	409	290	248	690	-	630	495
Costa Rica	-	-	...	-	...	-	-	-	409
Ecuador	-	470	-	-	-	-	-	-	-
Mexico	393	263	329	313	362	320	455	440	415
Panama	-	219	-	-	-	-	-	420	-
Uruguay	-	135	345	-	-	-	345	-	213
Venezuela	440	325	780	-	-	780	...	...	-

Source: Up to and including the third quarter of 1997: ECLAC, on the basis of figures published by the World Bank, in *Financial Flows and the Developing Countries* (various issues). From the fourth quarter of 1997 on: ECLAC, on the basis of figures from official and private sources.

<sup>a</sup> Up to and including the third quarter of 1997, refers to issues over US\$ 150 million.

<sup>b</sup> Includes only those issues floated after the crash on the Hong Kong (China) stock exchange of 27 October 1997. Earlier issues are included in the third quarter.

<sup>c</sup> The majority of issues were placed in July 1998.

<sup>d</sup> As from the fourth quarter of 1997, does not include the expansion of 30-year global bonds under terms obtained prior to the outbreak of the Asian crisis.

<sup>e</sup> As from the fourth quarter of 1997, includes euronotes and certificates of deposit.

<sup>f</sup> Refers to issues authorized but does not necessarily correspond to issues actually placed on the market.

<sup>g</sup> With a put option in the seventh year.

<sup>h</sup> For bonds having comparable maturities, 100 basis points equals 1%.

As in previous years, bond placements tended to be concentrated in a few of the larger Latin American countries, particularly Argentina, which absorbed nearly 40% of funds entering the region in this category, followed by Brazil and Mexico, which accounted for nearly 20% each. There was an improvement in terms of the geographical diversification of these funds in the first half of 1998, as half the Latin American countries were participating in the international bond market at that time; this trend was diluted, however, following the events of August.

Nonetheless, by the middle of February 1999, the Governments of Argentina and Mexico were again floating bonds on international markets, and in March

and April they were joined by other countries, including Brazil, Chile, Colombia, Costa Rica, Panama and Uruguay. The return of the Brazilian Government to international financial markets in April 1999 was an major event in itself, involving a massive bond placement of US\$ 3 billion.

#### - Bank loans

Gross inflows of bank loans to the region retreated sharply in the second half of 1998 and early 1999. According to IMF figures, after having amounted to US\$ 16 billion in the first half of 1998, bank lending fell to US\$ 10 billion in the second half of that year before tumbling to just US\$ 2 billion in the first quarter of



1999. The moratorium declared by the Russian Federation in August 1998 had a decisive impact on the pattern of commercial bank credit flows to Latin America and, in the early months of 1999, this category of financing was making a much slower recovery than international bond placements.

Figures from the Bank for International Settlements (BIS), which cover only the first nine months of 1998, confirm that lending to the region was drying up during this period and, in fact, show an outflow of US\$ 8.7 billion in the third quarter, 90% of which came from Brazil. Short-term loans were the type of bank credit that was the most affected in some countries, with sharp reductions in Brazil and smaller decreases in Chile, Colombia and Venezuela; in the fourth quarter a drop was also seen in Peru. Nevertheless, in most cases a sizeable proportion of short-term credits continued to be used in foreign trade operations and despite the financial turmoil affecting the region, they were never actually suspended, except in Brazil during the first two months of 1999.

#### *- Equity capital*

This was one of the categories of international capital where net outflows were recorded, but only in a few countries. The total withdrawal of equity capital from the region as a whole amounted to US\$ 5 billion, with Brazil suffering the largest exodus (close to US\$ 2 billion); there were also outflows, albeit on a smaller scale, in Chile, Mexico and Peru. This retreat from equity investment took place against the backdrop of an exceptionally severe slump in stock market values involving an unprecedented collapse in share prices. By September 1998, the regional index (measured in

dollars) had shed 45% of its value since June 1997. The downturn seen during this period affected all major Latin American stock exchanges across the board. Although prices began to recover in fits and starts in October 1998, by May 1999 they had still not regained their end-1996 levels (see table VII.9). The placement of American Depositary Receipts (ADRs) was practically nil during 1998 after having totalled US\$ 5 billion in 1997.

#### *- Multilateral financing*

A substantial amount of multilateral financing (US\$ 6 billion in net terms) was channeled into several of the region's economies in 1998, especially some of the smaller ones. Timely action by the World Bank and IDB helped to overcome external financing difficulties in the second half of 1998, and by the end of the year significant amounts had already been committed to help Argentina, Brazil and Colombia to cover their 1999 balance-of-payments current account deficits.

#### *(iii) Net resource transfers*

Despite the financial difficulties of 1998, the net transfer of resources to the region continued to be positive, as it has been throughout the 1990s; however, at slightly over US\$ 27 billion, the balance was down from the 1997 figure. In absolute terms, the inward resource transfer was concentrated in Argentina, Brazil, Colombia and Mexico, although the figure for Brazil included exceptional financing from IMF and other compensatory financing provided as part of the financial assistance programme signed in late 1998. When measured in relation to exports, net resource transfers

Table VII. 9  
**LATIN AMERICA: STOCK EXCHANGE INDEXES IN DOLLARS<sup>a</sup>**  
(Indices: June 1997 = 100)

	1991	1992	1993	1994	1995	1996	1997	1998	1999 <sup>b</sup>
<b>Latin America</b>	<b>49.0</b>	<b>51.0</b>	<b>77.4</b>	<b>76.2</b>	<b>62.5</b>	<b>72.5</b>	<b>90.6</b>	<b>56.0</b>	<b>67.7</b>
Argentina	70.0	50.7	84.9	63.6	69.1	82.1	96.3	68.9	86.2
Brazil	20.2	20.0	38.2	64.0	49.8	64.9	78.3	44.9	48.1
Chile	46.7	52.4	67.8	95.8	93.0	77.0	79.6	55.7	67.8
Colombia	45.5	62.0	81.6	103.5	77.1	80.5	99.9	56.4	57.9
Mexico	88.5	106.2	156.0	91.1	66.5	77.3	114.1	69.5	94.8
Peru	...	32.6	43.9	66.8	73.1	73.6	83.8	50.5	50.5
Venezuela	128.0	73.3	65.6	47.8	32.7	75.7	93.3	44.9	46.2

Source: ECLAC, on the basis of figures from the International Finance Corporation.

<sup>a</sup> Year-end figures. <sup>b</sup> Figures at the end of May.

Table VII.10  
**LATIN AMERICA AND THE CARIBBEAN: RATIO OF PROFIT REMITTANCES  
 TO EXPORTS OF GOODS AND SERVICES<sup>a</sup>**  
 (Percentages)

	1991	1992	1993	1994	1995	1996	1997	1998 <sup>b</sup>
<b>Latin America and the Caribbean</b>	<b>4.3</b>	<b>4.5</b>	<b>5.2</b>	<b>5.7</b>	<b>5.1</b>	<b>5.5</b>	<b>5.8</b>	<b>7.0</b>
Argentina	5.6	7.3	10.2	9.4	7.6	6.2	7.6	8.3
Bolivia	0.4	2.6	1.9	2.2	3.1	5.4	5.7	6.0
Brazil	3.0	2.1	4.5	4.7	5.3	8.3	11.1	12.6
Chile	7.9	8.4	8.1	12.9	11.4	11.9	12.7	9.8
Colombia	9.7	11.3	10.4	...	...	...	...	13.7
Costa Rica	3.0	3.0	2.9	1.7	2.4	1.8	2.9	3.7
Ecuador	3.8	3.5	4.0	3.9	3.7	3.4	3.3	4.8
El Salvador	4.0	2.7	2.2	1.6	1.3	...	...	...
Guatemala	2.6	1.9	2.6	2.6	2.6	3.7	4.4	2.8
Haiti	2.6	...	...	...	...	...	...	...
Honduras	7.1	7.1	4.5	1.8	3.6	3.6	2.8	2.9
Mexico	4.8	4.2	4.1	6.7	4.8	4.9	3.4	4.3
Nicaragua	3.4	3.9	2.8	2.1	2.3	2.7	2.7	3.0
Panama	4.2	5.1	4.8	3.8	4.0	6.6	6.4	8.6
Paraguay	1.0	0.9	1.3	1.0	1.3	1.6	2.4	2.0
Peru	0.9	3.5	3.0	3.3	4.3	5.7	8.3	5.9
Dominican Republic	6.5	10.6	10.8	10.7	10.9	9.8	10.1	11.1
Uruguay	...	...	1.7	1.3	1.5	0.9	0.6	1.1
Venezuela	1.4	3.3	3.6	2.9	2.1	1.7	2.4	3.5

Source: ECLAC, on the basis of figures from the International Monetary Fund and national sources.

<sup>a</sup> Includes reinvestment of profits. <sup>b</sup> Preliminary figures.

were also highly significant in Bolivia (40%) and Argentina (34%) and, to a lesser extent, in Peru (18%) and Colombia (17%). In Chile, Ecuador and Mexico, the amount of external finance received was only sufficient to cover outlays in respect of interest payments and profit remittances, as in these countries the level of resource transfers was low. In Costa Rica, Peru and especially Venezuela, 1998 closed with a negative net transfer of resources, which in the case of Venezuela amounted to US\$ 4 billion.

#### (iv) External debt

In 1998 the region's gross external debt rose by 10.8% in nominal terms (the largest increase since 1993) to US\$ 737 billion. Countries whose gross external liabilities were up sharply included Argentina, Brazil and Chile, which have raised their rate of borrowing to nearly 13% per annum over the past three years. In Ecuador and Paraguay this rate also rose—to 10%—but it did so following a biennium of moderate

expansion. In Argentina and Paraguay, borrowing has been led by the public sector, while in Brazil and Chile it has resulted from an increase in private-sector obligations. In contrast, El Salvador, Trinidad and Tobago, and Venezuela all managed to reduce their external debts. In a number of countries (including Costa Rica, Mexico, Peru, the Dominican Republic and Venezuela) which in previous years had reduced their foreign liabilities, the results varied, but in all these cases their debt levels remained below the highs reached several years earlier.

For the first time in the 1990s, indicators of the external debt burden deteriorated significantly, mainly because of the fall in the value of exports of goods and services. This deterioration was regionwide in scope, with the only exceptions being a few countries in Central America and the Caribbean whose external sales grew much faster than their outstanding debt.

At the regional level, the ratio of total interest payments to exports of goods and services rose from 15.1% to 16.3%, its highest level since 1995. This value

Table VII.11  
**LATIN AMERICA AND THE CARIBBEAN: RATIO OF TOTAL  
 INTEREST TO EXPORTS OF GOODS AND SERVICES<sup>a</sup>**  
*(Percentages)*

	1991	1992	1993	1994	1995	1996	1997	1998 <sup>b</sup>
<b>Latin America and the Caribbean</b>	<b>21.7</b>	<b>18.6</b>	<b>18.2</b>	<b>16.4</b>	<b>16.7</b>	<b>15.3</b>	<b>15.1</b>	<b>16.3</b>
Argentina	36.1	23.4	23.3	26.8	28.2	28.1	29.9	35.4
Bolivia	29.2	24.4	21.2	14.3	16.6	12.1	14.8	15.0
Brazil	27.2	20.8	21.8	17.9	21.9	24.1	23.9	26.7
Chile	14.7	11.4	10.3	8.2	7.3	7.0	6.7	8.0
Colombia	16.4	14.6	12.3	14.6	15.3	16.0	16.6	19.7
Costa Rica	10.1	7.3	6.8	5.5	5.7	4.8	3.9	3.1
Ecuador	29.9	22.8	21.7	19.0	15.7	15.9	15.9	21.2
El Salvador	12.6	10.5	10.3	6.3	5.6	6.1	6.0	6.5
Guatemala	7.1	8.8	6.2	5.8	4.8	6.1	5.2	4.2
Haiti	7.7	5.5	7.9	6.1	11.9	3.2	3.7	2.5
Honduras	21.1	25.9	15.6	15.6	13.2	11.3	8.9	7.8
Mexico	18.0	17.5	18.3	15.2	13.6	11.1	10.2	9.6
Nicaragua	106.5	158.5	119.3	97.1	54.2	36.0	24.7	19.3
Panama	22.9	19.1	15.7	15.4	22.6	17.2	15.9	19.7
Paraguay	4.7	6.9	3.0	2.5	3.1	2.9	3.8	3.9
Peru	36.7	37.3	38.9	34.5	34.1	25.1	19.6	23.7
Dominican Republic	8.6	9.1	5.8	4.1	4.6	3.9	3.1	3.4
Uruguay	21.2	15.7	14.4	14.9	16.5	15.9	16.9	17.6
Venezuela	15.4	18.3	17.0	17.0	16.1	11.2	13.6	15.3

Source: ECLAC, on the basis of figures from the International Monetary Fund and national sources.

<sup>a</sup> Includes interest actually paid plus interest due but unpaid. <sup>b</sup> Preliminary figures.

conceals widely varying individual results, however, since Argentina, Brazil and Peru each had to spend over a quarter of their export earnings on interest payments, while in Bolivia, Colombia, Nicaragua, Panama and Uruguay, interest payments absorbed between 15% and 20% of the income from exports. In contrast, there were nine other countries that used under 10% of their export revenues to pay for this factor service.

The region's debt/export ratio rose from 198% to 222%, which was close to the level recorded in 1995 (see table VII.12). Chile, Ecuador, Paraguay, Peru and Venezuela were the countries in which this indicator deteriorated the most. In the first three of these countries, this was due both to a rise in the external debt and to a decline in exports, while in Peru and especially Venezuela, the sharp drop in the value of exports was to blame. This indicator also climbed steeply in Argentina and Brazil and reached its highest level in recent years, mainly because of the increase in the external debt. Despite the deterioration seen in this indicator in 1998, a number of countries, including Colombia, Chile, Mexico, Paraguay, Uruguay and Venezuela, plus those of

Central America (except for Nicaragua), still managed to keep their debt/export ratios below 250%. Countries with figures above this level were Argentina (450), Bolivia and Ecuador (325), Brazil and Peru (400) and Nicaragua (785).

It should be noted that part of the increase registered in the debt burden in Argentina and Brazil is actually a consequence of the comprehensive revisions these countries made in their external debt series in 1998 and 1999. As a result of these revisions, the estimates of Argentina's non-financial private-sector external debt (including bank claims and liabilities with other creditors) were changed, and following the revision US\$ 14 billion was added to the total external debt figure for 1997. In Brazil, new estimates broadened the coverage of the figures; in addition, part of the massive amount of short-term capital that flowed out of the country in 1998 was used by residents to purchase dollar-denominated debt paper, and since these positions have not been liquidated, they have not yet been reflected on the books as a reduction in external liabilities.

Table VII. 12  
**LATIN AMERICA AND THE CARIBBEAN: RATIO OF GROSS DISBURSED  
 EXTERNAL DEBT TO EXPORTS OF GOODS AND SERVICES<sup>a</sup>**  
 (Percentages)

	1991	1992	1993	1994	1995	1996	1997	1998
<b>Latin America and the Caribbean</b>	<b>272.2</b>	<b>261.6</b>	<b>263.2</b>	<b>244.5</b>	<b>225.1</b>	<b>211.5</b>	<b>198.0</b>	<b>221.5</b>
Argentina	426.3	407.1	438.8	440.4	393.9	385.5	401.7	452.0
Bolivia <sup>b</sup>	390.5	489.5	421.1	346.8	364.9	331.5	299.6	323.4
Brazil	354.4	340.9	334.3	302.6	302.5	340.3	331.9	394.0
Chile	147.8	147.5	163.9	148.7	113.0	122.4	129.6	168.2
Colombia	190.5	186.9	190.0	204.9	203.3	223.8	225.3	254.3
Costa Rica <sup>c</sup>	182.3	130.4	110.0	100.1	87.1	69.8	59.9	50.9
Ecuador	375.8	344.1	367.2	318.5	265.1	253.8	248.1	327.8
El Salvador <sup>b</sup>	245.1	240.3	173.6	125.4	105.8	114.2	99.3	96.0
Guatemala	154.8	132.8	114.8	115.6	104.8	109.6	101.1	102.0
Haiti <sup>b</sup>	237.2	589.6	530.6	628.6	351.1	277.6	281.7	238.0
Honduras	338.8	344.8	318.0	295.0	244.5	214.6	185.2	178.0
Mexico	226.9	210.0	212.6	196.4	185.4	147.1	122.3	124.6
Nicaragua <sup>b</sup>	2944.7	3489.2	3368.2	2457.4	1585.2	757.1	692.8	782.4
Panama <sup>c</sup>	68.7	56.2	52.2	49.2	51.8	68.9	60.7	66.4
Paraguay	82.3	53.0	37.8	33.4	30.3	33.0	37.7	45.9
Peru	491.2	476.1	631.5	536.8	498.6	462.3	341.3	398.5
Dominican Republic <sup>bd</sup>	248.5	230.9	96.1	75.3	69.8	61.5	49.7	46.9
Uruguay <sup>b</sup>	137.7	131.4	132.1	133.0	127.4	121.7	112.7	124.8
Venezuela	219.7	247.8	253.3	232.8	185.5	140.7	129.1	162.0

Source: ECLAC, on the basis of figures from the International Monetary Fund and national sources.

<sup>a</sup> Includes public and private-sector liabilities.

<sup>b</sup> Includes public-sector liabilities.

<sup>c</sup> From 1992 on, includes *maquila* exports under the heading of "goods".

<sup>d</sup> From 1993 on, includes *maquila* exports under the heading of "goods".

### Box VII.1 EXTERNAL DEBT REDUCTION INITIATIVE

In September 1996, in line with a mandate issued by the Group of Seven (G7) at its meeting in Lyon, the International Monetary Fund and the World Bank adopted a programme of action to mobilize international support for an effort to reduce the debt of heavily indebted poor countries (HIPC) to sustainable levels. For the level of debt to be considered sustainable, it must meet two requirements: the debt service should represent no more than 20%-25%

of the value of exports, and its total sum should be no more than 200%-250% of that value. The Paris Club generally offers debt restructuring arrangements in accordance with the Naples terms (up to a 60% reduction), but it has agreed to forgive up to 80% of outstanding balances. To be eligible under this initiative, a country also needs to have an adjustment programme already in place that has been sanctioned by the World Bank and IMF. A total of 40

developing countries can take advantage of this arrangement, including four from Latin America. Under this scheme, Guyana was able to reduce its debt by US\$ 250 million in 1997 and Bolivia secured a reduction of US\$ 450 million in 1998. Honduras and Nicaragua, which suffered the devastating consequences of Hurricane Mitch, obtained a deferment of debt service from the Paris Club for the period 1999-2001 and soon hope to take advantage of the terms offered under the HIPC initiative.



## Chapter VIII

# Impact of the international crisis on Latin America and the Caribbean

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### 1. Overview

In 1997 the Latin American and Caribbean region turned in one of its best economic performances in two decades, as output expanded by 5.4% and inflation decreased to 10.4%. However, the currency crises which wracked East Asia and the subsequent global financial crisis dimmed Latin America's hopes of remaining on this growth track and riding out the external turbulence. Many economies in the region were hit by these shock waves during 1998, and some of them plunged into recession. As a result, the growth prospects for Latin America are bleak in 1999. The Caribbean countries were comparatively less affected by the international turmoil, and growth in this subregion did not lose its momentum. For the region as a whole, the actual growth rate was only 2.3% in 1998, down from an original estimate of 4.5%. Prospects for 1999 point towards a decline in regional GDP (from -0.5% to -1%). As a result, unemployment has been increasing, and it is a virtual certainty that poverty will rise as well.

**THE CRISIS** was transmitted to the region through two interrelated vectors, one financial and the other commercial in nature. Of these two effects, the most dramatic was related to the region's increasingly volatile financial flows. Investors' quest for quality investment undermined their previous interest in emerging markets, including Latin America. The average of the major Latin American stock indexes fell by 44% between October 1997 and March 1999. The plunge in stock market prices was closely associated with capital outflows from the region. At the same time, capital inflows of other types also waned, especially on the bond market. This, financial contagion affected Latin America despite the strong fundamentals the region exhibited in mid-1997: budget deficits had been sharply curtailed; inflation was declining and had already subsided to single-digit levels in more than half the countries; the domestic banking sector had been strengthened following the sectoral crisis of 1994-1995; international reserves were high; and the debt profile had been lengthened so that short-term obligations no longer posed an imminent threat.

The second way in which the crisis affected Latin America was via trade links. The central aspect of this phenomenon was a decline in commodity prices which was partially but not totally related to events in Asia. The price outcome was exacerbated by a quantity effect as demand in Asia—both in Japan and in the developing Asian economies— weakened, although this had a significant impact on only a few Latin American countries. This trade shock was closely linked to dependence on a very limited number of export commodities.

Fortunately for the region, nearly two thirds of its foreign capital inflows consisted of foreign direct investment, whose originators take a longer-term perspective and are less likely to flee in response to short-term fluctuations. Moreover, since they had been through many crises in the past, Latin American Governments were better prepared than their Asian counterparts to deal with these new shocks. When problems appeared in a given country, finance ministers and central bank governors were fairly quick to take action. When necessary, national initiatives were backed by the international community, and a consensus was emerging at the end of the first quarter of 1999 that the worst was over.

This global crisis has served as an opportunity for a new debate at both national and international levels concerning the most appropriate economic policy mix for the countries' increasingly integrated financial markets. In the region, this debate has centred around three

closely related aspects. The first refers to the management of structural reforms, particularly with regard to the timing and sequencing of capital-account and financial-sector liberalization and regulation; the second deals with the question of what type of exchange-rate regime is the most appropriate within today's context of greater regional and international integration and, in particular whether consideration should be given to convergence towards a common currency; the third concerns the respective roles of fiscal, monetary and exchange-rate policies in coping with balance-of-payment problems and the associated trade-offs in terms of growth.

#### (a) Vectors

The speed with which the initial turmoil in Asia has spread from one country and region to another, regardless of their particular economic situations, is one of the most disturbing aspects of the current global crisis. This contagion process is not well understood and requires further study. In the case of Latin America, three main transmission mechanisms are at the core of contagion process: financial operations, trade flows and government policies.

#### *Financial operations*

It was through monetary and financial operations that Latin America was first made intensely aware of the crisis. In October 1997, speculators attacked the Brazilian currency, and such assaults would later be repeated elsewhere in the region (see box VIII.1). A related financial mechanism of contagion had to do with the stock market, which had boomed when large volumes of short-term capital were flowing into emerging markets during the mid-1990s. When investors lost confidence, those same funds were quickly withdrawn, driving prices down. This first occurred in Latin America about the same time as the attack on the Brazilian *real*, in October 1997, as the South-East Asian market crash spread to other markets. It should be noted that, in the case of some investors, the reason for the sell-off was not a distrust in the region's economic fundamentals, but simply the need for profit-taking in Latin America in order to make up for their losses on other stock markets.

A third financial channel has to do with other types of foreign capital. During the first half of 1997, emerging markets enjoyed improved access to international financing and narrower spreads on Eurobonds and Brady bonds. This resulted in a gross influx of capital

Box VIII.1  
**THE PHASES OF THE GLOBAL FINANCIAL CRISIS IN LATIN AMERICA,  
 OCTOBER 1997-MARCH 1999**

Between October 1997 and March 1999, five phases of the financial crisis can be identified in the region:

1. October-November 1997: The Brazilian currency came under attack, but the government's response was quick and effective. Regional stock markets suffered their first slump, and the bond market contracted, but recovery was fairly rapid.

2. January-February 1998: Stock markets declined again in January, and the currencies of some additional countries (especially Chile and

Colombia) came under pressure; interest rates were raised.

3. May-June 1998: A third stock market downturn occurred due to falling oil prices and a gloomier economic picture in Japan.

4. August-September 1998: After the spread of the crisis to the Russian Federation, most emerging markets plunged into a deep crisis. Credit dried up again, and many countries faced severe currency problems.

5. January-March 1999: Brazil was forced into a devaluation despite the

agreement reached just two months before on a rescue package with the IMF. Fears of contagion spread across the region and briefly overflowed into international markets when the Brazilian currency looked as though it was about to be caught up in a process of spiraling devaluation coupled with a deep recession. Financial markets returned to normal when the exchange rate stabilized, opening the way for a decline in the Brazilian interest rate and better growth prospects.

amounting to some US\$ 90 billion between January and September 1997, two thirds of which was long-term capital. Foreign direct investment maintained an upward trend, with flows amounting to US\$55 billion. After the crisis broke out in July, spreads increased for some of the Asian countries, but held steady or declined in Latin America and other regions. This situation changed in October, when stock market indexes plunged and the risk premiums for many emerging economies, including Latin American countries, shot up. A similar situation arose again in August and September 1998 in the wake of Russia's devaluation and debt default, which undermined investor confidence in all emerging markets.

### *Trade flows*

The trade flows of the eight main developing economies of East and South-East Asia, most of which were affected by the crisis,<sup>1</sup> represented 15% of total world trade in 1996. Moreover, they were the most dynamic actors in international commerce, accounting for 31% of the increase in world imports between 1990 and 1995 and 28% of the increase in exports. If Japan, which was also in a deep slump at the time, is included in this group, then the percentage of world trade accounted for by these economies in 1996 rises to 22%. However, under the combined pressure of devaluation and economic recession, their demand for imports weakened, which affected not only the volume traded but also the prices of some sensitive products. For ex-

ample, these countries accounted for around 15% of world imports of agricultural raw materials, minerals and metals, and petroleum. Moreover, their share of world imports of minerals and metals was rapidly increasing.

The contraction of East and South-East Asian imports has had a direct impact on demand for Latin American exports. In volume terms, however, this effect has been relatively minor because the market is not an important one for Latin American countries, with the exception of Chile and Peru. More importantly, via the contraction of imports, the Asian crisis has also had an impact on the prices of Latin America's commodity exports.

In addition to the contraction of Asian imports, it would also be reasonable to expect that the crisis would increase the competitiveness of that region's exports. Nevertheless, the Asian countries' difficult financial conditions and lower capacity to import as a result of the crisis have so far tended to hinder a rapid expansion of export supply.

### **(b) Policy measures**

The principal economic measures taken in response to the crisis have been in the areas of monetary, fiscal and trade policy (see table VIII.1). Monetary measures have been adopted by countries whose financial and foreign exchange markets have experienced volatility, either as a direct consequence of short-term

<sup>1</sup> They include Hong Kong (Special Administrative Region of China), Indonesia, Malaysia, Philippines, Republic of Korea, Singapore, Taiwan (Province of China) and Thailand.



Table VIII.1  
**ECONOMIC POLICY MEASURES ADOPTED IN RESPONSE TO THE INTERNATIONAL CRISIS  
 IN 1997 AND 1998 (SELECTED LATIN AMERICAN COUNTRIES)**

Country	Fiscal adjustment	Monetary tightening	Trade measures
Argentina	X		X
Brazil	X	X	X
Chile	X	X	
Colombia	X	X	X
Ecuador	X		X
Mexico	X	X	
Paraguay		X	
Peru		X	
Venezuela	X	X	

Source: ECLAC.

capital flows or as a reaction to a fall in export prices. Fiscal measures—chiefly budget cuts—have been applied in response to declining fiscal revenues in countries that derive an important part of their revenues from royalties or from the sale of commodities by government-owned companies (oil in Ecuador, Mexico, Venezuela and, to a lesser extent, Colombia, and copper in Chile). Budget cuts have also been made as part of austerity packages designed to cool off aggregate demand so as to reduce current-account deficits and to increase the credibility of monetary and exchange-rate

policies. In the particular case of Brazil, the fiscal packages it has put together, which have included tax hikes, have also been necessary in order to finance the increase in interest payments on the domestic public debt caused by the monetary measures it has taken and to signal to financial investors that the country is capable of mounting a timely and comprehensive response. Lastly, some countries have adopted anti-dumping and safeguard measures to protect domestic producers threatened by “unfair” competition from Asian products and to improve the current-account balance.

## 2. Magnitude of the effects of the global financial crisis and of policy measures

### (a) The impact on the financial sector

The channels through which the crisis has spilled over into Latin America and the Caribbean vary from country to country. As noted above, financial factors first came into play in October 1997 and then again in August–September 1998, when stock-market and foreign-exchange crises spread further and internationally-based investors began to flee the emerging economies, especially in the case of countries that appeared to be suffering from external imbalances similar to those of the Asian countries in crisis. A third wave swept over the region shortly the Brazilian devaluation of January 1999.

In Latin America, the hardest-hit country was Brazil, which has been running an increasingly large deficit on its fiscal accounts and a hefty current-account deficit. In international crisis situations, markets usually interpret the latter as a sign of an overvalued currency. On the other side of the spectrum, the Central American and Caribbean countries were among the least affected by these changes in the international financial situation thanks to a series of factors, including the small size of their financial markets.

Three interrelated factors played a part in determining the extent of this financial contagion: (i) the evaluation of the country risk premium, (ii) the magnitude of the resulting capital flight, and (iii) the impact of these factors on exchange rates.

*Country risk reassessment.* Until the events of October 1997, Latin America was still highly rated by international investors. The region's stock exchanges were maintaining the gains made earlier in the year, spreads on Latin American Eurobonds were continuing to narrow, and capital inflows showed no signs of slackening. In fact, in the third quarter of 1997, international bank credit balances rose by US\$ 10 billion, a figure roughly equal to the increase for the entire first half of the year. Then, at the end of October, the market's bull run came to an abrupt halt.

Investors began to reassess their investment position on the basis of their Asian experience, and the international market's reassessment of country risk caused regional stock prices to drop sharply, by 20% on average. The influx of portfolio capital dropped off steeply during the last quarter of 1997, with international bond issues declining to under US\$ 4 billion, compared with US\$ 20 billion in the third quarter. To a great extent, the decline was due to a severe deterioration in the terms offered by the market, which, by demanding wider spreads and shorter maturities, pushed potential issuers into a holding pattern. Beginning in November 1997, a number of Governments and firms postponed issues they had planned, although some returned to the market shortly thereafter: the Governments of Argentina and Colombia began to place debt paper in January, Brazil in February and Mexico in March 1998.

A similar pattern was seen in 1998, after a brief respite during the first quarter of the year when the region's stock markets recouped part of their losses. For the region as a whole, bond issues rebounded during the first half of 1998; during this time, the Government of Argentina was particularly active and used the funds it raised primarily to pay off maturing debt. This favourable situation did not last long, however.

The alarming signs of recession in Japan and the currency crisis in Russia generated a second shock wave which hit the region during the second semester. The first shock had reached Latin America at a time when it was growing rapidly and had strong macroeconomic fundamentals, but this second wave found the region in a weaker position, as it confronted a growing external deficit and a delicate external liquidity situation. A major credit squeeze began in the second half of 1998, just after the Russian crisis. Only a handful of bonds were issued in the fourth quarter because of the enormous interest premium being demanded. A similar situation arose in equity markets during the third quarter of 1998, when stock prices fell by 30%.

*Capital flight.* Along with a decline in bond placements and a weakening in stock market, some countries were troubled by short-term capital flight. In the case of Brazil, these outflows reached US\$ 8 billion in October 1997 and US\$ 17 billion in September 1998, and thus were tantamount to an attack on the currency. In Venezuela, the estimated outflow for October 1997-September 1998 was US\$ 5 billion.

Even countries enjoying a good reputation with the international market were affected. Chile experienced currency pressures in December 1997, January 1998 and in June-July 1998; during those months it registered a cumulative drop in international reserves of US\$ 2.6 billion.

On the other hand, there is no evidence that foreign direct investment in Latin America has been significantly affected by the international crisis. Long-term factors, such as the privatizations scheduled in some countries, the liberalization of service markets and the funds attracted by integration programmes (especially Mercosur), support the assumption that foreign direct investment will not be hurt to any appreciable extent.

Nevertheless, for the first time since the tequila crisis, it was necessary for the region as a whole to draw on international reserves to finance its current-account deficit. While the deficit increased from US\$ 64 billion to US\$ 84 billion between 1997 and 1998, capital inflows fell from US\$ 80 billion to US\$ 62 billion.

In order to staunch (or prevent) the loss of reserves and the flight of deposits from the banking system, various countries resorted to raising domestic interest rates significantly. Thanks to these measures and the perception that the region's banking systems were sounder (in comparison with their condition when the "tequila effect" hit), the tension that was apparent in foreign-exchange markets was not accompanied by any appreciable loss of bank deposits. Had it been otherwise, the pressures on exchange rates might have been much greater, and a loss of deposits might have forced banks to cut lending, thus further slowing the pace of economic activity, as happened in Mexico and Argentina in 1995.

The large volume of reserves on hand meant that the shortfall could be covered relatively easily, so long as it only lasted for a single year. In addition, the gap was partially filled by Brazil's use of the large rescue package put together by the international community.

*Exchange rate.* The problems troubling the external sector were transmitted to the domestic economy through the restrictive macroeconomic policies and high domestic interest rates that many governments

were obliged to apply in order to defend the exchange-rate regime and avoid a loss of international reserves and bank deposits.

The majority of the countries maintained their existing exchange-rate systems during 1998. Despite the losses of international reserves that occurred (principally in Brazil, Chile, Colombia and Venezuela) in the 15 months ending in December 1998, no major changes were seen in real effective exchange rates. Brazil continued with its periodic mini-devaluations. Chile and Colombia adjusted the width or gradient of their exchange-rate bands but maintained their general approach to exchange-rate management. Mexico, which had allowed its exchange rate to fluctuate since its balance-of-payment crisis in December 1994, was in a relatively better position. Even though the Mexican authorities had to adjust their public budget to compensate for the drop in oil revenues and tighten their monetary policy to control the devaluation in the wake of the Russian crisis, growth prospects remained positive.

The situation appeared to be changing at the beginning of 1999, when Brazil was forced into a devaluation in January, followed by Ecuador a month later. Nevertheless, the spectre of a spiraling devaluation in Brazil and of the contagion of other Latin American countries, especially its main trading partners in Mercosur, did not materialize. Once the new Brazilian exchange-rate policy received the backing of a revised IMF arrangement and domestic inflation appeared to be under control, confidence in the long-term prospects for economic recovery returned. By the end of the first quarter of 1999, the pressure on exchange rates started to ease in Brazil and other countries of the region.

Exchange-rate policies based on a crawling-peg regime, along with their associated revaluation bias, which had already been accused of being one of the leading causes of the currency crisis in Asia, came under attack in the region. The trade implications of large devaluations, especially in the context of regional integration, fuelled a heated debate between advocates of free floats (as in Mexico) and currency boards (as in Argentina).

## **(b) The impact on trade**

Though the effects of the Asian crisis in Brazil and Colombia, and, temporarily, Argentina and Mexico were mainly felt through financial channels, in several other countries trade was the area most affected. In Chile, the financial effects of the crisis were felt later

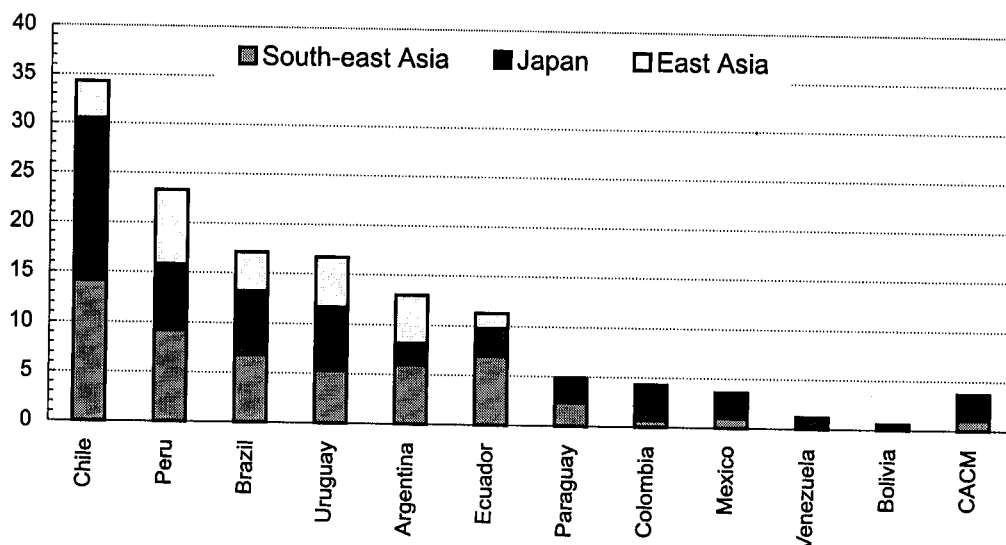
than, and to a large extent were due to, its effects on trade. The available data show that in the majority of the countries the main impact of the crisis on trade was a drop in the prices of some commodities, rather than a contraction in export volumes. The main reason for this is that Asia, where the recession has been centred, is not a major market for most Latin American countries, with the two main exceptions being Chile and Peru (see figure VIII.1).

The information available on Latin America's exports for 1998 points to a regionwide slowdown, with at least half of the countries suffering a decline in the absolute value of export revenues in comparison with 1997. Caribbean exports of goods and services were not affected, except in the case of commodities (bauxite and aluminium in Jamaica, oil in Trinidad and Tobago).

The sharpest falls (more than 10%), have occurred in Chile, Ecuador, Nicaragua, Peru and Venezuela. An examination of the price trends of the main Latin American export products indicates that the worsening of export sales was due to the steep drop in prices rather than to variations in volume. Petroleum exporters suffered especially serious problems because of the tumbling price of oil. Venezuela, for example, saw the prices of the blend of petroleum it exports fall to less than US\$ 10 per barrel in June 1998, compared to US\$ 16.3 dollars in 1997. This obliged the Government to make several budget cuts to reduce the projected deficit. Venezuela's access to the international bond market was closed off after August, eliminating an alternative to budget cuts. The fall in the price of petroleum, in turn, increased speculation against the bolivar. Since the Government did not want to devalue, it had to raise interest rates and use part of its ample supply of reserves to support the currency. Ecuador also suffered from the fall in oil prices, together with the downswing in banana prices. The decrease in export revenues (15% during 1998) was responsible for the country's trade balance shifting into the red, worsening the deficit on the current account. Given its large budget deficit, Ecuador was eventually forced to allow its currency to depreciate.

Petroleum accounts for a smaller share of the other oil producers' export revenues. In Mexico, for example, oil export revenues fell by 34% during the first part of the year, but non-oil exports (thanks, in particular, to *maquila* industries) rose by 13%, with the net result being an overall increase of 6%. While this was quite positive in comparative regional terms, imports continued to outpace exports, leading to a widening of the current-account deficit. The 7% devaluation in 1998 has made Mexico's exports even more competitive in its

Figure VIII.1  
**LATIN AMERICAN EXPORTS TO ASIA AND THE PACIFIC**  
*(As a percentage of each economy's total exports in 1996)*



Source: ECLAC, on the basis of official figures.

<sup>a</sup> Includes Australia, China, Hong Kong (Special Administrative Region of China), Indonesia, Malaysia, New Zealand, Philippines, Republic of Korea, Singapore, Taiwan (Province of China) and Thailand.

main market, the United States, although the fall in the value of the currency was detrimental in terms of inflation. Moreover, since a large share of Mexico's fiscal revenues come from petroleum sales, several budget cuts had to be made and growth was slower than predicted.

Other commodity producers with especially serious problems were copper exporters (Chile and, to a lesser extent, Peru). Copper prices for 1998 were down by more than 25% with respect to 1997. Since around 40% of Chile's export revenues come from copper, this was the major cause of the 11% fall in total export revenues during the year. Although the Government owns the country's largest copper company, fiscal revenues were buffered to some extent by the Copper Stabilization Fund, which the Government drew upon in 1998. Peru's exports, although more diversified than Chile's, were down by a larger amount (17%); part of this fall was due to El Niño, as well as to the low prices of various metals. Peru's main mines are privately owned, so in this case, too, the fiscal impact was cushioned. Chile and Peru are also the two countries in Latin America that conduct a significant share of their trade with Asia.

Thus, unlike the other countries in the region, they suffered from volume as well as price effects because of Asia's problems.

Argentina's trade performance held up surprisingly well in 1998, considering the earlier fears about the negative impact of slower growth in Brazil. Argentina is also a commodity exporter, especially of oil and grains; the prices of both of these items were down, but a bumper grain crop partially compensated for these lower price levels. The devaluation of the Brazilian *real* in January 1999 and the prospect of a severe recession in that country changed the situation, however. Exports of manufactured goods were particularly affected, since the lower-priced Brazilian products competed more aggressively in the domestic market. The trade performances of Paraguay and Uruguay, which are also members of Mercosur, were also affected by the Brazilian economy's slower growth during 1998 and its recession in 1999.

The Central American and Caribbean countries' main trading partners are the European and North American economies. Thanks to a sustained demand from these two regions, their exports were not hurt by

the Asian crisis. Moreover, many of these countries benefited from the drop in commodity prices and thus experienced a net gain in their terms of trade. This was not the case, however, in Caribbean countries that export mineral products (Jamaica) or oil (Trinidad and Tobago). The available information indicates that tourism activity, an important source of income for Caribbean economies, was not negatively influenced by the global crisis.

As a matter of fact, except in specific cases and categories, there was no drop in export volumes at the regional level, as falling demand for Latin American commodities in the Asian countries was balanced, at least in part, by the relative strength of other markets. For example, the available data for 1998 show that, in the case of Brazil, declining demand from Asia was more than offset by sales to the countries of the Latin American Integration Association (LAIA) and the European Union. Chile also managed to shift some of its output to other customers.

Preliminary figures for Latin American and Caribbean trade for 1998 indicate also that there was no massive influx of goods from East and South-East Asia or any significant displacement of regional exports in major OECD markets. This would appear to be further proof of the difficulties that Asian countries are having in trying to expand their exports rapidly, despite the devaluation of their currencies. However, a number of Latin American countries have adopted or announced anti-dumping or safeguard measures in view of the risk of an influx of certain types of goods at very low prices. In Colombia, for instance, in late January the Council on Foreign Trade considered introducing safeguard measures which could block the entry of foreign goods that threaten local production for up to four years; Argentina has streamlined procedures for anti-dumping investigations in the case of Asian imports; and in Peru and Uruguay, manufacturers are demanding the introduction of safeguard clauses to protect the apparel and footwear industries.

### **(c) Overall impacts on the region's economic performance**

One of the difficulties entailed in any attempt to quantify the impact of the crisis on the region is how to go about isolating that impact from the effects of other contemporary events which also influence the economic performance of the Latin American and Caribbean countries. To the extent that these events are manifested through trade and financial channels, their effects are superimposed upon those of the inter-

national crisis; it is therefore difficult to make reliable estimates of the causal relationships involved.

An example of this overlapping of factors is seen in the pricing of certain commodities, especially oil and minerals. Lower demand in the countries of East and South-East Asia is not the only factor that is weakening commodity prices. Many economies of the region were also affected by the climatic phenomenon known as "El Niño", which has caused staggering human and material losses and has done a great deal of damage to production activities and infrastructure. Caribbean and Central American countries were also negatively affected by an exceptionally severe 1998 hurricane season. In addition to these factors, growth forecasts for 1998 also reflected the difficulties that some Latin American countries were likely to have in maintaining growth rates at their high 1997 levels owing to rapidly worsening external imbalances and/or decreases in idle production capacity. Argentina, Mexico, and Peru are examples of countries in which the particularly high growth rates posted in 1997 could probably not have been maintained in 1998 even if special international problems had not arisen.

The successive revisions of ECLAC growth forecasts for 1998 thus provide an approximate picture of the impact of the crisis on growth, especially since some of these factors had already been taken into account in forecasts prepared by ECLAC in September 1997, before the crisis struck the region. (See table VIII.2 for a comparison between those estimates and the ones prepared in March, September and December 1998.) Thus, although GDP is now estimated to have grown by 2.2% in 1998 (a drop of more than three percentage points with respect to 1997), it had already been expected to fall by one percentage point even before the international crisis became a factor. Thus, the crisis cut GDP growth in the region by another two points, while national income was further depressed by the worsening terms of trade.

In fact, the Latin American and Caribbean region as a whole did not record the negative growth rates registered by many Asian countries or by a number of individual countries in Latin America itself in 1995 (Argentina, Mexico and Uruguay). Indeed, many Caribbean countries actually registered higher growth rates in 1998.

Nevertheless, the combined effects of these external shocks and the domestic policies adopted to deal with international turbulence have had a high cost in terms of growth opportunities, employment and, in some cases, inflation. In point of fact the effect of the region's reduced growth rate on employment levels

Table VIII.2  
**PROJECTIONS FOR 1998 GDP PREPARED AT DIFFERENT STAGES**  
*(Variation with respect to 1997 at constant 1990 prices)*

	September 1997 (1)	March 1998 (2)	September 1998 (3)	December 1998 (4)	Difference (4) - (1)
Argentina	5.5	4.5	4.5	4.0	-1.5
Bolivia	5.0	4.5	4.5	4.5	-0.5
Brazil	3.5	1.1	1.1	0.5	-3.0
Chile	6.5	5.5	4.3	4.0	-2.5
Colombia	3.5	4.0	2.5	2.0	-1.5
Costa Rica	3.5	3.5	4.0	5.5	+2.0
Ecuador	3.5	2.5	1.7	1.0	-2.5
El Salvador	5.0	4.5	4.5	3.5	-1.5
Guatemala	3.5	5.0	4.0	4.5	+1.0
Honduras	4.5	4.5	4.5	3.0	-1.5
Mexico	5.0	5.0	4.1	4.5	-0.5
Nicaragua	4.0	4.5	4.5	3.5	-0.5
Panama	3.5	4.5	4.5	3.5	0.0
Paraguay	3.0	2.5	2.0	0.0	-3.0
Peru	4.5	4.5	3.1	1.0	-3.5
Dominican Republic	6.0	6.0	5.0	7.0	+1.0
Uruguay	4.5	3.0	3.0	2.5	-2.0
Venezuela	5.0	3.0	-1.0	-1.0	-6.0
<b>Regional average</b>	<b>4.4</b>	<b>3.2</b>	<b>2.6</b>	<b>2.3</b>	<b>-2.1</b>

Source: ECLAC.

started to become noticeable in the second half of 1998 and continued into the first quarter of 1999. Consequently, the slump has pushed many vulnerable groups below the poverty line. Indeed, the negative social repercussions of economic slumps are not only quick to manifest themselves, but also last for an extended period of time thereafter, making it even more difficult to solve the problems of social marginalization that characterize the region.

The balance-of-payments current account deficit has also widened as a result of the crisis. This came

about mainly because the value of exports fell for the first time in the decade, mostly owing to the decline in commodity prices. Imports also rose more slowly, but even so they continued to grow faster than exports. Again, other factors, especially El Niño, also played a part in the deterioration of the trade balance and the current account. For lack of a September 1997 (pre-crisis) forecast, table VIII.3 compares the actual results for 1997 with the latest forecast for 1998. This comparison indicates that the deficit widened from 3.3% to 4.1% of GDP (0.8 percentage points).

### 3. Lessons of the international crisis for Latin America and the Caribbean

The Asian crisis, its rapid spread to Russia and Latin America and the experience painfully gained in implementing international rescue packages has given rise to

a renewed debate on the design and coordination of financial and macroeconomic policy, at both international and country level. After presenting briefly the

Table VIII.3  
**PROJECTIONS FOR 1998 CURRENT-ACCOUNT DEFICIT PREPARED  
 AT DIFFERENT STAGES**  
*(As percentages of GDP)*

	Actual 1997 (1)	March 1998 (2)	September 1998 (3)	December 1998 (4)	Difference (4) - (1)
Argentina	-2.9	-3.8	-3.5	-3.6	-0.7
Bolivia	-9.1	-8.6	-10.2	-9.7	-0.6
Brazil	-4.3	-3.7	-3.8	-4.2	+0.1
Chile	-5.3	-6.2	-6.5	-6.7	-1.4
Colombia	-6.0	-4.7	-5.8	-6.5	-0.5
Costa Rica	-3.5	-6.1	-4.5	-3.6	-0.1
Ecuador	-3.8	-5.0	-6.3	-8.5	-4.7
El Salvador	+0.8	-2.3	-1.3	-1.8	-2.6
Guatemala	-3.1	-3.7	-2.9	-3.7	-0.6
Honduras	-4.0	+0.9	-2.0	-5.4	-1.4
Mexico	-1.8	-2.9	-3.6	-3.6	-1.8
Nicaragua	-40.3	-21.0	-22.6	-36.9	+3.4
Panama	-3.6	-4.3	-2.9	-6.7	-3.1
Paraguay	-6.5	-8.6	-9.4	-2.6	+3.9
Peru	-5.2	-5.6	-6.0	-6.4	-1.2
Dominican Republic	-1.5	-0.5	-0.8	-3.2	+1.7
Uruguay	-1.6	-2.1	-1.4	-2.1	-0.5
Venezuela	+5.4	+2.8	-0.5	-1.5	-6.9
<b>Regional average</b>	<b>-3.3</b>	<b>-3.5</b>	<b>-4.0</b>	<b>-4.1</b>	<b>-0.8</b>

Source: ECLAC.

major point of consensus regarding the need to reform the present international financial arrangements,<sup>2</sup> the section focuses the attention on the lessons for the conduct of national policies.

#### (a) Reforming the international financial architecture

The rapid spread of the crisis from South-East Asia to other countries—including developing, transition and industrialized economies—and the crucial role played by the international community in putting together contingency funds has given rise to a broad consensus on the need to strengthen international financial arrangements for coping with what is increasingly perceived as the inherent instability of capital flows.

In particular, a general agreement has emerged concerning two areas of action in which steps can be taken to improve the international response to crisis situations: (i) the importance of macroeconomic coordination among the G7 countries, in particular with a view towards more expansionary policies; and (ii) the need for increased contingency financing for countries in difficulties. The Brazilian crisis, in particular, has demonstrated the importance of being able to draw upon contingency funds before international reserves are depleted. Indeed, creating temporary special drawing rights (SDRs) when several countries are faced with financial difficulties would be the most flexible way to increase international liquidity in times of crisis. Yet there is still a debate as to the best ways of extending international liquidity, as well as about the conditionality of these funds.

2 For more detailed information, see ECLAC, "Towards a new international financial architecture: Report of the Task Force on Economic and Social Affairs of the United Nations" (LC/G.2054), March 1999. This publication outlines the position of the United Nations Secretariat on the prevention and management of financial crises.

A third area of action concerns the establishment of formal mechanisms to help affected countries in renegotiating or rescheduling their external debt service. These provisions would allow the introduction of internationally agreed standstill provisions into external lending.

Another area in which a consensus has emerged has to do with the steps that need to be taken to prevent financial crises. One way to advance in this direction is to improve information flows and adopt common minimum standards for financial regulation and supervision as well as principles of sound corporate governance.

### **(b) Adapting national policies**

The recurrence of capital-account liberalization experiments that have ended in balance-of-payments difficulties and the complexity of the factors at work in the Asian crisis are a reflection of the growing number of elements that tend to increase countries' external vulnerability in the current international context. Several lessons can be drawn from these experiences concerning the need to strengthen countries' capacity to respond to exogenous financial factors.

For purposes of analysis, these factors can be classified as macroeconomic variables, institutional aspects and elements relating to production structure and competitiveness. However, assigning responsibility to any one of these categories in isolation generally would not provide a satisfactory explanation of vulnerability and would not take into account the interrelationship among the various factors. In fact, the first important lesson to be learned from the Asian experience is that macroeconomic, institutional and competitiveness policies all need to be coordinated and should be consistent with one another.

#### *Macroeconomic variables*

In the macroeconomic area, there is a need to examine the policies that precede a crisis. In both the Asian and the Latin American cases, policy management in periods of economic expansion has had a considerable influence on subsequent difficulties. In the 1980s, countries in Latin America began to be confronted with abrupt changes in external capital flows, in addition to the usual fluctuations in commodity export earnings. This accentuated the influence exerted by external factors in terms of the sharp changes in output levels characteristic of most developing countries.

As a result of the liberalization of trade and financial flows in a context of uncompleted fiscal reforms,

national economic policies became strongly procyclical. During periods of expansion, and with the encouragement of creditors, external flows were channelled into a rapid upswing in both public and private spending. These external flows also led many economic agents into lower saving rates and overindebtedness. Later on, mounting debts and deteriorating current accounts eventually prompted foreign banks to withdraw their loans as country risk indicators worsened. At that point tight fiscal and monetary policies became necessary in order to boost the confidence of international investors and mitigate the downturn in capital inflows. An additional objective of these policies was to keep domestic inflation under control.

To avoid this boom-and-bust cycle, it would therefore seem desirable to adopt fiscal and monetary policies designed to even out spending over time. During periods of expansion, it is possible to exercise greater selectivity with regard to kinds and amounts of capital flows and to levy temporary taxes to discourage private spending. Such measures can act as a brake on private spending booms in periods when there is a surge in external inflows, and vice versa. Moreover, instead of setting fiscal goals on the basis of the current deficit, policy makers might use a structural deficit indicator, as OECD countries do. This approach preferably entails sterilizing the transitory tax revenues characteristic of expansionary periods and setting up stabilization funds in hard currencies to manage the less stable types of fiscal revenues. Many countries may also find it beneficial to offset short-term trends in private spending (both expansionary and contractionary), either in whole or in part, through compensatory changes in public expenditure or revenue. Such an approach to the management of public finances would be beneficial under both free-floating and fixed exchange-rate regimes. In the first case, it would provide a mean of avoiding sharp swings in the exchange rate; in the second, it would help to smooth out the effects of the strong procyclical bias of such a regime.

In the area of macroeconomic management, short-term approaches must give way to a medium- or long-term perspective. As the Asian crisis has shown, in order to assess the dynamic equilibrium of the balance of payments, trends in five areas must be examined jointly: exports, imports, foreign capital, real exchange rate and reserves. When changes in the trends of any of these variables give rise to a significant deficit in the current account, it is vital to assess the sustainability of that deficit. A relevant example would be a case in which imports are growing faster than exports and the resulting imbalance is systematically sus-



tained by the inflow of capital; this type of situation proved to be the prelude to crisis in both Latin America and Asia. In the internal counterpart of this disequilibrium, the main factors involved are public and private spending and the behaviour of the banking sector. In this and other cases, vulnerability—and especially the opinion in that regard formed by important external agents—is linked to the level and fluctuation of reserves. In addition, any assessment concerning the entry of capital must take into consideration the purposes for which such capital is intended and, in particular, whether it is being invested in export sectors or is strengthening competitiveness in the production of tradable goods.

Measures can also be introduced to give monetary policy greater autonomy. One such measure is the use of mechanisms to discourage excessive inflows of short-term capital, such as the reserve requirements imposed in Chile and Colombia, and variable taxes on financial movements in Brazil. There is a growing consensus that, despite their flaws, such mechanisms play a positive role in discouraging excessive inflows and decreasing the proportion of short-term flows. The latter action, in particular, makes a country less vulnerable to exchange crises. Discouraging excessive capital inflows, moreover, helps lessen pressure for an overvaluation of the local currency; this, in turn, will help to maintain export competitiveness and dynamism and to control the size of the current account deficit.

#### *Institutional aspects*

In the institutional sphere, Latin America has made progress towards strengthening the extremely weak banking situation system which was the legacy of the 1980s and 1994-1995 crises, and of the lack of prudential regulation. In several countries, including Brazil, this has involved the reform of State banks and intervention in some private banks. Other countries, such as Argentina, have chosen to consolidate and recapitalize their banking system, and, as part of this approach, have permitted a higher proportion of foreign banks to operate in the country. There has also been an increasing awareness of the need to ensure that bank portfolios do not present serious risks of insolvency. Nevertheless, much still remains to be achieved. These reforms now require new capital investment and, in many cases, public resources. Furthermore, in order to be successful these policies need to be backed up by appropriate legislation and budgetary resources.

There is also a broad consensus concerning the need to strengthen the prudential regulation of banks.

Among other measures, a much higher capital-to-assets ratio should be required for banks than is recommended by the Basle Committee on Banking Supervision, since currency crises in Latin American countries can be particularly detrimental to bank assets. In any case, as the Asian crisis again demonstrates, in the developing countries financial openness should be strictly conditional upon the prior existence of strong prudential regulation. The policies that are established in this area must be in keeping with, a medium- and long-term macroeconomic vision. Prudential policy, and especially the rating of bank portfolios, should be based on a broad range of asset prices rather than solely on current prices (in particular the exchange rate), since the latter can be influenced by cyclical factors, such as inflows of short-term external credits.

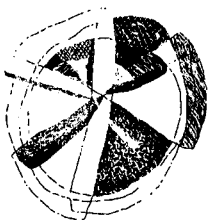
#### *Production and competitiveness*

An analysis of the crisis and prospects in Asia as they relate to the issues of changing production patterns and competitiveness is of special interest. Such an examination sheds light on the rapid changes that are occurring in international markets for goods and non-financial services and permits an evaluation of Latin American external trade from that standpoint. For example, the entry of countries such as China and India into the market for certain types of manufactures may seriously affect prices and limit small countries' market access because of the huge production potential of continent-sized countries. On the other hand, the sharp fall in prices on semi-conductor markets is an example of how manufactures have become subject to price fluctuations that used to be considered more typical of raw materials.

While an analysis of the Asian crisis as such is more useful for understanding markets for certain types of manufactures, the way the crisis has spread to Latin America holds lessons with respect to the more traditional types of commodities. Specifically, the latter underscores the need for the countries of Latin America and the Caribbean to continue promoting export diversification. The impact of the crisis via the fall in commodity prices, especially for oil and copper, underscores the continued dangers of specialization in these products. Moreover, the degree of expansion and diversification of exports achieved thus far by a number of countries in the region cannot always be considered self-sustaining. Continuous monitoring of competitiveness and of the evolution of external markets, including their possible saturation, is essential.

## Second part

### Countries





## Argentina

### 1. General trends

Economic activity slowed in 1998, although average growth for the year, at slightly over 4%,<sup>1</sup> was still enough to generate an increase in employment. Output growth was concentrated in the first half of the year, after which there was a marked turnaround that lasted into the early months of 1999. The weakness of external demand throughout 1998 led to a fall in the value of exports (notwithstanding an increase in total volume), while imports increased, albeit more slowly than in 1997. Capital inflows exceeded previous highs, despite wide fluctuations in foreign credit supplies. Government revenues grew less than originally anticipated; nevertheless, public-sector borrowing requirement declined to around 1% of gross domestic product (GDP). Prices rose only slightly (0.7%), continuing the pattern of recent years.

**I**N THE FIRST half of 1998, instability on the international scene particularly affected export prices. Interest rates fell, however, and recently imposed restrictions on financing did not do much to restrain the expansion of domestic demand. Thus, against a background of massive capital inflows, GDP grew by more than 7% in the first half of 1998 with respect to the same period in 1997, and investment rose sharply. At the same time, significant job creation outpaced the growth of labour supply.

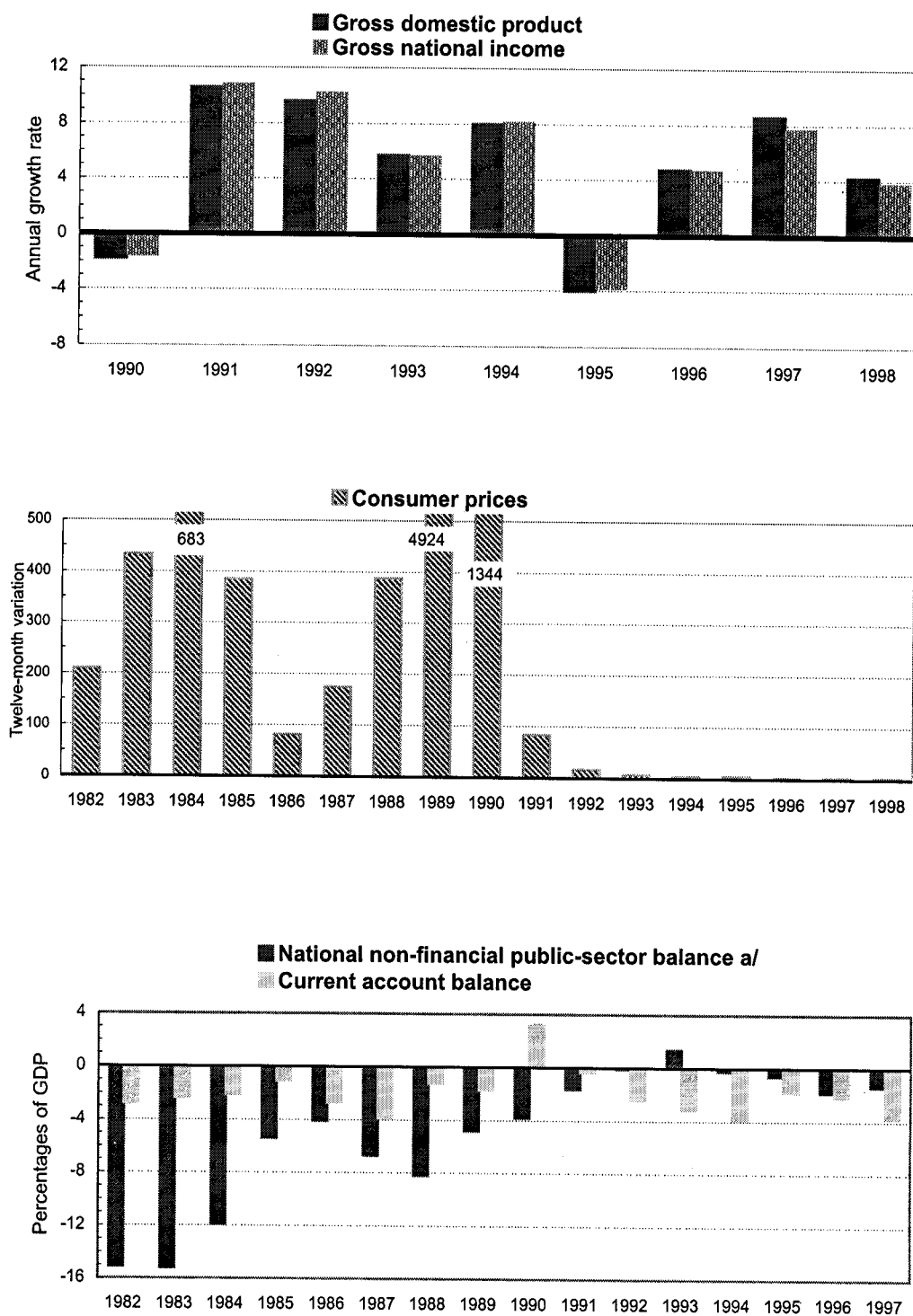
In these circumstances, the financial upheaval in Russia had a marked impact on security prices and interest rates. In sharp contrast to a similar episode some years earlier, however, the volume of bank deposits continued to grow, thanks in part to measures the Government had been taking to strengthen the financial system. Moreover, there was no pressure on international reserves despite a shift of demand towards dollar-denominated assets. The effect on asset prices abated relatively quickly, and by the end of 1998, interest rates—on loans to blue-chip companies, for example—had returned to levels comparable to those of the previous year.

At any rate, the pace of bank lending eased, and there were signs of greater caution in both the supply of and the demand for credit; this was reflected in the goods and services markets. By the third quarter, activity had already begun to slow down, and this trend was accentuated during the final months of the year. In the fourth quarter, aggregate production and all major components of demand were posting lower values than in the same period in 1997.

The prospect of instability in the Brazilian economy was a source of concern in 1998. Apart from the potential impact on Argentina's financial markets, the importance of Brazil in Argentina's trade makes direct transmission of negative macroeconomic shocks a real possibility. Following the depreciation of the Brazilian real in January 1999, imports into Argentina, including those from Brazil, continued to decline, and exports fell sharply. As a result, a substantial trade deficit persisted despite the slowdown in activity. The substantial fluctuations in trade in goods within the Southern Common Market (Mercosur) raised questions as to how well this trade area actually worked; nonetheless, the authorities

<sup>1</sup> The National Accounts figures used in this text represent estimates based on 1986 prices. After the writing of this document, new estimates were made available using 1993 as the base year. According to these figures, GDP at constant prices grew by 3.9% in 1998.

Figure 1  
ARGENTINA: MAIN ECONOMIC INDICATORS



Source: ECLAC, on the basis of official figures.

<sup>a</sup> Does not include provinces or municipalities.

continued to stress the need for the integration project it represents.

Although the financial repercussions of the Brazilian devaluation were significant during the initial months of 1999, they were less intense than in other recent episodes of this type. Stock and bond prices dropped suddenly, and interest rates rose. Nevertheless, these effects were not as serious as those that followed the Russian crisis, and they tended to fade over time. Having stayed out of the market for several weeks, the Government started to issue debt again. By mid-April, both credit terms—reflected by interest rates on bank loans to large companies—and yields on bonds were lower than before the Brazilian devaluation. The recovery of the supply of funds seems to have been the result of optimism on the part of asset-holders (which in turn had tempered the increase in premiums charged for the risk implicit in Argentine securities), together with a regional effect arising from improved prospects for Brazil. Asset markets remained unstable, however.

In the first quarter of 1999, weakness in exports and domestic spending worked together to prolong the recession, and GDP contracted by nearly 3%; however, the absence of major disruptions on financial markets helped to moderate the extension of the slowdown. Nevertheless, major external-financing requirements, even at a time of sluggish activity, focused attention on the likely course of foreign trade, the performance of international prices and demand from Brazil. During the early months of 1999, several sectors encountered difficulties, and this put pressure on economic policy at a time when it looked like the fiscal targets for the year might not be met, and an election campaign was approaching. In April, the Government renegotiated the targets established in the agreement with the International Monetary Fund (IMF), based on a revised set of projections, including a 1.5% drop in output for 1999. A ceiling of 1.6% of GDP was established for the national public-sector deficit, as opposed to the 1% limit set originally, and spending cuts were ordered. The distribution of budget cuts among the different areas of government led to some controversy, particularly in sectors such as education.

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## 2. Economic policy

In February 1998, the Government signed a multi-year extended facility agreement with the IMF, which it had been negotiating since 1997. However, the Government announced that it did not plan to use IMF resources except for unforeseen expenses. The macroeconomic targets for the year included reducing the national public-sector deficit to just above 1% of GDP; in addition, a number of reform measures were envisaged especially in the areas of taxation and labour, with a view to reducing labour costs. The trade deficit was expected to be similar to that of 1997.

The robust expansion of output in the first half of the year was reflected in public revenues, and government financing needs fell within the anticipated range. At the same time, imports rose sharply, and the trade deficit exceeded the projected values. Other than keeping fiscal accounts strictly in order, the Government did not consider it necessary to take measures aimed specifically at restraining demand. Following the impact of the Russian crisis, the authorities focused on sending

signals designed to minimize contagion and differentiate Argentina from economies that were in difficulties, so as to attract a greater supply of financing from abroad. As regards debt-management policy, the fact that the Government had placed issues in advance meant that it did not need to issue paper when the demand for securities declined, and could make bond placements again once the financial turbulence had calmed down. At any rate, the weakening of economic activity did affect fiscal policy, and second-semester tax revenues remained unchanged in respect of the same period in 1997. The Government cut back on outlays, and the primary expenditure outturn was below the limits set in the extended facility agreement. Despite this, the cumulative national public-sector deficit for the year exceeded the target by about 0.2% of GDP; however, this was accepted by the International Monetary Fund.

During 1998, the authorities proposed significant reforms to the tax system. These reforms were intended

Table 1  
**ARGENTINA: MAIN ECONOMIC INDICATORS**

	1990	1991	1992	1993	1994	1995	1996	1997	1998 <sup>a</sup>
<b>Annual growth rates<sup>b</sup></b>									
Growth and investment									
Gross domestic product	-1.8	10.6	9.6	5.7	8.0	-4.0	4.8	8.6	4.2
Per capita gross domestic product	-3.2	9.1	8.1	4.3	6.6	-5.3	3.4	7.2	2.9
Gross domestic product, by sector									
Goods	-3.1	10.6	10.0	5.4	6.5	-3.7	4.6	10.0	4.2
Basic services	-0.2	8.1	11.3	6.9	9.1	1.9	6.4	7.0	6.4
Other services <sup>c</sup>	-1.9	9.9	7.6	5.6	8.8	-3.3	4.4	6.8	5.1
Total consumption <sup>c</sup>	-1.6	14.8	13.2	5.3	6.7	-5.8	6.1	7.8	3.9
Domestic fixed investment	-16.9	29.9	32.6	15.3	20.7	-16.0	8.8	26.5	7.3
Exports of goods and services	18.0	-3.6	-1.0	4.7	15.9	22.3	6.7	12.1	7.0
Imports of goods and services	-1.9	80.1	65.7	14.9	22.6	-11.6	18.2	27.6	8.2
<b>Percentages of GDP<sup>d</sup></b>									
Gross national income	97.5	98.3	99.5	99.3	99.2	98.5	98.8	98.6	97.6
Gross domestic investment	11.9	14.1	17.1	18.7	20.8	18.0	18.8	22.0	22.5
National savings	14.4	13.7	14.5	14.9	16.3	16.1	16.4	17.6	17.2
External savings	-2.5	0.4	2.7	3.8	4.5	1.9	2.4	4.4	5.4
<b>Percentages</b>									
Employment and wages									
Labour force participation rate <sup>e</sup>	39.1	39.5	40.0	41.3	41.0	42.0	41.5	42.2	42.2
Open unemployment rate <sup>f</sup>	7.4	6.5	7.0	9.6	11.5	17.5	17.2	14.9	12.9
Real average wage (index: 1995 = 100) <sup>g</sup>	99.1	100.4	101.7	100.4	101.1	100.0	99.8	99.3	98.2
<b>Growth rates</b>									
Prices (December-December)									
Consumer prices	1 344	84.0	17.6	7.4	3.9	1.6	0.1	0.3	0.7
Wholesale prices	798	56.7	3.2	0.1	5.8	6.0	2.1	-0.9	-6.3
<b>External sector</b>									
Terms of trade (index: 1995=100) <sup>d</sup>	94.3	103.9	102.6	106.0	106.1	100.0	108.5	108.9	103.9
Nominal exchange rate (pesos per dollar)	0.5	1.0	1.0	1.0	1.0	1.0	1.0	1.0	1.0
Real effective exchange rate for imports (index: 1995=100)	163.9	116.3	103.0	94.4	93.8	100.0	101.9	98.9	96.8
<b>Millions of dollars</b>									
Balance of payments									
Current account	4 552	-647	-5 488	-8 003	-10 949	-4 938	-6 468	-12 036	-14 730
Trade balance (goods and services)	7 954	2 820	-3 859	-5 585	-7 831	-969	-1 606	-6 301	-7 504
Exports	14 800	14 386	15 418	16 457	19 451	25 016	28 471	30 940	30 822
Imports	6 846	11 566	19 277	22 042	27 282	25 985	30 077	37 241	38 326
Capital and financial accounts <sup>h</sup>	-5 169	-159	8 631	11 039	11 171	2 920	9 984	15 342	18 822
Overall balance	-617	-806	3 143	3 036	222	-2 018	3 516	3 306	4 092
Variation in reserve assets (- indicates an increase)	-3 121	-2 040	-3 274	-4 250	-682	102	-3 882	-3 273	-3 438
<b>Percentages</b>									
Enxternal debt									
Gross debt (as a percentage of GDP)	...	32.3	27.4	28.0	30.4	35.2	36.9	38.4	42.1
Net interest (as a percentage of exports) <sup>i</sup>	25.4	24.0	9.4	9.0	8.9	9.7	11.4	13.3	16.5

Table 1 (concluded)

	1990	1991	1992	1993	1994	1995	1996	1997	1998 <sup>a</sup>
<b>Percentages of GDP</b>									
Non-financial public sector									
Current revenue <sup>j</sup>	13.3	15.0	17.4	19.8	17.7	17.4	15.8	17.0	16.5
Current expenditure	15.4	16.2	16.8	17.2	16.9	17.3	16.6	17.4	16.7
Saving	-2.1	-1.2	0.6	2.6	0.9	0.1	-0.8	-0.4	-0.2
Capital expenditure (net)	1.7	0.4	0.7	1.2	1.1	0.7	0.9	1.0	1.0
Financial balance	-3.8	-1.6	-0.1	1.4	-0.2	-0.6	-1.8	-1.4	-1.2
<b>Growth rates</b>									
Money and credit									
Monetary balances of banking system									
Net domestic credit	230	152	15.0	33.8	27.6	5.6	11.7	20.4	15.1
To public sector	220	56	-21.6	-61.2	-9.6	112.8	17.0	-6.0	16.4
To private sector	735	112	53.5	23.7	8.8	-0.6	9.4	17.0	12.0
Money (M1)	1 071	144	51.5	34.0	13.4	1.7	10.6	14.6	2.0
Local currency savings and time deposits	809	65	73.9	51.3	9.1	-10.5	19.3	36.2	14.1
M2	1 803	104	60.7	41.7	11.4	-4.0	14.4	24.4	8.0
Dollar deposits	473	269	64.6	60.7	25.6	-0.4	23.0	24.0	20.4
<b>Annual rates</b>									
Real interest rate (annualized)									
Deposit rate	-25.2	-10.4	-3.8	3.4	4.3	10.6	7.6	6.5	6.9
Lending rate	81.9	43.6	12.5	14.3	17.2	23.5	19.5	13.5	13.4
Equivalent interest rate in foreign currency <sup>k</sup>	138.0	-8.8	13.1	10.1	8.2	12.4	7.6	7.0	7.9

Source: ECLAC, on the basis of official figures.

<sup>a</sup> Preliminary figures. <sup>b</sup> Based on constant 1986 pesos. <sup>c</sup> Includes changes in stocks. <sup>d</sup> Based on constant 1995 dollars. <sup>e</sup> Percentages of the total population; urban areas. <sup>f</sup> Percentages of the economically active population (EAP); urban areas. <sup>g</sup> Refers to manufacturing industry. <sup>h</sup> Capital pending classification according to the methodology used in the fifth edition of the *Balance of Payments Manual*. Includes the banking sector and the non-financial public and private sectors. Includes errors and omissions. <sup>i</sup> Refers to net interest as shown on the balance of payments, divided by exports of goods and services. <sup>j</sup> Includes the national administration, the national social security system and public-sector enterprises. Relates to final budget figures. <sup>k</sup> Interest rate on deposits, deflated by the variation in the exchange rate.

to reallocate the tax burden, rather than to adjust aggregate revenue or change the distribution between the national and provincial jurisdictions. Among other measures, the executive branch was empowered to reduce certain social security taxes in 1999, and the value added tax (VAT) was extended to activities that formerly had been exempt. Under the reforms the maximum tax on profits was raised from 33% to 35%, and regulations were drawn up to govern the taxation of incomes earned abroad and the monitoring of transfer prices. In addition, a tax was established on "minimum assumed income", estimated as a percentage of assets. Interest paid by firms was also taxed, in order to level the playing field between financing with debt and with internally generated funds. Apart from these reforms, the system for sharing tax revenue between the national and provincial levels was also modified.

In recent years, there has been much discussion about the labour market regime. In 1998, legislation was passed slightly lowering redundancy payments and abolishing several types of previously authorized contracts. Following approval of the new rules, which were supported by the unions but criticized by employer groups, debate ensued regarding the rules by which the labour market operated. In addition to this, in early 1999 reforms in the social security regime were proposed.

#### (a) Fiscal policy

The national non-financial public-sector deficit dropped in 1998 to slightly under 1.2% of GDP, while at the provincial level, it amounted to 0.5% of GDP. The shrinking of the deficit nationally was due to the



Table 2  
**ARGENTINA: MAIN QUARTERLY INDICATORS**

	1996				1997 <sup>a</sup>				1998 <sup>a</sup>				1999 <sup>a</sup>
	I	II	III	IV	I	II	III	IV	I	II	III	IV	I
Gross domestic product (change from same quarter of preceding year)	- 3.2	4.8	6.7	8.8	8.2	8.2	9.0	8.2	7.2	7.4	3.2	-0.5	-3.0
Consumer prices (12-month variation, %)	0.4	- 0.0	0.2	-0.0	0.9	0.8	0.6	0.4	0.8	1.1	1.1	0.7	-0.7
Exports (millions of dollars)	4 738	6 606	6 439	6 029	5 774	7 205	6 903	6 335	5 889	7 670	7 031	5 854	5 067
Imports (millions of dollars)	4 986	5 726	6 579	6 471	6 493	7 520	8 195	8 242	7 535	8 214	8 430	7 226	5 823
Real effective exchange rate <sup>b</sup> (index: 1995=100)	101.2	102.2	102.6	101.5	99.4	99.6	98.1	98.5	96.6	96.7	95.7	98.1	90.7
Real interest rates (annualized, %)													
Deposit rate	10.1	7.4	5.3	7.6	6.7	5.9	5.5	7.8	6.9	6.2	7.5	7.9	6.7
Lending rate	30.9	18.2	14.0	14.9	13.5	13.3	13.3	14.0	13.4	12.7	12.8	14.9	16.9

Source: ECLAC, on the basis of official figures.

<sup>a</sup> Preliminary figures. <sup>b</sup> Refers to exchange rate for imports.

moderate trend of outlays, which decreased as a proportion of output; the only category of current expenditure to grow more than GDP was that of interest payments. Payroll expenses, on the other hand, went down in nominal terms, while transfers from the national security system rose, albeit marginally. Other transfers (including remittances to provinces under revenue-sharing arrangements) amounted to 7.6% of GDP, while capital expenditure by the national public sector as a whole remained at just 1.1% of GDP.

National Government tax revenues rose by 3.6%, while the tax burden fell to 15.5% of GDP. Revenue from the main taxes increased slightly, or, in some cases, declined in nominal terms, except for taxes on income and personal assets, which continued their upward trend. Combined receipts from the two taxes rose by slightly over 16%, while VAT revenues grew by just under 2%, or less than GDP. Receipts from social security taxes were down, owing partly to the fact that an increasing number of people transferred their contributions to individual retirement accounts in the private sector. The drop in revenues from social security taxes continued into the first quarter of 1999, compounding the effects of lower receipts from VAT and

from taxes on foreign trade. Despite the fall in revenues, the size of the national public-sector deficit in that period was still within the target range agreed with the International Monetary Fund, thanks partly to the inclusion of non-tax income arising from the sale of shares in Yacimientos Petrolíferos Fiscales (YPF).

The National Government debt at the end of 1998 rose to nearly 33% of GDP, which was considerably higher than the fiscal deficit for the year, partly because the Government issued paper to secure advance financing for the subsequent period, and other issues were made in order to consolidate unsecuritized liabilities. In 1998, securities totalling US\$ 11.7 billion were placed on the international market, at terms ranging between three and 30 years. As regards privatization, the operation of the airports system was handed over in concession, and ownership of the Banco Hipotecario Nacional was partly privatized. The Government also sold part of its remaining stake in YPF, and in early May 1999, a Spanish firm, which already had a substantial share in the company, made a public bid for a controlling interest. Policies aimed at protecting competition and regulating privatized public utilities were also issues under discussion during the period.

### (b) Monetary policy and financial markets

The financial liabilities of the Central Bank of the Argentine Republic grew by nearly 10% in 1998; this was closely in line with the expansion of foreign currency holdings. The growth of international reserves was evidence of the absence of significant pressures on the existing monetary framework, even in times of considerable tension in financial markets, such as that of the third quarter. Part of the increase in foreign assets held by the Central Bank resulted from banks having deposited funds which they had been holding abroad, in order to comply with liquidity requirements. In any event, the reserves of the financial system as a whole rose. In addition, the Central Bank broadened its contingency credit arrangements with foreign banks, so as to have liquid resources available in case of emergency.

The monetary aggregate M3, which includes both peso- and dollar-denominated assets, grew by 13% in 1998—more slowly than in the two preceding years. Growth was rapid during the first semester and again in the final months of the year, but the third quarter was sluggish owing to the disturbance generated by the crisis in Russia. This shock made itself felt particularly in peso-denominated assets: M2 fell by over 6% in the third quarter, although it recovered considerably (8%) in the fourth quarter. Taking the year as a whole, peso-denominated monetary assets grew by about 7%, with the increase concentrated mainly in interest-bearing deposits (14%), while the medium of payment in private-sector hands grew slightly (1.8%) in

keeping with the slowdown of output. Once again the demand for deposits was biased towards those denominated in dollars, which grew by more than 20%, thus taking their share of M3 to nearly 49%. Meanwhile, financial system credit to the private sector rose by nearly 12%, with peso- and dollar-denominated loans growing at similar rates.

The number of financial institutions continued to decline as a result of mergers and closures; in addition, several provincial banks were privatized. Some medium-sized banks experienced serious problems, and had to suspend operations. Nevertheless, this situation did not lead to mistrust of the overall financial system. Indicators of bank portfolio quality improved up to the third quarter of 1998; towards the end of that period, there was evidence of a rise in arrears indicators, consistent with the slowdown of activity.

Bank interest rates fell in the first seven months of 1998, following the upturn caused by the Asian crisis. The Russian episode led to an abrupt rise in all rates, together with a widening of the spreads between peso and dollar yields and between deposit and lending rates. The easing of tensions on financial markets in the final months of 1998 was reflected in lower interest rates (as well as in a narrowing of the difference between dollar and peso yields), although they failed to regain their pre-disturbance levels. The pattern of response to the Brazilian crisis was similar to that noted with the earlier shocks: a sharp initial rise in rates was followed by a substantial drop.

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## 3. The main variables

### (a) Economic activity

A GDP growth of 4.2% in 1998 further extended an upswing during which the economy grew by 18.5% with respect to the low of 1995, and by 13.8% compared to the previous peak. In 1998, the fall in the terms of trade, together with significantly higher factor payments abroad, limited national income growth to around 2.5%.

The expansion of aggregate demand was based on a fairly uniform increase in its constituent parts. Domestic spending was up by just over 4.5%, and consumption rose by slightly less than GDP; as a result, the domestic saving ratio went up again, although it remained below 17.5%. Fixed investment growth slowed

down considerably, although it still easily surpassed the expansion of GDP. As a result, the rate of capital formation, at nearly 25%, was the highest it had been since the early 1980s. Although on average, construction grew significantly over the year, the use of machinery and equipment, especially imported items, once again represented the most dynamic segment of investment. The increase in investment easily outpaced the growth of domestic savings; hence, the physical balance of trade was increasingly negative. This meant that the volume of imports increased, despite an overall slowdown. Despite this unfavourable situation on the international scene, total exports rose again, continuing the upward trend of recent years.

In 1998, the goods and services sectors grew at similar rates (somewhat over 4%). In the goods sector, the expansion of agricultural output, at nearly 11% for the year, was outstanding. The 1997/1998 grain harvest was very large, up by 24% with respect to the previous season, which had already set an all-time record. This result was achieved thanks to decisions on planting and inputs that were taken while international prices were still comparatively favourable, and to management techniques and practices that have been applied in recent years. Conditions for the 1998/1999 season were clearly less propitious than those of the preceding year, and a harvest of 61 million tons is expected; this figure is 6.5% lower than in 1997/1998, but still higher than any previous harvest. As regards livestock, cattle herds were maintained at around 50 million head in 1998, although the number of animals slaughtered declined considerably.

Mining production, which had been growing rapidly slowed down. Oil and gas extraction rose by about 2%, compared to more than 6% in 1997. In previous years, a number of metal mining projects had been growing strongly, but their profitability was hit by the fall in international prices.

Manufacturing output grew by approximately 1.5% in 1998, considerably less than in 1997, owing to the slowdown in the final months of the year. By the middle of the period, industrial firms were already seeing signs of weaker demand, and there were indications of inventory accumulation. This downward trend was particularly marked in sectors where demand responds elastically to changes in aggregate income and borrowing conditions. Such is the case of automobile production (also affected by weak demand in Brazil), which fell by 30% in the fourth quarter with respect to the same period in 1997. There were also considerable drops in other metallurgical and engineering products, and the negative trend persisted into the early months of 1999.

## **(b) Prices, wages and employment**

Prices remained stable throughout 1998, with the rise in the consumer price index (CPI) staying comfortably below 1%, despite being slightly up on the preceding two years. The marginal upturn in the index was mainly due to a small rise in prices of goods, in contrast to the deflation of the preceding biennium. Food prices in general rose by 0.3%, reflecting a 3.5% increase in meat prices. Public utility prices rose more slowly (0.6%) than in 1997 (5%), when increases occurred in transport and, especially, in telecommunications. Despite increases in segments such as tourism and leisure,

price fluctuations for sundry services as a whole did not exceed 0.8%. From mid-1998 on, there was a clear drop in the general level of prices; between July 1998 and April 1999, the variation in the CPI was either zero or negative every month except one, and the cumulative annual decrease up to April amounted to 0.7%.

Lower international prices had repercussions on domestic wholesale prices, the general level of which dropped by more than 6% during 1998. The fall was across the board, including locally produced non-agricultural goods, imports and agricultural products.

The very slow rise in domestic prices in recent years, below international levels, allowed the real exchange rate to rise against the dollar, but not against the currency basket comprising Argentina's main trading partners. Given the importance of Brazil in Argentina's trade, the sharp devaluation of that country's currency in early 1999 caused the real exchange rate to fall to comparatively low levels.

In October 1998, the unemployment rate stood at 12.4%, 1.3 points below the previous year's figure, but still higher than before the crisis of the mid-1990s. Rapid job creation continued in the first half of 1998; in May, the number of employed people in urban areas was growing at an annual rate of over 6.5%, a figure that was consistent with the growth in output. However, the absorption of manpower slowed down in the second half of the year; in October, the employment rate was the same as in May (following a drop in August), and the economically active population declined relative to the population as a whole.

Employment in private enterprise in Greater Buenos Aires increased slightly during 1998; however, towards the end of the year, the number of hours worked was lower than it had been a year earlier. Hirings basically occurred mainly in services, whereas the demand for labour fell in the manufacturing industry and construction. Once again, labour turnover was rapid; this was especially true in trial-period and fixed-term contracts, but turnover was also significant under the more traditional hiring modalities. With some variations, the share of jobs covered by indefinite contracts in surveyed firms in 1998 (about 87% on average for the period) held steady, although the figure was lower than it had been a couple of years earlier. In the early months of 1999, demand for labour weakened and, in March, employment in surveyed firms was down by 0.8% with respect to March 1998. This drop was especially noticeable in industry, although it also affected certain segments and firms in the service sector —financial services, for example.

Manual wages in manufacturing industry were somewhat lower in 1998 than in 1997 (when they had been virtually unchanged from 1995). There was a slight fall in real wages, but this overall figure probably covers a wide range of situations, since rapid turnover in hirings may have led to a high frequency of wage re-negotiation.

### (c) The external sector

The current account deficit increased again in 1998, to approximately 4.5% of GDP. Despite ups and downs in international conditions and in the domestic macroeconomic context, the negative balance was of similar magnitude in both halves of the year. The deficit for the year as a whole came mainly from merchandise trade and factor payments, with the deficit attributable to real services varying only slightly.

Interest payments grew to more than US\$ 10.1 billion; of this amount, US\$ 550 million arose from higher charges on the non-financial public sector, with the private sector accounting for a similar amount, and the rest corresponding to debts of financial institutions. The increase in interest payments was partly offset by higher interest income received by the Central Bank and other financial institutions. Incomes earned abroad by the non-financial private sector remained stable at about US\$ 2.5 billion, while the negative balance for profits and dividends increased.

Net capital inflows in 1998 amounted to over US\$ 17 billion, and despite occasional upheavals in the credit market during the second semester, net external financing in that period topped US\$ 10 billion. As a result, international reserves grew by US\$ 3.4 billion during the year, with increases in every quarter except the first (reflecting the seasonality of the demand for money). Capital movements relating to privatization operations were again relatively small in 1998. The non-financial public sector received net credit from abroad (excluding international organizations) in amounts similar to those of 1997. International organizations again generated a positive flow of net financing, in larger amounts than in 1997, with the increase coming from an expansion of loans from the World Bank (IBRD) and the Inter-American Development Bank (IDB); the IMF made no disbursements during the year but received loan repayments.

Capital flows in the foreign direct investment category were down from the two preceding years, although they still accounted for over 30% of the net inflow of funds. External operations of the banking system resulted in a net inflow, in contrast to 1997, and fi-

nanacial transactions of the non-financial private sector as a whole gave rise to net external financing that was also considerably lower than in 1997. Despite slipping in the fourth quarter, securities issues for the year amounted to US\$ 6.9 billion, but a high maturity rate caused the balance to decline.

The gross financial external debt amounted to just over 40% of GDP, which was equivalent to 5.3 times the value of exports of goods; the rise in this coefficient reversed the decrease that had been accumulated since 1994. The 1998 increase in the external debt arose from higher liabilities in both the public and private sectors. Just under 10% of total public-sector external debt outstanding at the end of 1998 is set to expire in 1999.

Following several years of rapid growth, the value of merchandise exports fell back in 1998, in contrast to an 11% increase in 1997 and an average growth of nearly 20% per year between 1993 and 1997. This was due to the fall in international prices, which affected the competitiveness of local production; the situation was aggravated by the devaluation of the Brazilian currency in early 1999.

During the first half of 1998, export values were higher than in the same period the year before; this was followed by a fall in the second semester, which became steeper in the first quarter of 1999 (when the year-on-year decrease stood at over 18%). The value of agricultural exports posted a small rise in 1998, despite a sizeable drop in prices. This increase was due to strong growth in sales of oil and oil-seed products, a significant expansion in the supply of grains and a relatively less negative trend in prices. Apart from this, larger grain shipments made up for lower prices. There was a sharp decrease in exports of animal origin, including meats (despite improved supply conditions arising from the eradication of foot-and-mouth disease), along with hides and wool. Fish exports declined by 13.5% to a level similar to that of three years earlier. The increase in the fish catch in recent years had led to an over-exploitation of fish stocks, giving rise to closed seasons being declared on certain species. Fuel exports plunged by nearly 29%, owing to weak international markets; sales of non-traditional products (mainly manufactures from outside the Pampas region) increased slightly, and accounted for 40% of the total. In this group, automobile sales rose sharply, to US\$ 3 billion, nearly double the figure of two years earlier. These exports went mainly to Brazil, and were affected by the contraction in that market in the early months of 1999. Other non-traditional manufactured exports fell back in 1998, although performance varied between products.

The growth of merchandise imports decelerated in 1998 in terms of volume, although such imports again grew quicker than GDP. Since prices were considerably lower, import values only rose by a little over 3%. Once again, the largest increases were in final products, both consumer goods (7.5%) and capital goods (9.3%), although in both cases the variation was considerably less than in 1997. Meanwhile, lower prices contributed to a slight reduction in the value of imports of intermediate goods. In early 1999, imports fell steeply and across-the-board, with the cumulative figures for January to March showing a drop of 22% with respect to a year earlier.

Broadly speaking, the geographical direction of trade in 1998 was similar to that of the year before. Brazil's importance as an export destination decreased slightly, although it still accounted for over 30% of total exports. Once again Mercosur as a whole accounted for nearly 36% of exports and 25% of imports. Exports to the European Union recovered somewhat, and imports from that region accounted for nearly a quarter of Argentina's total imports. In keeping with the recent pattern, the United States provided a larger share of Argentina's imports (19.4%) than its exports (8%).

## Bolivia

### 1. General trends

In 1998 the Bolivian economy grew by 4.7% in a context of relative price stability: inflation, at 4.4%, was the lowest since the beginning of the 1970s. On the other hand, for the second year running there was an increase in both the external and the fiscal deficits, which were financed largely by external resources. In keeping with the pattern of recent years, investment stood out as the driving force behind economic growth, and it expanded to 23% of gross domestic product (GDP), thanks especially to private investment from abroad relating to the privatization of State-owned enterprises. The growth of the external deficit was partly due to a drop in prices of Bolivia's main export products in the wake of the international crisis. Imports also increased significantly, however, especially capital and intermediate goods associated with construction of the gas pipeline between Bolivia and Brazil. The current account deficit, equivalent to 8% of GDP, was mainly financed by very buoyant foreign direct investment, although international reserves also declined slightly.

**BOLIVIA IS ONE** of two countries —the other one being Uganda— to have been chosen as beneficiaries of an initiative implemented by several multilateral agencies and donor countries aimed at reducing the external debt of highly indebted poor countries (HIPC). This programme requires beneficiary countries to apply appropriate economic policies, and as a result of the agreement, which took effect on 1 October 1998, Bolivia was able to obtain external debt relief of about US\$ 760 million in present-value terms, in return for a commitment to substantially increase its investment in education and health care.

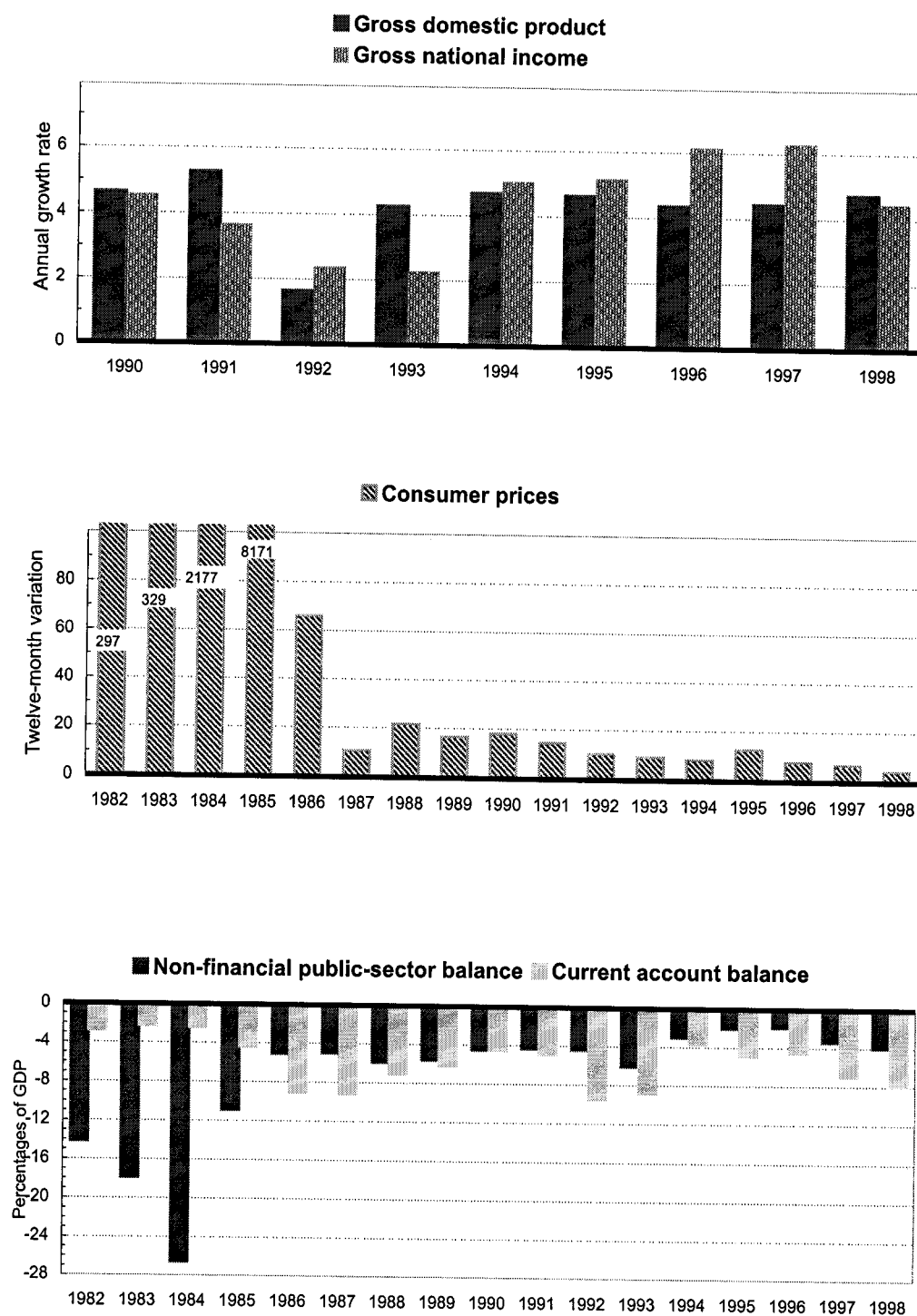
In 1998 the global deficit of the non-financial public sector grew to 4% of GDP, as against 3.4% in 1997. The increase stemmed almost exclusively from higher public spending related to pension reform, for without this expenditure the budget would have been in balance. The cost of pension reform is expected to grow

further over the next few years, raising the need for fiscal prudence.

In the fight against drugs, the Government announced the eradication of 8,000 hectares of coca plantations (net, after deducting new crops from the number of coca plantations destroyed). The Government pays US\$ 2,000 for each hectare voluntarily destroyed, but provides no compensation in cases of forced elimination. From 1999 onwards, compensation will be paid to communities rather than to the farmers who own the plots.

Although initial estimates suggested an economic growth rate of about 4.5% in 1999, figures for the early months of the year, especially in the external sector, could show a lower growth outturn. The fiscal deficit is forecast to increase significantly in 1999, in the wake of the rising cost of pension reform, as mentioned above.

Figure 1  
BOLIVIA: MAIN ECONOMIC INDICATORS



Source: ECLAC, on the basis of official figures.

## 2. Economic policy

In 1998 no major changes were made to the overall monetary and exchange-rate policies applied independently by the Central Bank of Bolivia. The central goal of monetary and credit policy continued to be to preserve the purchasing power of the local currency and supply the means of payment needed for economic growth. Foreign-exchange policy was concerned with maintaining stability in the real multilateral exchange rate, in a context of medium-term external economic equilibrium. Fiscal policy was directed towards preserving macroeconomic equilibria and price stability, while at the same time guaranteeing sufficient funds to finance the public investment programme yet keep the fiscal deficit within the bounds of the country's domestic and external borrowing capacity. In 1998, the cost of pension reforms, initiated by the previous Government with a view to boosting medium-term economic growth, led to a significant increase in public expenditure.

### (a) Fiscal policy

Fiscal management in 1998 was conducted in a scenario of two opposing trends. The first was the satisfactory performance of the non-financial public-sector deficit over the last six years, which was systematically reduced from 6% of GDP in 1993 to a point where revenue and expenditure were balanced in 1998. On the other hand, the fiscal effects of the structural reform programme caused a widening of the non-financial public-sector deficit in 1998, with the implementation of pension-system reform involving additional outlays on the order of 4% of GDP.

In 1998, tax revenues received by the Government grew faster than GDP. Current receipts rose from 28.9% of GDP to 29.6%, due largely to an increase in taxes on hydrocarbons, which grew from 2.9% to 4.7% of GDP. This increase is related to the structural reform programme put into effect by the previous Government, along with the privatization of Yacimientos Petrolíferos Fiscales Bolivianos (YPFB), which, in turn, led to a drop in current revenues from oil sales. Another important area in improving tax revenues was domestic income; a programme was successfully applied to collect overdue vehicle taxes.

On the expenditure side, there was a significant increase in the goods and services category, which went

up from 6.9% to 8.6% of GDP. Interest payments, especially on external debt, continued their trend downward, and capital expenditure as a percentage of GDP declined for the sixth consecutive year. This reduction is a result of the privatization process that has been unfolding in recent years and the consequent reduction of public investment in the divested firms. Other public investment was increasingly directed towards social sectors such as education, health, basic services and infrastructure.

Pension reform involved changing from a public pay-as-you-go system to one administered by private firms, and financing this entailed a fiscal cost equivalent to 4% of GDP in 1998, as the Treasury ceased to receive contributions from people affiliating to the new system, but was left with commitments to pay existing pensioners under the old system. The costs could even increase over the next few years, given that the period for retirement under the old system has been extended until 2001. Of the total fiscal deficit, 70% was financed with foreign loans and the remainder was financed domestically via the purchase of National Treasury Bonds by private pension-fund managers.

### (b) Monetary policy

Although slightly tighter than the year before, Monetary policy in 1998 continued to pursue the goal of keeping expansion of the means of payment in line with growth and inflation targets.

In May 1998, the legal reserve requirement system was reformed. The new system essentially requires financial institutions to deposit the reserve in a liquid assets fund (RAL) which is then invested in highly safe national and foreign instruments earning a market return. Guaranteed by the monies deposited in the RAL, financial institutions can access an immediate liquidity credit line from the Central Bank, thereby affording financial institutions better control and management of liquidity. The reform caused very sharp fluctuations in the monetary base, which ultimately shrank by 25% in 1998 (whereas in 1997 it had expanded by 19%); this decline occurred for accounting reasons, as a result of the considerable reduction in bank reserves (49%).

Two developments that affected the level of reserves in 1998 are worth highlighting. On the one hand, reserves grew thanks to the revaluation of gold that was



Table 1  
BOLIVIA: MAIN ECONOMIC INDICATORS

	1990	1991	1992	1993	1994	1995	1996	1997	1998 <sup>a</sup>
<b>Annual growth rates <sup>b</sup></b>									
Growth and investment									
Gross domestic product	4.6	5.3	1.6	4.3	4.7	4.6	4.4	4.4	4.7
Per capita gross domestic product	2.3	2.8	-0.8	1.8	2.2	2.2	1.9	2.0	2.3
Gross domestic product, by sector									
Goods	6.3	6.0	-0.4	4.6	5.1	5.0	4.2	4.8	4.3
Basic services	5.4	6.6	4.6	6.0	6.8	6.4	6.3	7.3	7.5
Other services	2.5	3.8	4.1	4.2	4.0	3.0	5.2	5.1	5.2
Consumption	2.9	3.3	3.6	3.2	3.0	3.4	3.2	4.4	3.6
Government	-0.1	3.3	3.7	2.5	3.1	6.6	2.6	2.5	5.0
Private	3.4	3.3	3.6	3.3	2.9	2.9	3.3	4.7	3.4
Gross domestic investment	17.7	29.3	5.3	-0.1	-10.6	12.3	9.6	29.1	24.2
Exports of goods and services	11.1	7.3	1.1	5.3	15.1	9.1	4.1	-3.7	2.7
Imports of goods and services	10.2	12.6	9.9	-0.7	-0.6	8.9	7.9	13.3	10.1
<b>Percentages of GDP <sup>c</sup></b>									
Gross national income	102.2	100.5	101.2	99.3	99.6	100.1	101.7	103.9	103.8
Gross domestic investment	13.6	16.8	17.4	16.7	14.2	15.2	17.3	22.2	25.4
National savings	10.0	10.2	9.2	8.2	9.3	10.7	13.4	16.3	17.4
External savings	3.6	6.6	8.2	8.5	4.9	4.6	3.9	5.9	8.0
<b>Percentages</b>									
Employment and wages									
Labour force participation rate <sup>d</sup>	51.3	51.7	50.7	52.5	53.7	55.1	56.5	52.5	...
Open unemployment rate <sup>e</sup>	7.3	5.8	5.4	5.8	3.1	3.6	3.8	4.4	...
Real average wage (index: 1995=100)	88.8	82.9	86.2	92.0	99.3	100.0	101.1	109.3	113.2
<b>Growth rates</b>									
Prices (December-December)									
Consumer prices	18.0	14.5	10.5	9.3	8.5	12.6	7.9	6.7	4.4
Wholesale prices	19.8	13.8	13.6	7.5	...	...	...	...	...
External sector									
Terms of trade (index: 1995=100) <sup>c</sup>	114.5	112.4	92.0	88.3	102.5	100.0	111.7	115.6	109.9
Nominal exchange rate (bolivianos per dollars)	3.17	3.58	3.90	4.27	4.62	4.80	5.08	5.25	5.51
Real effective exchange rate for imports (index: 1995=100)	84.0	83.8	87.3	92.7	97.7	100.0	93.4	91.1	87.4
<b>Millions of dollars</b>									
Balance of payments									
Current account	-220	-263	-534	-506	-218	-328	-333	-553	-676
Trade balance (goods and services)	-110	-198	-579	-537	-244	-334	-399	-649	-845
Exports	977	917	773	897	1 216	1 239	1 317	1 413	1 355
Imports	1 086	1 115	1 352	1 433	1 460	1 574	1 716	2 062	2 200
Capital and financial account <sup>f</sup>	58	115	402	525	228	421	633	668	647
Overall balance	-161	-147	-132	20	10	92	301	115	-29
Variation in reserve assets (- indicates an increase)	-5	-8	-41	100	-26	-147	-308	-88	-13
<b>Percentages</b>									
External debt									
Gross debt (as a percentage GDP)	77.4	67.0	67.0	65.9	70.5	67.4	59.0	53.1	51.1
Net interest (as a percentage of exports) <sup>g</sup>	25.4	26.8	22.4	20.2	13.4	14.3	10.0	10.8	10.0

Table 1 (concluded)

	1990	1991	1992	1993	1994	1995	1996	1997	1998 <sup>a</sup>
<b>Percentages of GDP</b>									
Non-financial public sector									
Current revenue	27.1	28.8	28.8	29.6	31.1	31.5	28.1	28.9	29.6
Current expenditure	24.7	26.0	25.8	28.0	27.6	26.7	24.2	26.5	28.6
Saving	2.4	2.8	3.0	1.6	3.5	4.8	3.9	2.4	1.0
Capital expenditure (net)	8.3	8.7	10.0	9.2	9.0	8.5	8.2	7.2	6.3
Financial balance	-4.5	-4.3	-4.4	-6.1	-3.0	-2.0	-1.9	-3.4	-4.0
<b>Growth rates</b>									
Money and credit									
Monetary balances of banking system									
Net international reserves	197.9	48.1	6.9	8.8	24.4	50.0	97.7	10.1	38.3
Net domestic credit to public sector	54.5	6.5	184.2	29.9	6.0	- 84.6	- 2.7	96.7	4.6
Domestic credit to private sector	41.1	47.8	45.7	39.3	24.0	12.6	28.2	21.7	23.3
Money (M1)	17.6	25.2	19.0	14.6	33.4	23.5	10.6	18.6	7.0
Local-currency savings and time deposits	- 90.5	8.9	- 19.5	7.8	74.6	- 22.4	181.3	- 10.6	4.3
M2	- 56.5	22.7	13.9	14.0	37.0	18.3	23.2	13.7	6.7
Dollar deposits	106.7	68.1	44.2	41.8	18.7	7.5	52.9	19.2	15.3
<b>Annual rates</b>									
Real interest rates (annualized, %)									
Deposit rate	5.3	8.4	11.9	11.9	9.2	5.6	9.4	9.6	4.8
Lending rate	20.7	23.5	32.7	40.8	43.5	36.7	43.4	43.4	30.7
Equivalent interest rate in foreign currency <sup>h</sup>	8.4	12.2	12.4	12.1	12.1	13.5	13.1	10.9	7.3

Source: ECLAC, on the basis of official figures.

<sup>a</sup> Preliminary figures.

<sup>b</sup> Based on bolivianos at constant 1990 prices.

<sup>c</sup> Based on constant 1995 dollars.

<sup>d</sup> Percentages of the working-age

population. <sup>e</sup> Percentages of the economically active population (EAP).

<sup>f</sup> Includes errors and omissions.

<sup>g</sup> Refers to net interest as shown

on the balance of payments, divided by exports of goods and services.

<sup>h</sup> Interest rate on deposits, deflated by the variation in the exchange rate.

converted into monetary form; on the other hand, the setting up of the liquid assets fund brought about a reduction in Central Bank reserves of nearly US\$ 200 million, matched by proportionate growth in financial-system reserves. By December 1998, RAL had accumulated some US\$ 300 million in foreign currency. The consolidated reserves of the system remained largely unchanged through 1998.

Liquidity, in terms of money creation, expanded by 12.1% in 1998, compared to 15% the year before. There was also greater liquidity in terms of cash held at banks, as a result of which currency in circulation increased by just 6.5% (14.2% in 1997). Variables relating to total liquidity in national currency (M1, M2 and M3) grew by nearly 7%, whereas under the broader definition, including foreign-currency instruments, total liquidity increased substantially (14%), and the dollarization of the Bolivian economy proceeded.

Inter-bank interest rates were quite stable at around 8% during the first nine months of 1998. In the final quarter, however, they rose sharply, to nearly 12%

by the end of the year, as the demand for loans expanded faster than liquidity, which itself was hindered by the slow growth of deposits in the final quarter and by more restricted access to foreign credit.

The Bolivian stock exchange experienced a spectacular upturn in 1998, with traded volume up 40% from the previous year. Stock market operations were concentrated in the fixed interest segment over a very narrow range of instruments involving a small number of issuing houses and institutional investors (mutual funds, pension funds).

### (c) Foreign-exchange policy

Foreign-exchange policy was directed towards maintaining stability in the multilateral real exchange rate, along with external balance. Currently the central-parity exchange rate is calculated on the basis of a basket of currencies corresponding to the country's main trading partners (mark, yen, pound sterling, Brazilian real, Chilean peso, Argentine peso and Peruvian

Table 2  
BOLIVIA: MAIN QUARTERLY INDICATORS

	1996				1997				1998 <sup>a</sup>				1999 <sup>a</sup>
	I	II	III	IV	I	II	III	IV	I	II	III	IV	I
Consumer prices (12-month variation, %)	14.5	12.3	13.3	8.0	3.6	5.2	3.7	6.7	9.4	7.9	7.2	4.4	2.0
Real effective exchange rate <sup>b</sup> (index: 1995=100)	93.4	94.0	92.9	93.2	92.1	91.7	90.5	90.0	86.7	86.9	86.8	89.2	86.3
Real interest rates (annualized, %)													
Deposit rate	2.7	16.6	8.1	10.2	12.2	10.0	8.7	8.5	4.8	4.2	4.9	5.2	9.7
Lending rate	27.7	53.2	40.1	52.7	43.4	50.7	41.7	29.7	33.3	32.4	32.7	24.5	35.3

Source: ECLAC, on the basis of official figures.

<sup>a</sup> Preliminary figures. <sup>b</sup> Refers to exchange rate for imports.

new sol), and weighted according to each country's trade with Bolivia. The Central Bank persisted with its policy of setting the exchange rate parity through mini-devaluations, undertaken through foreign-exchange market intervention using an auction mechanism known as the *bolsin* or mini-market. In principle, economic policy focused on preserving price stability, with foreign exchange policy being aimed at simultaneously ensuring the stability and competitiveness of the real exchange rate in order to safeguard the position of the Bolivian economy *vis-à-vis* its main trading partners.

By year's end, the Central Bank was selling bolivianos at 5.64 to the dollar, which represented a nominal devaluation of 7.2% compared to the same period in 1997. The real exchange rate, however, was relatively stable throughout the year, depreciating by just 1.4% between December 1997 and December 1998. This depreciation rate was largely explained by the low rate of domestic inflation, together with parity changes inside the currency basket between the dollar, the European currencies and the yen.

#### (d) Structural reforms

In 1998, the Government continued to negotiate with multilateral agencies and donor countries over the terms of the HIPC Debt Initiative, and managed to substantially improve on the original conditions for external debt relief, which had envisaged an amount of US\$ 448 million. The final agreement called for a reduction of US\$ 760 million at market value, equivalent to over US\$ 1.2 billion of accumulated external debt stock. Implementation of this agreement was limited in 1998,

however, as it only came into force on 1 October. External debt relief is generated through a variety of mechanisms, including a reduction of the accumulated external debt stock and a lowering of interest rates. The latter was the method agreed with Japan and the Inter-American Development Bank (IDB), whereas the World Bank opened a special account for the payment of interest on and amortization of the Bolivian debt. In the case of the International Monetary Fund (IMF), it was decided that expired loans would not be disbursed. In the context of the HIPC Initiative, the Government of Bolivia committed to a programme of social investment in education, health, sustainable development, housing and public works. An overall assessment of the fulfilment of this phase of the programme, at the end of 1998, reported satisfactory results.

To attract new investment to the hydrocarbon, electricity and telecommunication sectors, legislation was approved, known as the "*ley corazón*", which is aimed at turning Bolivia into a Latin American hub for energy distribution, transport and telecommunications.

In the credit sphere, the Peoples' Property and Credit Act was passed, setting up a consolidated financial oversight system. In addition, the administration of public-service cooperatives was reformed, access to micro-credit was expanded, and work began on the creation of a National Identification Registry (RIN). In addition, with IMF support, a plan was drawn up for a complete overhaul of the customs system with a view to cutting out the high rate of customs duty evasion. As part of this effort, one administrative staff sector was replaced, and a long-term customs-reform adviser was appointed.

### 3. The main variables

#### (a) Economic activity

Economic growth in 1998, at 4.7%, was very much in line with the average for the 1990s. Without doubt, the most important factor in this growth was gross capital formation, which increased by more than 20%, to account for 25% of GDP. As a whole, growth mainly stemmed from the positive performance of public and private construction, and above all to the competition of the Bolivia-Brazil gas pipeline and to investment in oil exploration. There was also a notable increase in public consumption, which went up by more than 5%, while private consumption grew by 3.4%. Exports expanded by 2.7% and imports by 10%.

In the financing of investment, the trend of recent years persisted: gross domestic saving, which had been below 10% of GDP at the beginning of the decade, grew to over 15% in 1998, while the role of external saving in the financing of gross domestic investment also increased slightly, by just under one percentage point of GDP. Private-sector investments are expected to continue, especially in the hydrocarbon sector, with the expansion of Bolivia's domestic network and the investment commitments made by the firms participating in the YFPB capitalization.

The sectors that most contributed to growth in 1998 were construction and public works (1.32%); transport, storage and communications (0.82%); financial services (0.75%) and manufacturing industry (0.66%). The construction sector posted the largest increase (39%), thanks to the construction of the Bolivia-Brazil gas pipeline, which involved an investment of nearly US\$ 400 million in 1998. Growth in the transport, storage and telecommunications sectors is mainly explained by expansion and diversification in telecommunications services. The Empresa Nacional de Telecomunicaciones (ENTEL), one of the public enterprises privatized in the capitalization process, has led the sector with investments averaging about US\$ 100 million per year since 1996. Most of these investments are directed at mobile telephony.

In 1998, crude oil and natural gas production, which accounts for 5% of GDP, grew by 11.6%, and this was accompanied by a 6.2% expansion in the gas, electricity and water sector stemming from the high level of investment in the sector. A national rural electrification programme (PRONER) was introduced to

extend the coverage of the rural network from 13% to 28% in the next five years.

Manufacturing industry posted a moderate gain on the previous year's figure, rising by 3.9%. The fastest growing segments were paper and paper products, beverages, foodstuffs and non-metallic mineral products. Mining (except for oil and gas) continued on its long downswing, falling by 0.46% with respect to the previous period.

In 1998, the agriculture and forestry sector declined by 3.49% with respect to 1997, largely because of the poor performance of agriculture, which can basically be put down to the El Niño weather pattern which affected the country from late 1997 onwards. A surfeit of rain in the east and drought in the west of the country damaged livestock and crops for domestic consumption, along with export crops such as cotton and sugar cane. In addition, export agriculture in 1998 was hit by sharp drops in the international prices of key commodities, especially soybeans and soybean products; this, in turn, led to a cut of approximately 30% in prices paid to producers for the summer and winter harvests.

#### (b) Prices, wages and employment

Inflation in 1998 came in at 4.4%, the lowest rate since the early 1970s. As mentioned above, prices rose more slowly than GDP for the first time in many decades. This level of inflation was the outcome of transitory factors (falling world oil prices and only a slight rise in food prices), together with policies designed to restrain demand. Domestic prices of petroleum products fell between December 1997 and December 1998, mainly because of the drop in prices on international markets, which are used as a benchmark for calculating domestic prices. Excluding energy and foodstuffs, inflation was slightly above 6%, having followed a stable course during the year, with monthly increases of less than 0.5% in every month between March and December, except October. In February 1998, the Government set a new minimum wage of 300 bolivianos; this represented an increase of 25% from 1997. Data on the performance of employment and wages in 1998 are not available, as the gathering of statistical information from household surveys was discontinued. It appears, however, that the growth of the Bolivian economy in recent years, based on a substantial increase in invest-

ment (especially by the private sector), has not been matched by comparable increases in the quantity and quality of jobs.

**(c) The external sector**

The current account deficit of the balance of payments widened to 8% of GDP in 1998, as against 7% the year before. This was mainly the result of a negative trade balance, caused particularly by larger capital goods purchases, which accounted for 43% of all imports. The current account deficit was financed with funds from foreign direct investment, worth US\$ 870 million (about 10% of GDP), and external debt disbursements. Nonetheless, foreign exchange reserves drained to just US\$ 30 million, compared to US\$ 115 million in 1997 and US\$ 300 million in 1996.

Natural gas exports to Argentina totalled US\$ 56 million, down by 19% on the 1997 figure, as a result of the termination of the export contract in 1999. The gas pipeline to Brazil will start to operate in the first half of 1999; natural gas exports to that country are expected to

be worth US\$ 50 million in the first year, with the figure rising to over US\$ 100 million in 2000, and, according to forecasts, to US\$ 500 million as from the year 2005, at which time 30 million cubic meters will be exported daily.

The drop in exports was largely the result of the international crisis, the shock waves from which were reflected in lower demand for raw materials. Re-exports became the most dynamic export segment, growing from US\$ 16 million to US\$ 200 million during the year. All the main import categories increased, and capital goods purchases maintained their momentum, growing by 37.7% (far more than in previous years) to account for 43% of total imports. Second place corresponded to consumer goods imports which grew by 22.9%, much more than in 1997. Lastly, imports of intermediate goods and raw materials rose by 14.5%. The reasons for this substantial expansion of imports are to be found in the nearly 50% increase in the imported component of investments related to the building of the gas pipeline to Brazil, along with the high import component of investments undertaken by capitalized firms.

## Brazil

### 1. General trends

The Brazilian economy has been severely shaken by the financial crisis that has been afflicting the world economy since mid-1997. GDP growth amounted to just 0.2%, which pushed unemployment up to 7.6%, while the country's balance-of-payments position —already extremely vulnerable to external shocks because of the country's sizeable fiscal deficit and overvalued currency— was further complicated by a downturn in the terms of trade and an abrupt reduction in capital flows to emerging economies. This, in turn, put a huge drain on foreign exchange reserves. On the other hand, the major achievement of 1998 was the reduction of inflation to its lowest level in the past 50 years (2.5%).

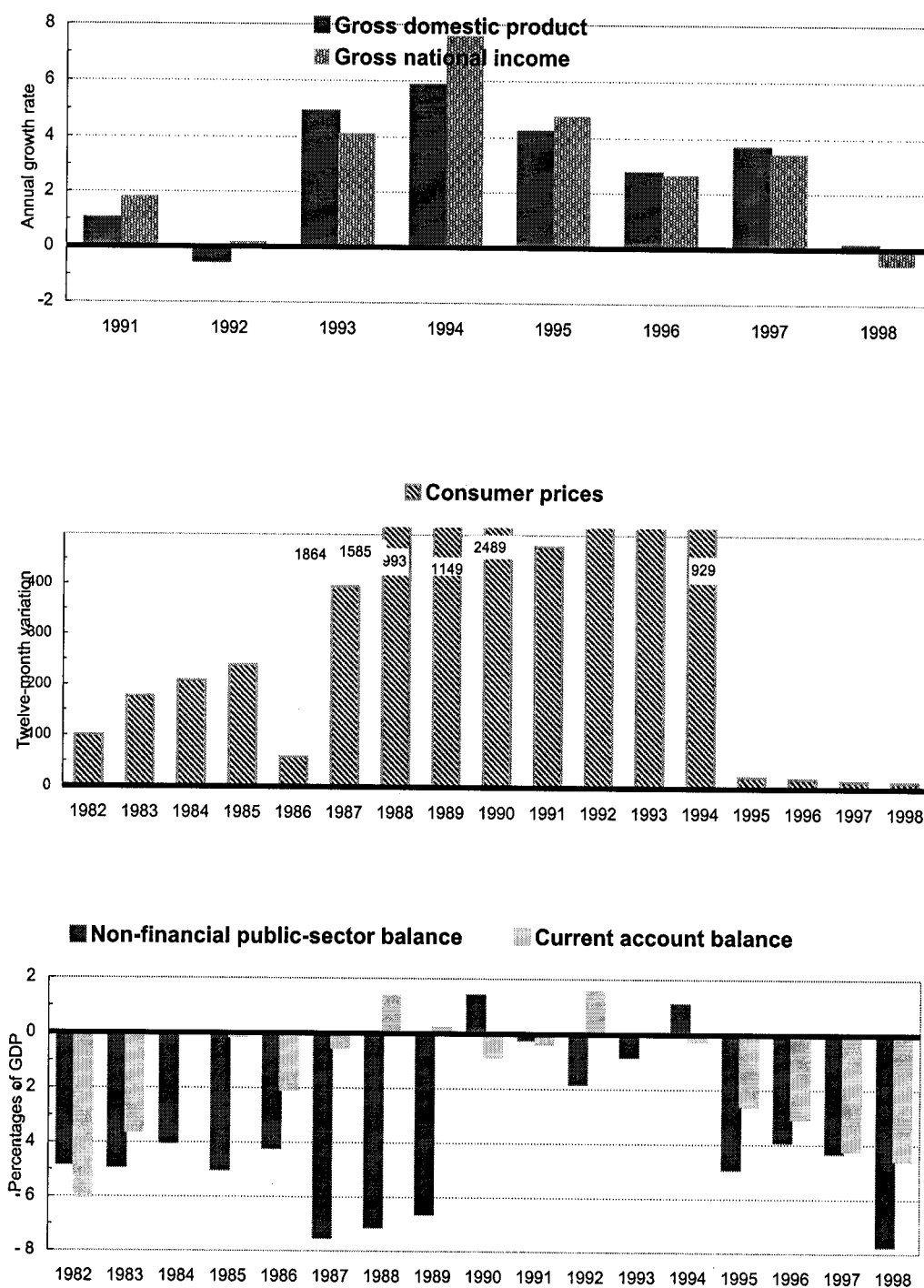
IN MID-JANUARY 1999, as a result of this critical situation in terms of the country's external accounts, the policy of gradual adjustments in the exchange rate became unsustainable, and the *real* was sharply devalued. The exchange rate remained volatile for some weeks before finally stabilizing in March —albeit at a level 40% higher than at the beginning of the year— thanks to an agreement with the International Monetary Fund (IMF) and to Congressional approval of major adjustment measures. Despite the devaluation, however, prices rose only slightly; this was due to the prevailing recessionary climate and to the fact that indexation mechanisms were not reinstated, since the sharp fluctuations in the exchange rate lasted for a relatively short period of time.

Despite the highly unstable situation existing in the Brazilian economy since October 1997, there have also been some significant positive events, such as the record level of foreign direct investment, which was only partially due to privatizations. This would seem to indicate that medium- and long-term expectations for the Brazilian economy, which are based mainly on the structural changes currently under way, are more auspicious than the short-term outlook, which continues to

hinge upon the progress made towards building solid foundations for stability.

In the second half of 1998, the situation in the external sector became very tense as the international crisis continued to deepen. Foreign exchange reserves fell by US\$ 35 billion (this figure does not include the US\$ 8.9 billion in financial aid received in the final days of the year) to the equivalent of just nine months' worth of imports —the lowest coverage ratio since the start of the Real Plan. The country's merchandise trade deficit (US\$ 4.4 billion) was exacerbated by a decrease in exports, and foreign exchange outflows in the form of profit remittances climbed to the unprecedented level of US\$ 7.6 billion for the year, with US\$ 4.6 billion of this amount being taken out of the country in the second semester. What is more, new inflows of foreign financial resources were virtually nil. Inflows in the final quarter amounted to just US\$ 3.1 billion and were obtained at a very high cost, with the average spread of 775 basis points being more than double what it had been prior to the outbreak of the financial crisis. Despite the stagnation of economic activity, the current account deficit was held to 4.5% of GDP, compared to 4.2% in 1997.

Figure 1  
**BRAZIL: MAIN ECONOMIC INDICATORS**



Source: ECLAC, on the basis of official figures.

In early 1999 the turmoil was further intensified when the State of Minas Gerais declared a moratorium. The market's reaction was immediate, and international reserve losses accelerated dangerously. The currency band was widened in an attempt to staunch this outflow, but this measure was not enough to contain the pressure. In response to this situation, the Central Bank of Brazil radically altered the exchange-rate regime and, as from 15 January, allowed the currency to float. The strategy of gradual currency adjustments thus ceased to be viable in the external scenario existing in the wake of the Russian crisis.

Starting in March 1999, expectations concerning the Brazilian economy began to take on a less pessimistic tone. The conclusion of negotiations with IMF was particularly important in this respect because the agreement reached with that institution permitted the Government to use funds from the aid package to stabilize

the currency market, and this enabled the Central Bank to intervene immediately. Moreover, there was a growing perception that the fiscal adjustment being implemented since late 1998 was bearing fruit.

Nonetheless, there was concern that the adjustments that were being made would prove to be unsustainable in the medium term. It seems clear, for example, that certain one-off receipts played a part in the improved primary balance registered for the first half of 1999, including revenues from taxes whose legality is being challenged in the courts, advance payments on concessions associated with the privatization of Telecomunicações Brasileiras (Telebras) and the income represented by the decrease in wage payments that resulted from a change in payment dates. Other causes for concern were the dismal performance of exports, which continued to slide during the first half of 1999 despite the devaluation of the *real*, and the slowdown in economic activity.

## 2. Economic policy

In 1998, the main goal of economic policy-makers was to deal with the increasing vulnerability of the Brazilian economy, which had been growing more acute since November 1997 and reached its height in January 1999. Fiscal policy focused on reducing the massive public-sector deficit, while exchange-rate policy underwent a major change when the currency band was abandoned and the *real* was allowed to float freely. In addition, monetary policy was gradually relaxed during the first half of 1998, after having been very tight in the latter part of 1997. In the wake of the Russian moratorium, however, very high real interest rates were again used to take pressure off international reserves, and monetary policy has remained very restrictive since the January 1999 devaluation in order to curb the inflationary pressures generated by the exchange-rate correction and by projected hikes in public utility rates.

Within this general framework, economic policy was adjusted in order to accommodate the fluctuating conditions that were observed as the economy passed through a number of different phases, as described below.

Economic policy has largely been determined by the external situation, since, in its efforts to achieve sta-

bilization over the past four years, the Brazilian economy has relied on external funds to finance its rising import demand and to make it possible for consumption and investment to expand. As a result, the current account deficit widened dramatically between 1994 and 1998—from less than 0.5% to 4.5% of GDP—while the merchandise trade balance saw a US\$ 10.4 billion surplus evaporate into a US\$ 6.4 billion deficit.

The Asian crisis sharply reduced the volume of foreign funds available to countries such as Brazil, and in the last quarter of 1997, net capital inflows dwindled to less than US\$ 1 billion after having averaged US\$ 8.3 billion in the preceding quarters. Over US\$ 10 billion in international reserves had to be used to finance the shortfall. In view of this situation, severe adjustment measures were adopted in late 1997, including a tight monetary policy that sent real interest rates soaring to over 30% per year. In addition, a 51-measure fiscal package was announced to reduce the public-sector deficit and a renewed commitment was made to continuing with the privatization programme. It was hoped that these measures would make it possible to maintain the existing exchange-rate policy, which was based on a pre-established band that allowed for gradual devaluations under the guidance of the Central Bank.



Table 1  
**BRAZIL: MAIN ECONOMIC INDICATORS**

	1990	1991	1992	1993	1994	1995	1996	1997	1998 <sup>a</sup>
<b>Annual growth rates<sup>b</sup></b>									
Growth and investment									
Gross domestic product	...	1.0	-0.5	4.9	5.9	4.2	2.8	3.7	0.2
Per capita gross domestic product	...	-0.6	-2.1	3.4	4.3	2.7	1.3	2.3	-1.2
Gross domestic product, by sector									
Goods	...	0.1	-2.8	5.8	6.9	2.1	3.6	4.4	-1.3
Basic services	...	6.3	2.2	5.8	6.1	10.6	6.0	4.4	6.1
Other services	...	-0.1	-0.4	2.2	2.6	1.0	-0.2	1.3	0.8
Consumption	...	0.5	0.1	4.1	5.9	7.0	3.6	3.1	-0.3
General government	...	2.3	2.8	2.3	0.3	1.3	0.8	2.2	...
Private	...	-0.1	-0.7	4.6	7.5	8.7	4.5	3.3	...
Gross domestic investment	...	9.0	-8.6	14.3	13.0	8.1	3.0	9.0	8.5
Exports of goods and services	...	-4.9	16.6	11.7	4.0	-2.0	1.5	8.9	4.9
Imports of goods and services	...	11.1	4.5	26.8	20.3	30.7	9.1	14.1	-0.2
<b>Percentages of GDP<sup>c</sup></b>									
Gross national income	96.3	97.1	97.5	97.1	98.3	98.9	98.7	98.4	97.6
Gross domestic investment	19.3	20.8	19.1	20.8	21.8	22.3	22.3	23.4	22.2
National savings	18.8	20.6	20.1	20.8	21.6	19.6	18.9	18.5	16.9
External savings	0.5	0.2	-1.0	0.0	0.2	2.7	3.4	4.8	5.3
<b>Percentages</b>									
Employment and wages									
Labour force participation rate <sup>d</sup>	61.5	61.0	59.5	58.6	59.3	59.3	59.6	58.5	58.2
Open unemployment rate <sup>e</sup>	4.3	4.8	5.8	5.4	5.1	4.6	5.4	5.7	7.6
Real average wage (index: 1995=100) <sup>f</sup>	104.5	89.0	87.0	95.6	96.3	100.0	107.9	110.8	110.9
<b>Growth rates</b>									
Prices (December-December)									
Consumer prices	1 585	476	1 149	2 489	929	22.0	9.1	4.3	2.5
Wholesale prices	1 450	472	1 154	2 640	921	13.1	3.9	3.1	-0.3
External sector									
Terms of trade (index: 1995=100) <sup>c</sup>	60.3	71.2	74.2	79.9	91.5	100.0	101.0	106.8	104.6
Nominal exchange rate ( <i>reals</i> per dollar)	0.000025	0.00015	0.0016	0.032	0.64	0.92	1.01	1.08	1.16
Real effective exchange rate for imports (index: 1995=100)	82.4	108.5	117.3	112.6	113.6	100.0	94.2	93.2	97.6
<b>Millions of dollars</b>									
Balance of payments									
Current account	-3 823	-1 450	6 089	20	-1 153	-18 136	-23 602	-33 840	-35 330
Trade balance (goods and services)	6 986	6 687	11 897	8 739	5 515	-10 652	-13 898	-19 561	-17 826
Exports	35 170	34 938	39 881	43 595	49 010	52 641	52 872	60 256	59 657
Imports	28 184	28 251	27 984	34 856	43 495	63 293	66 770	79 817	77 483
Capital and financial account <sup>g</sup>	-5 702	-3 974	4 550	6 870	7 751	31 105	32 339	25 966	17 536
Overall balance	-9 525	-5 424	10 639	6 890	6 598	12 969	8 737	-7 874	-17 794
Variation in reserve assets (- indicates an increase)	-474	369	-14 670	-8 709	-7 215	-12 920	-8 667	7 907	8 491
<b>Percentages</b>									
External debt									
Gross debt (as a percentage of GDP)	26.5	30.4	34.8	33.1	27.1	22.6	23.2	24.9	30.3
Net interest (as a percentage of exports) <sup>h</sup>	27.7	24.7	18.2	15.6	13.1	7.9	17.3	17.2	20.3

Table 1 (concluded)

	1990	1991	1992	1993	1994	1995	1996	1997	1998 <sup>a</sup>
<b>Percentages of GDP</b>									
Public sector									
Total revenue	28.9	24.6	24.2	26.3	28.5	27.2	28.1	28.9	32.1
Total expenditure	33.2	30.6	30.7	33.3	29.3	32.8	32.9	34.1	40.2
Operating balance <sup>i</sup>	1.4	-0.2	-1.8	-0.8	1.1	-4.9	-3.9	-4.3	-7.7
Nominal balance	...	...	...	...	...	...	-5.9	-6.1	-8.0
<b>Growth rates</b>									
Money and credit									
Net international reserves	3.0	-5.7	152.5	35.6	20.5	33.6	16.0	-13.2	-14.6
Money (M1)	2 334.7	330.7	867.3	2 129.4	-99.0	23.4	4.6	58.9	6.7
<b>Annual rates</b>									
Real interest rate (annualized, %)									
Deposit rate	3.3	34.7	31.9	23.0	26.0	24.8	16.5	17.8	24.1
Lending rate	405.8	89.6	196.8	229.1	301.0	81.8	41.0	41.9	88.5
Equivalent interest rate in foreign currency <sup>j</sup>	6.4	30.2	40.8	27.0	54.6	33.9	18.3	16.5	...

Source: ECLAC, on the basis of official figures.

<sup>a</sup> Preliminary figures. <sup>b</sup> Based on local currency at preceding-year prices. <sup>c</sup> Based on constant 1995 dollars. <sup>d</sup> Percentages of the working-age population; six metropolitan areas. <sup>e</sup> Percentages of the economically active population (EAP); six metropolitan areas. <sup>f</sup> Workers covered by existing social and labour laws. <sup>g</sup> Includes errors and omissions. <sup>h</sup> Refers to net interest as shown on the balance of payments, divided by exports of goods and services. <sup>i</sup> Includes operating adjustments. <sup>j</sup> Interest rate on deposits, deflated by the variation in the exchange rate.

This adjustment policy had repercussions on the level of activity in the fourth quarter of 1997 and the first of 1998, with the manufacturing sector, in particular, reporting a cumulative contraction of 5.5% over those two quarters. The unemployment rate in March 1998, at 8.2%, was more than two percentage points higher than a year earlier.

From February 1998 on, however, foreign capital began to flow back in significant amounts; as a result, by the end of April international reserves had rebounded to US\$ 73.4 billion, thus more than making up for the losses registered during the crisis of the fourth quarter of 1997. Thanks to this new level of reserves, and with an eye to the approaching electoral campaign, the authorities were able to ease the adjustment in an effort to alleviate the recession.

The Central Bank's base interest rate fell steeply from March 1998 on, after having been raised to an annual level of over 40% at the end of October 1997. By July it had slipped to 19%, its lowest level since the start of the stabilization process in July 1994.

The fiscal effort whose commencement was announced in late 1997 had little effect on tax revenues. National Treasury receipts were up in real terms by

16% in the first half of 1998, but this was due to higher income tax rates, increased receipts from the tax on financial transactions and revenues from concessions. Meanwhile, federal expenditure continued its expansionary course during this period, growing by 16% in real terms. The primary balance registered by the other levels of government and by State enterprises also deteriorated, although considerable progress was made by the privatization programme during the period, which included the sale of the country's telecommunications system for US\$ 19 billion.

In the second half of August, the Russian debt moratorium had a very negative impact on Brazil at a time when general elections were less than two months away. The stock market's response was instantaneous and violent, with the São Paulo exchange shedding 40% of its value during the month of August; the price of Brazilian securities traded abroad also plunged (mainly C-bonds, which fell by 20%).

The Central Bank tried to act as a cushion for external pressures, which made themselves felt on the domestic front in the form of capital outflows and a reduction in the availability of financing. In fact, in August and September international reserves shrank by

Table 2  
BRAZIL: MAIN QUARTERLY INDICATORS

	1996				1997				1998 <sup>a</sup>				1999 <sup>a</sup>
	I	II	III	IV	I	II	III	IV	I	II	III	IV	I
Gross domestic product (change from same quarter of preceding year) <sup>b</sup>	-2.0	1.7	6.3	5.0	4.7	4.9	2.8	1.5	1.0	1.6	-0.1	-1.0	-1.0
Consumer prices (12-month variation, %)	20.1	16.4	13.0	9.1	8.6	5.9	4.4	4.3	4.3	4.6	3.2	2.5	3.9
Real effective exchange rate <sup>c</sup> (index: 1995=100)	95.2	93.5	93.5	94.5	92.6	92.4	93.0	94.7	94.2	95.4	97.8	103.1	150.3
Exports (millions of dollars)	10 286	12 617	12 955	11 889	10 656	14 130	14 899	13 301	11 901	14 067	13 492	11 660	10 042
Imports (millions of dollars)	10 739	12 478	14 234	15 836	13 223	15 409	17 248	16 103	13 416	14 557	15 299	14 286	10 794
Real interest rates (annualized, %)													
Deposit rate	19.9	9.9	17.2	19.0	12.7	13.2	15.6	29.7	26.2	16.3	20.9	33.0	32.2
Lending rate	44.0	28.1	46.0	48.5	41.3	29.5	3.3	63.6	68.6	93.9	86.8	104.8	126.4
Money (M1) (change from same quarter of preceding year)	...	...	...	...	63.6	60.3	55.6	58.9	11.9	16.2	12.3	6.7	8.4

Source: ECLAC, on the basis of official figures.

<sup>a</sup> Preliminary figures.

<sup>b</sup> Based on figures expressed in the local currency at constant prices.

<sup>c</sup> Refers to exchange rate for imports.

US\$ 24.4 billion. An attempt was made to highlight the differences between the Russian and Brazilian economies, but the size of the public sector's deficit, together with its hefty short-term, high-interest domestic debt and very sizeable external borrowing requirements, made it impossible to allay the prevailing uncertainty.

In late September 1998, the authorities reintroduced the economic policy measures that they had adopted to deal with the crisis in November 1997. The Central Bank raised its base rate to 49% and announced that a new fiscal adjustment was to be undertaken; in addition, target figures for the central government's primary deficit were set by law. In support of these measures, budgetary allocations were reduced by 20%, thereby cutting outlays by US\$ 4 billion.

These measures fell short, however, as significant amounts of capital continued to flow out of the economy during October, making it necessary to deepen the fiscal adjustment, come to an agreement on an IMF programme and seek financing in other countries. The new fiscal package sought to improve the primary financial balance by 26 billion *reais* through higher tax

rates and social security contributions. In addition, the 1999 budget estimates were subjected to another review which resulted in further cuts amounting to 8.9 billion *reais*.

One of the essential components of this package was the passage of constitutional amendments relating to public administration (late in the first semester) and social security (in November). Neither of these amendments is as extensive in scope as the Government had hoped, but they will allow it to start taking steps to reduce the fiscal deficit, although they will not generate significant savings immediately.

Once these measures were in place, Brazil signed an agreement with IMF, the World Bank, the Inter-American Development Bank (IDB) and a number of developed countries (with IDB acting as an intermediary in most cases) for a three-year US\$ 41 billion financial aid programme. An important point in the agreement was the commitment to maintain the existing exchange-rate policy, which was further reinforced by the re-election of President Cardoso.

Despite this significant level of financial support, the loss of reserves intensified, and in early 1999 the ex-

change rate was therefore allowed to float, resulting in a steep devaluation. The authorities kept fiscal and monetary policy as restrictive as the year before in view of the continuing instability in the currency market. Tensions eased two months later, however, thanks to the renegotiation of the agreement with IMF, which enabled the Government to use the financial aid it had received for currency stabilization purposes. As a result, monetary policy began to be relaxed and the Central Bank's base rate was gradually lowered.

### (a) Fiscal policy

Fiscal management was key to the credibility of economic policy in 1998. In particular, there was some doubt as to whether the measures announced in November 1997 in an effort to increase revenues and cut expenditures would be enough to bring about the targeted US\$ 17 billion improvement in fiscal accounts in 1998. In fact, the effect of these measures on revenues actually surpassed the target, although this was mainly due to non-recurring revenues, but the reduction in expenditure was not large enough to offset the increase in disbursements caused by the high interest rates applying to domestic public-sector debt. When the Russian crisis erupted, the federal government resumed its commitment to set its primary surplus target for the year by law. Things turned out badly, however, and the public deficit widened from 6.1% of GDP in 1997 to 8.1% in 1998.

Federal government revenues rose in 1998 thanks, in particular, to non-recurring receipts from privatizations and public concessions, especially in the telecommunications sector. Another factor was that the provisional tax on financial operations remained in force throughout the year, and an additional levy was imposed on financial income. For the most part, the revenues of the various states and municipalities stagnated because of the economy's near-zero growth rate. Nonetheless, some states did see an increase in revenues, such as Rio de Janeiro, whose income expanded by 18%; in others, however, the decrease in receipts arising from the exemption of commodity exports from state taxes was only partly offset by additional federal government transfers. Privatization operations were also a significant source of funds at the state level, with 26.9 billion *reais* being taken in over the past two years from the sale of state-owned firms, particularly electrical power distribution companies.

The upward trend in federal government expenditure was reversed in 1998, but this positive development was counteracted by larger social security deficits

in both the general system and the system for civil service employees. After rising by 16% in real terms during the first semester, the primary expenditures of the National Treasury held steady in the second half of the year, with a 5% reduction being registered in the final quarter.

Thanks to these trends in revenue and expenditure, the federal government succeeded in posting a primary surplus equivalent to 0.6% of GDP in 1998, in contrast to a deficit of 0.3% in 1997.

In 1998 there was a marked deterioration in the financial performance of the social security system, with the amount paid out in retirement benefits and other pensions in the public sector growing by 13% in real terms and payments in the general system rising by 15%. This upswing was attributable to the increase in applications for early retirement that was sparked by the expectation of constitutional amendments that would restrict access to benefits.

The primary surplus at the municipal level in 1998 amounted to 0.2% of GDP, while the deficit recorded at the state level was equivalent to 0.4%. These figures are a reflection of the unbalanced structure of financing in the Brazilian system, in that, ever since the 1988 Constitution has been in effect, the municipalities have benefited from larger mandatory transfers from the federal government and from the states. The latter, for their part, have implemented extremely dynamic fiscal incentive policies despite the limitations imposed by the slow growth of their tax revenues and by legal provisions and policies forcing them to cut payroll expenses, which in some states used to amount to as much as 80% of total revenues.

The effort to improve the public sector's primary accounts failed to offset the effect of soaring interest payments, however, which surged to 7.8% of GDP in 1998 from the previous year's level of 5.2%. Privatization revenues notwithstanding, the net public debt grew significantly in 1998, reaching the equivalent of 42.6% of GDP by year's end, compared to 34.5% in 1997 and 29% in 1994. Part of this increase was due to the acknowledgement of new liabilities by the public sector.

Recent constitutional amendments are a significant factor in terms of the country's fiscal adjustment, although their effect has not been immediate. Subject to criteria to be defined in legislation to be drawn up for that purpose, it will now be possible to lay off—either permanently or temporarily—civil service employees if payroll expenses become excessive or in the event of a negative performance evaluation. New hiring procedures are also to be defined which will not guarantee full benefits or job stability. In addition, a minimum age

for retirement was set in the social security system for civil servants, in the general system the formula based on years of service was replaced with one based on years of contribution, and pension fund options were expanded for public servants earning over 1,200 *reais* per month.

### (b) Monetary policy

Monetary policy in 1998 had to be adapted to fluctuating external financing conditions and to the erosion of the public sector's assets as a consequence of the international financial crisis. The Central Bank had to adjust domestic liquidity in response to wide swings in international reserves and was obliged to accept new terms and conditions for domestic public-sector paper.

The monetary base and M1 grew by 5.9% and 23.1%, respectively, in 1998, which was sharply down from their 1997 figures of over 50%. The measures taken by the Central Bank to control the expansion of the money supply pursued two goals: in the first half of the year, the objective was to neutralize the impact of the upswing in international reserves; in the second, it was to maintain the liquidity of the system in the face of an outflow of resources.

One of the most significant costs of the Asian crisis, which was later compounded by the crisis in Russia, was a drastic change in the structure of Brazil's domestic public-sector debt. In August 1997, 61% of federal debt paper was issued at fixed interest rates, 19% was issued at the Selic (Serviço Especial de Liquidação e de Custódia) overnight rate and 9% was indexed to the exchange rate. By December 1998, these proportions had changed to a mere 3.5% at fixed rates, 70% at the Selic rate and 21% pegged to the exchange rate. There was also a decrease in average maturities from 6.5 to 3.3 months over the same period. In the second half of the year the Central Bank sought to guarantee the liquidity of public-sector debt paper in the face of dwindling foreign exchange reserves while at the same time consolidating new markets for such securities. In August the cash reserve requirement on time deposits was replaced by a bond reserve requirement, thereby generating an additional demand for 12 million *reais* worth of bonds.

Because of its use of very short-term floating rates and bonds indexed to the exchange rate, the Central Bank was rapidly losing its response capacity. The rate

hikes of the second half of 1998 did not have the same impact as the October 1997 domestic interest rate increases had produced and actually opened up even more room for speculation.

Domestic interest rates and the yields of Brazilian securities traded overseas are becoming increasingly closely linked. The crisis of August and September 1998 drove down the price of these securities, partly owing to the operations conducted by hedge-fund managers<sup>1</sup> in Brazilian and Russian bonds and partly because of the losses incurred by Brazilian investors in other international markets. Domestic interest rates had to adapt to this situation, and the Central Bank was forced to raise its benchmark rate to 40%.

These high interest rates' negative impact on the financial market was mitigated to some extent by the restructuring that the Brazilian banking system had been through in earlier years. This involved the entry of new foreign banks as a result of the sale of the fourth-largest national group to a bank from the Netherlands and the transfer of a local bank that was in the midst of restructuring to one of Spain's largest banking firms. Meanwhile, the sale of state banks, or their transformation into development agencies, continued.

### (c) Foreign exchange policy

Foreign exchange policy remained largely unchanged in 1998, which contributed enormously to domestic price stability but failed to prevent a sharp widening of the current account deficit.

Despite the adverse repercussions of the Russian crisis, the monetary authorities decided to accelerate the pace of the currency's depreciation only slightly so as not to compromise the stabilization process. A number of monetary and fiscal measures had to be adopted to help ensure the success of this policy, however. For example, the common external tariff was raised by three percentage points, under an agreement reached with the other members of the Southern Common Market (Mercosur), while the payment-on-sight requirement for imports was maintained, except in the case of credit operations having a term of over one year. Along with the devaluation of January 1999, import restrictions, which had given rise to a series of disputes with Brazil's Mercosur partners, began to be reduced. A selective tariff reduction process began, and the minimum period for import credit was cut from 360 to 90 days.

<sup>1</sup> Private-sector organizations that enjoy a great deal of flexibility in undertaking speculative financial investments (taking uncovered foreign currency positions), are subject to few regulations and are usually located in tax havens.

The depreciation of the currency in 1998 amounted to 8.3%, at a monthly average rate of nearly 0.7%, and the currency band was adjusted to allow for a faster rate of devaluation. In reality, a managed peg system was in effect, since the Central Bank was intervening in the market on a regular basis; this resulted in alternating periods of significant increases and substantial losses of foreign exchange reserves. Thanks in part to the near-zero rate of inflation, the average real exchange rate rose by almost 4% for 1998 as a whole.

In early 1999, the pressure of hefty reserve losses prompted the Government to try to shore up the exchange rate by widening the currency band, but it was forced to abandon this attempt just two days later in favour of a free float. The currency market was extremely unstable for the next two months, before the situation began to calm down in mid-March. The prospect of a long period of instability and economic contraction following the devaluation of the *real*—owing to the need to maintain a tight monetary policy to lessen its inflationary impact—gradually began to give way to the belief that the country's main economic policy

problems would be managed in such a way as to put the economy back on a sustainable growth path, thanks in part to the favourable conclusion of the IMF negotiations. Once authorization was given to use the financial aid package to stabilize the currency market, the Central Bank was able to take immediate action. As a result, exchange rate expectations—which until then had been strongly influenced by the shortage of foreign exchange caused by the concentration of bond and bank loan maturities in the early months of the year—took on a less downbeat tone.

#### (d) Structural reforms

As part of the process of State reform, during 1998 US\$ 36.6 billion in privatizations were completed at both the federal and state levels, which was an increase of 23% from the preceding year's figure. The largest such transaction was the sale of federal telecommunications companies, which yielded 22.1 billion *reals*. At the state level, the process of selling off electricity distribution companies and other assets, which had begun in 1997 in most cases, continued in 1998.

### 3. The main variables

#### (a) Economic activity

The Brazilian economy stagnated in 1998, with GDP growing by just 0.2% and per capita output falling by 1.1%. The agricultural sector grew by a dismal 0.4% and services by 0.8%, while the manufacturing sector slumped by 3.3%. The full impact of the economic measures was felt in the final quarter. High interest rates, federal spending cuts, a shortage of external credit and uncertainty among economic agents regarding the continuity of the authorities' foreign exchange policy all had a negative effect on production sectors.

The modest expansion of agricultural output came exclusively from the livestock industry, which grew by 3.9% as against 2.4% in 1997. Crop production slipped by 0.2% owing to El Niño-related weather problems (drought in the north-east and excessive rainfall in the southern part of the country). Some crops did produce bumper harvests, however, such as soybeans, with a record production level of 31.3 million tons, and coffee, where output surged by 85%.

The drop in manufacturing output was largely due to the poor performance of the automotive industry, where production was down by 24%, domestic sales were 27.5% lower and the number of vehicles exported fell by 8%. The downturn in the production of electrical equipment and electronics grew steeper in 1998 (–9.5%), and the output of consumer durables as a whole was consequently down by 20% from the year before; the other categories also turned in negative results. Capital goods were unable to sustain the growth trend that had begun in 1997 and continued to be highly vulnerable to external competition; the production of intermediate goods, on the other hand, fell only slightly (–0.8%).

Mining output expanded by 9% thanks to the positive results of oil exploration operations. In construction, the high real rates of interest prevailing throughout the year, together with the fact that the political-administrative cycle at the state government level reached its end, led to a severe slowdown, with the in-

dustry expanding just 1.7% after having turned in a much more buoyant performance in 1997, when it had grown by 8.5%.

In services, the growth of the electricity, gas and water sector slowed from 6% in 1997 to 4.2% in 1998, mainly due to the flagging pace of economic activity in the closing months of the year. Meanwhile, the transport and communications sector prospered on the back of greater public and private investment. On the other hand, the negative trend in consumer durable goods, the lower level of imports, high interest rates and the flat trend in real wages all worked together to produce a drop of 3.4% in activity in the commercial sector.

The sluggishness of the economy hurt investment, which fell to 21.2% of GDP at current prices, or half a percentage point below the 1997 figure.

### (b) Inflation, wages and employment

Consumer prices went up by just 2.5% in 1998 (the lowest inflation rate recorded since the Second World War), thereby consolidating the downward trend that has been in evidence since the start of the stabilization plan. Moreover, for the first time in several decades, some price indices were actually registering deflation: the cost-of-living index in São Paulo fell by 1.8%, and the national wholesale price index for the manufacturing sector yielded a deflation rate of 0.3%.

A breakdown of the consumer price index reveals slower increases in practically all categories and, in some (such as beverages, cigarettes and clothing), prices actually fell. The steepest increases were in education and health care, but the prices of some food products also climbed substantially, mainly as a result of weather problems related to El Niño.

The inflation rate edged up slightly in the wake of the devaluations of January and February 1999, raising fears that indexation mechanisms, which had been widely used during earlier bouts of high inflation, would be reinstated. However, after the turbulence in the currency market began to subside in March, the exchange rate declined to around 1.7 *reais* to the dollar (it had been as high as 2.2 for a few days in February), whereupon inflation began to slacken once again. In May and June the rate was virtually zero (0.1%) despite further increases in the exchange rate.

Urban employment in the formal sector of the economy declined across the board, both regionally and by sector, and in the country as a whole it was down for the third year running (−1.4%), with a particularly steep decrease in manufacturing jobs. In some metropolitan areas, such as São Paulo, the reduction was as

much as 7.1%. As a result, the urban unemployment rate rose from 5.7% in 1997 to 7.6% in 1998. In the first quarter of 1999 the trend continued, and unemployment climbed to 7.8%, or two-tenths of a percentage point higher than the already considerable level registered for the same period of the preceding year.

The shaky employment situation had an effect on wages. In 1998, the main indicators of the total wage bill were down, both nationwide and for the manufacturing sector in São Paulo, thereby breaking with the nearly continuous upward trend observed ever since the start of the Real Plan. Nationwide, the average wage and the total wage bill both declined in real terms, although by under 1%. For manufacturing workers in São Paulo, the wage bill fell by 3.2% in real terms, but the average real wage grew by 2.2%. This was attributable to the fact that the more highly-paid employees came to account for a larger share of the wage bill, since they were less likely to be laid off. Had it not been for the very low rate of inflation, the trend in real wages in 1998 would have been more unfavourable than it actually was.

### (c) The external sector

The external vulnerability of the country, which has been discussed in previous editions of the *Economic Survey*, was underscored in 1998 by a deterioration in the balance of payments. This demonstrated that the maintenance of the existing exchange-rate policy under the new international market conditions that have arisen in the wake of the Asian and Russian crises could only be accomplished with the help of immediate extraordinary financing and deeper domestic adjustments, in particular to deal with the reduced availability of external savings.

The current account deficit came in at US\$ 35.3 billion in 1998, compared to slightly over US\$ 33.8 billion in 1997. Although the trade deficit narrowed to US\$ 6.4 billion—down by one quarter from the 1997 level—this was not enough to offset the sharp increase in net profit remittances (which reached an all-time high of US\$ 7.2 billion, as against an average of US\$ 3.3 billion in 1994-1997) and interest payments, which climbed to US\$ 12.1 billion. In any event, the country's merchandise trade performance was disappointing, especially in view of the fact that activity was stagnant and the real exchange rate rose by a reasonable amount. The sluggishness of the domestic economy did not have much impact on outlays under the headings of international travel and transport, which between them ended the year with a deficit of US\$ 8.4 billion, or only 5.7% less than in 1997.

The value of exports declined by 3.5% in 1998, mainly because of the contraction in commodities, with sizeable downturns being registered for coffee and soy exports. There were also reductions in semi-manufactures, and industrial goods remained at a virtual standstill, with the only significant increases being in orange juice and transport equipment. This state of affairs is a direct result of the position in which the world economy found itself following the sharp slowdown that occurred in developed countries, one of whose effects has been a steep drop in commodity prices.

The value of imports contracted by 6.2% across the board in 1998, but the slump in fuel imports was espe-

cially serious owing to sharply lower prices on international markets.

In the early months of 1999, this bleak situation persisted despite the devaluation of the *real* as the world economy continued to turn in a dismal performance and commodity prices remained low, although lately there have been signs of a gradual recovery. One of the most conspicuous aspects within this generally negative picture was the poor performance of exports, which were down even in comparison with the corresponding months of the preceding year. This was due in part to the scarcity of lines of credit for export activity and the uncertainty surrounding the future course of the exchange rate during the first few months of the year.





## Chile

### 1. General trends

The shock waves from the external crisis that first hit the Chilean economy in October 1997 led to a sharp increase in the merchandise trade deficit, with net capital inflows falling by more than half and international reserves thus shrinking considerably after nine years of uninterrupted growth. This made it necessary to moderate the growth of economic activity and domestic demand in an economy already overstretched and in urgent need of adjustment; the combination of domestic austerity measures and the impact of the external crisis cut GDP growth to 3.4% in 1998 from its 1997 figure of 7.6%.

**ECONOMIC ACTIVITY** and domestic demand both slowed down sharply during the course of the year, culminating in a sharp downturn in expenditure in the final quarter together with a smaller contraction in GDP; as a result, domestic demand expanded on average by 1.9%, and the differential between expenditure and output was negative for 1998 as whole (1.5%). This slump in output and expenditure carried over into the first quarter of 1999.

With the terms of trade deteriorating by 13%, gross national disposable income declined by 0.2% in real terms. As a result, gross national saving, measured in current prices, fell back to 20.2% of GDP (1.6 percentage points down from the 1997 figure), while gross capital formation at current prices came in at 26.5% of GDP. The shortfall had to be financed by a current account deficit equivalent to 6.3% of GDP.

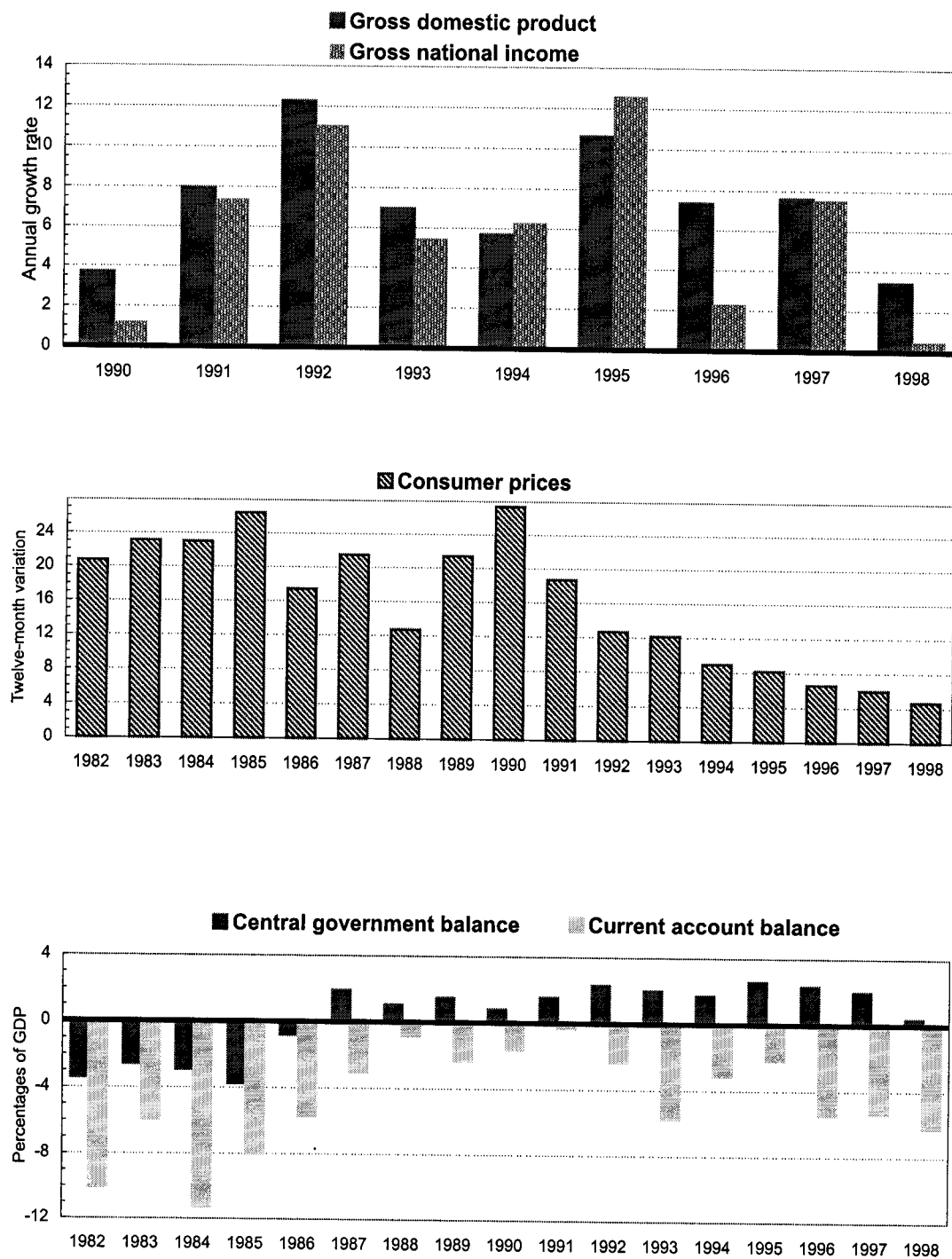
Inflation dropped from 6% in 1997 to 4.7% in 1998, despite the fact that, in the second half of the year, the real exchange rate departed from the downward path it had been on since 1991. Given the lag in the labour market's reaction to the economic cycle, the rate of unemployment for the year edged up to 6.4%, which was only slightly above the 1997 figure, but the situation worsened in the final quarter as the jobless rate moved above 7%. Employment expanded by 1.8% and average labour productivity by 1.6%; real wage growth moderated in the second half of 1998, after having been

on an upswing until the end of the first semester, and ended the year with a variation of 2.9%.

Despite a slump in tax revenues and copper earnings, the central government once again ended the year with a surplus, although at 0.4% of GDP it was well below the surpluses achieved in previous years, which have tended to fluctuate around 2% of GDP. As a result, the non-financial public sector recorded a deficit—equivalent to 0.7% of GDP—for the first time during the 1990s.

The worsening of the Asian crisis, caused by major upheavals in the Korean economy in November 1997, surprised the Chilean economy with a steep drop in copper prices and in the value of exports, which led to a current account deficit of approximately 7% of GDP in 1998. The price of copper, which had averaged US\$ 1.032 per pound in 1997, fell to US\$ 0.75 in 1998, and this triggered a significant commercial and fiscal retrenchment. Every one-cent decrease in the price of copper means the economy receives approximately US\$ 65 million less in revenue; as a result, the merchandise trade deficit widened by US\$ 1.2 billion, equivalent to about 1.6% of GDP. The fiscal budget had been predicated on a copper price of US\$ 0.92 per pound, but the significantly lower value, together with a downward adjustment in growth projections for economic activity and tax receipts, made it necessary to tighten fiscal policy.

Figure 1  
CHILE: MAIN ECONOMIC INDICATORS



Source: ECLAC, on the basis of official figures.

As the real exchange rate had fallen by 10% over the 12 months to October 1997, the market was wagering on an adjustment in the rate. This led to several small but unaccustomed nominal devaluations, which brought to an end a ten-month period of stagnation in nominal terms and a period of over five years in which expectations had consistently been for a revaluation of the peso. The rapid growth of activity and spending in the final quarter of 1997 (9.6% and 13.7%, respectively), together with deteriorating merchandise trade and current accounts in 1998, sparked an overreaction in the financial system, which made a drastic adjustment in its portfolios as it reshuffled assets and liabilities towards the dollar. This process persisted throughout the first half of the year and involved a sum amounting to nearly US\$ 4.5 billion.

Between the third quarter of 1998 and the second of 1999, private expenditure was reined back sharply in the face of worsening terms of trade, the prevalence of high interest rates and the gradual upward trend of the exchange rate. Several months of high interest rates put

a sharp brake on spending and helped to narrow the external deficit, but they also impaired investment and productive activity, and this pushed unemployment up to 8.3% in the quarter ending March 1999.

Greater international stability in the first four months of 1999, along with a contraction in both economic activity and spending, considerable progress in reducing the trade deficit and a general perception that inflation was under control, created the conditions for a successive easing of monetary policy. The Central Bank lowered its benchmark interest rate to 6.5%, which was more or less where it had stood before the Asian crisis worsened in November 1997, thereby bringing the interest-rate adjustment cycle to a close. The above, together with signs of an incipient recovery in economic activity and a slight improvement in copper prices, helped to turn expectations in a favourable direction. Expectations were also given a boost when the Chilean State launched a sovereign bond for US\$ 500 million in April, an operation that has benefited from the narrower spread now being obtained by emerging economies on the international market.

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## 2. Economic policy

Reducing the external deficit and ensuring a further decrease in 1999 were the main economic policy challenges in 1998. These tasks involved cutting excess expenditure and holding output growth below its potential rate during the biennium. The use of tight monetary and fiscal policies, together with the unfavourable trends of the terms of trade and external demand, were what set the tone in late 1998 and early 1999. Early in the second quarter of 1999 expectations picked up, and there were signs pointing to a possible revival in the second half of the year. This situation has been bolstered by a series of measures aimed at loosening up monetary policy, greater stock market activity and a vigorous recovery of external capital flows, along with signs of a gradual upturn in the price of copper.

### (a) Fiscal policy

Fiscal policy helped to contain spending by reducing budgeted expenditure by 5.5%, or the equivalent of nearly 0.9% of GDP. Despite shrinking tax revenues

and lower copper receipts, the central government again achieved surpluses on its current and global accounts, equivalent to 4.6% and 0.4% of GDP, respectively. In addition, the Government trimmed its proposed increase in public expenditure for 1999 to 2.8%, which included a rise in pensions equivalent to 1.3% of GDP, to be financed by an increase in indirect taxes. This was the smallest real increase in public spending during the 1990s and was in line with estimated GDP growth of between 2% and 3%. The non-financial public sector posted a deficit equivalent to 0.7% of GDP, however, with revenues stagnating because of the problems discussed above and expenditure rising slightly.

Legislation was passed that would permit the establishment of an international offshore exchange in the country for the trading of foreign-issued securities with no tax or capital restrictions for foreign investors. An infrastructure fund was also created with an initial contribution of US\$ 150 million in a effort to give stability and continuity to the flow of funds and to com-

Table 1  
CHILE: MAIN ECONOMIC INDICATORS

	1990	1991	1992	1993	1994	1995	1996	1997	1998 <sup>a</sup>
<b>Annual growth rates<sup>b</sup></b>									
Growth and investment									
Gross domestic product	3.7	8.0	12.3	7.0	5.7	10.6	7.4	7.6	3.4
Per capita gross domestic product	2.0	6.2	10.4	5.2	4.0	8.9	5.9	6.1	2.0
Gross domestic product, by sector									
Goods	3.8	5.3	8.8	6.8	5.0	8.1	6.3	5.4	0.9
Basic services	3.9	12.4	19.8	5.6	5.6	12.9	8.3	11.6	9.8
Other services	3.0	8.7	11.2	5.8	5.1	9.3	6.9	7.3	4.1
Consumption	2.0	8.2	12.7	7.0	7.4	9.2	8.8	8.0	3.5
General government	0.8	3.6	5.6	4.3	1.9	4.2	4.0	5.1	3.9
Private	2.2	8.9	13.8	7.4	8.2	9.8	9.4	8.3	3.5
Gross domestic investment	5.4	0.7	21.8	21.1	0.8	34.2	5.9	11.5	-1.4
Exports of goods and services	8.6	12.4	13.9	3.5	11.6	11.0	11.8	10.1	5.9
Imports of goods and services	5.8	7.0	21.8	14.2	10.1	25.0	11.8	12.9	2.1
<b>Percentages of GDP<sup>c</sup></b>									
Gross national income	93.1	93.2	93.3	92.3	93.3	96.3	92.1	92.6	90.3
Gross domestic investment	19.7	18.4	19.9	22.7	21.5	25.8	25.7	26.6	25.5
National savings	18.7	18.2	18.0	17.9	18.7	23.6	20.3	21.0	19.1
External savings	1.1	0.2	1.9	4.8	2.8	2.1	5.4	5.6	6.3
<b>Percentages</b>									
Employment and wages									
Labour force participation rate <sup>d</sup>	52.6	52.7	53.2	55.2	55.4	54.8	54.2	54.2	54.4
Open unemployment rate <sup>e</sup>	7.8	8.2	6.7	6.5	7.8	7.4	6.4	6.1	6.4
Real average wage (index: 1995=100)	80.9	84.9	88.7	91.8	96.1	100.0	104.1	106.6	109.5
<b>Growth rates</b>									
Prices (December-December)									
Consumer prices	27.3	18.7	12.7	12.2	8.9	8.2	6.6	6.0	4.7
Wholesale prices	25.7	16.5	8.9	6.7	7.8	8.2	3.1	1.9	0.3
External sector									
Terms of trade (index: 1995=100) <sup>c</sup>	83.2	83.2	82.1	75.3	87.1	100.0	83.4	86.6	74.8
Nominal exchange rate (pesos per dollar)	305	349	363	404	420	397	412	419	460
Real effective exchange rate for imports (index: 1995=100)	112.1	111.8	108.1	110.1	106.3	100.0	96.4	90.0	92.4
<b>Millions of dollars</b>									
Balance of payments									
Current account	-485	-99	-958	-2 554	-1 585	-1 398	-3 744	-4 057	-4 548
Trade balance (goods and services)	1 055	1 518	545	-1 217	583	1 020	-1 448	-1 610	-2 820
Exports	10 221	11 069	12 365	11 709	14 444	19 234	18 771	20 608	18 755
Imports	9 166	9 551	11 820	12 926	13 861	18 214	20 219	22 219	21 575
Capital and financial account <sup>f</sup>	2 808	1 355	3 505	2 984	4 736	2 456	6 249	7 242	2 409
Overall balance	2 323	1 257	2 546	430	3 151	1 058	2 505	3 185	-2 140
Variation in reserve assets (- indicates an increase)	-2 121	-1 049	-2 344	-173	-2 919	-741	-1 107	-3 185	2 140
<b>Percentages</b>									
External debt									
Gross debt (as a percentage of GDP)	57.5	47.2	43.6	43.1	42.2	33.3	33.5	35.2	43.2
Net interest (as a percentage of exports) <sup>g</sup>	13.2	9.5	7.1	6.1	4.3	3.1	3.4	2.6	3.4

Table 1 (concluded)

	1990	1991	1992	1993	1994	1995	1996	1997	1998 <sup>a</sup>
<b>Percentages of GDP</b>									
Non-financial public sector									
Current revenue				35.3	33.0	31.4	32.1	31.1	30.3
Current expenditure				28.8	27.2	24.9	25.2	25.0	25.6
Saving				6.5	5.8	6.5	6.9	6.1	4.7
Capital expenditure (net)				4.5	3.8	4.0	5.1	5.3	5.4
Financial balance				2.0	2.0	2.5	1.8	0.8	-0.7
<b>Growth rates <sup>h</sup></b>									
Money and credit									
Monetary balances of banking system									
Net international reserves	124.6	34.8	62.8	17.8	22.5	13.3	8.3	14.5	-9.8
Net domestic credit	-10.8	36.2	-19.4	39.7	-4.0	59.9	32.3	31.3	217.5
To public sector	18.6	14.3	-2.9	11.8	-17.4	1.6	-13.7	-9.4	-31.6
To private sector	16.1	22.4	37.0	30.2	12.8	28.8	18.0	13.6	63.2
Money (M1)	27.0	39.7	21.2	29.2	-2.9	14.8	-7.8	97.9	-2.0
Local-currency savings and time deposits	32.0	36.9	32.4	22.5	22.6	32.9	24.0	10.7	...
M2	30.8	37.6	29.7	24.0	16.8	29.4	18.6	22.1	78.8
Dollar deposits	28.7	23.2	-17.2	31.3	-20.7	-7.3	-9.9	6.2	...
<b>Annual rates</b>									
Real interest rates (annualized, %)									
Deposit rate	10.4	3.1	5.0	5.3	5.7	5.1	6.4	5.6	9.5
Lending rate	17.1	8.4	10.0	10.8	10.4	9.2	10.1	9.0	14.5
Equivalent interest rate in foreign currency <sup>i</sup>	24.0	10.2	16.5	5.9	22.2	14.9	10.0	8.6	6.6

Source: ECLAC, on the basis of official figures.

<sup>a</sup> Preliminary figures. <sup>b</sup> Based on figures in constant 1986 pesos.

<sup>c</sup> Based on figures in constant 1995 dollars.

<sup>d</sup> Percentages of the work-

ing-age population.

<sup>e</sup> Percentages of the economically active population (EAP).

<sup>f</sup> Includes errors and omissions.

<sup>g</sup> Refers to net interest

as shown on the balance of payments, divided by exports of goods and services.

<sup>h</sup> Owing to changes in the methodology used, the figures given

for 1998 are not strictly comparable with those of previous years.

<sup>i</sup> Interest rate on deposits, deflated by the variation in the exchange rate.

mitments made in connection with public works carried out under concession contracts. A tariff cut was also approved in 1998 whereby the general tariff will be gradually lowered from 11% to 6% over a five-year period. The legislation on pension increases also included incentives for private saving in the form of equities, financial deposits and corporate stock dividends and simplified the corresponding tax rules.

### (b) Monetary and foreign exchange policy

In January 1998, at the height of the turmoil in international financial markets, the currency and interest rate instability that had begun in October 1997 intensified. Between then and January 1998, the exchange rate jumped from 414 to 453 pesos per dollar and the real annual interbank interest rate shot up, within a very

short amount of time, to nearly 100%, thereby undermining the credibility of the year's inflation target of 4.5%. In the absence of nominal anchors, chaos reigned on financial and foreign exchange markets, until the Central Bank of Chile —after a modest rise in the real annual interbank interest rate from 6.5% to 7% in early January was deemed insufficient by the market— raised the rate again, to 8.5%, and this time managed to restore credibility in the authorities' handling of macroeconomic policy.

After three months of currency stability, in June the peso came under pressure once again, this time owing to the yen's sharp fall against the dollar and to fears about the possible impact of this on copper prices and on prospects for obtaining external financing. In that month alone, international reserves at the Central Bank shrank by US\$ 1.3 billion.

Table 2  
CHILE: MAIN QUARTERLY INDICATORS

	1996				1997				1998 <sup>a</sup>				1999 <sup>a</sup>
	I	II	III	IV	I	II	III	IV	I	II	III	IV	I
Gross domestic product (change from same quarter of preceding year) <sup>b</sup>	8.9	7.5	5.5	7.7	5.1	6.4	8.9	9.9	8.0	5.9	2.9	-2.8	-2.3
Consumer prices (12-month variation, %)	7.9	8.3	6.3	6.6	6.8	5.3	6.0	6.0	5.3	5.4	4.8	4.7	4.1
Real effective exchange rate <sup>b</sup> (index: 1995=100)	98.3	95.9	95.6	95.8	92.2	90.8	88.6	88.3	91.3	91.5	93.0	93.8	95.2
Exports (millions of dollars)	4 062	4 273	3 516	3 502	4 643	4 364	3 999	3 918	4 040	3 990	3 426	3 439	3 940
Imports (millions of dollars)	3 799	3 925	4 212	4 564	4 000	4 213	4 741	5 264	4 613	4 518	4 498	3 763	3 317
Real interest rates (annualized, %)													
Deposit rate	5.0	7.3	6.5	6.9	5.6	3.7	5.2	7.1	6.3	7.2	13.7	10.7	4.7
Lending rate	8.5	10.9	10.4	10.5	9.0	7.4	8.5	10.5	10.8	10.7	20.7	15.7	15.7
Money (M1) <sup>c</sup> (change from same quarter of preceding year)	...	...	...	...	14.7	18.2	20.4	20.0	10.8	8.2	-5.3	-8.3	-2.1

Source: ECLAC, on the basis of official figures.

<sup>a</sup> Preliminary figures.

<sup>b</sup> Refers to exchange rate for imports.

<sup>c</sup> Held by the private sector.

In view of this situation, the Central Bank lowered the reserve requirement on foreign credits from 30% to 10% for the first year they were in the country in an attempt to reduce the cost of external financing. In addition, it introduced inflation-linked dollar-denominated paper in order to take pressure off the spot market and narrowed the currency band from 12.5% either side of the reference rate for the dollar to 3.5% below and just 2% above it. This measure increased the chances of achieving exchange-rate stability and attaining the inflation target, and made explicit reference to the option of using interest rate flexibility to curb speculative pressure against the peso.

In September, with the collapse of the Russian economy and the threat of crisis in Brazil, the peso again came under siege. The Central Bank sought to counter this trend with a package of measures designed to: (i) restore the symmetry of the exchange rate band by raising its upper limit from 2% to 3.5%, and to move towards a gradual widening of the band, which by the end of the year had expanded to 5% on either side of the reference value; (ii) eliminate the 2.4% deduction for external inflation; and (iii) link the readjustment of

rates for the dollar to expected rather than past inflation. These measures made room for a rise in the exchange rate; the Central Bank also raised its base rate from 8.5% to 14% and lowered the reserve requirement on external capital inflows to zero.

These measures were intended to stabilize liquidity by imposing a higher interest rate, avoiding sharp fluctuations in the interbank rate and taking care to prevent liquidity from spilling over into the exchange market. Supported by the fiscal adjustment effort, the Central Bank managed to secure the stability of the dollar and paved the way for a drop in both short- and long-term interest rates. External developments, which were favourable from October on, continued to play a decisive role in controlling expectations. This, in turn, set the stage for an orderly devaluation and for successive steps to relax monetary policy from late October onward. The base interest rate came down gradually from 14.5% in mid-September to 12% a month later, then to 10% in early November and 8.5% by the end of that month. A series of additional adjustments lowered the rate to 6.5% in early April 1999, thereby re-establishing credit conditions similar to those seen in the mid-1990s.

### 3. The main variables

GDP slowed down sharply in 1998, while inflation continued to decline from the preceding years' already low levels. By year's end, employment figures were less favourable than in the recent past, whereas wages continued to rise in real terms, albeit more slowly than before. The current account deficit again rose, and net capital inflows decreased sharply; as a result, international reserves contracted for the first time following several years of expansion.

#### (a) Economic activity

Economic activity expanded by 3.4% in 1998 as a whole, but its pace clearly slowed down as the year progressed, marking up an increase of 8% in the first quarter, rates of 5.9% and 2.9% in the next two quarters, and a contraction of 2.8% in the fourth quarter. The slowdown in expenditure was even more abrupt, plummeting from an annualized growth rate of 15.5% in the first quarter to a drop of 13.2% in the final quarter of the year. The differential between expenditure and output, which had reached a positive figure of 7.5 points in the first quarter, changed sign in the third, ending up at minus 10.4 points in the final quarter.

The most buoyant component of total expenditure was external demand, as exports of goods and services expanded by 5.9% in volume terms, while imports slowed down sharply compared to the preceding year, growing by just 2.1%. Domestic demand felt the effects of the adjustment, with private consumption increasing by 3.5% and gross fixed capital formation by only 2.1%.

The following sectors grew faster than GDP as whole: transport and communications (11.2%); commerce (5.3%); electricity, gas and water (4.8%); mining (4.1%); and financial services (3.5%). Agriculture, forestry and fishing grew by around 3%, and manufacturing declined by 1.5%. The severe drought from which the country has been suffering since 1998 had an adverse impact on field crops and fruit orchards, but these industries achieved positive results nonetheless. The drought also hurt hydroelectric power generation, and this was reflected in lower value added figures for the sector, as hydroelectricity is gradually being replaced by thermoelectric plants.

#### (b) Prices, wages and employment

Inflation amounted to 4.7%, as a result of a 6.2% increase in the price of non-tradable goods and 2.3% in tradables. This achievement was made possible by a sharp deceleration in tradable goods prices, particularly in the final quarter, which was attributable in part to lower international inflation and currency stability. Inflation in non-tradables has been slower to decline, although the sharp downward trend of expenditure was exerting downward pressure in the early months of 1999. The trend inflation rate, which excludes what are considered to be seasonal price variations, remained substantially above the inflation target, at 6.3% for the year. In the first quarter of 1999, tradable goods prices continued to contribute to the decline in the inflation index, but inflation in non-tradables had still not fallen below 6% year-on year. The slowdown in nominal wages and a more stable exchange rate should be of considerable help in achieving the inflation target for 1999 (4.3%), even though trend inflation to the month of March continued to stand at an annualized rate of 5.6%.

The economic slowdown has gradually been making itself felt in the labour market as, with the usual effect, employment began to weaken in response to the changes taking place in the activity level. Employment grew at an annual rate of 2.5% in the second quarter, before slowing to 1.3% in the third to post an average increase of 1.8% for the year as a whole. The unemployment rate was 5.3% at the beginning of the year, but had climbed to 7.2% by the final quarter of 1998 and to 8.3% by the first quarter of 1999.

Nominal and real wages grew on average by 7.9% and 2.7%, respectively. These levels represented a decrease from the peaks reached at the beginning of the third quarter, which reflected the lagged effect of previously high activity levels. By late February 1999, the 12-month increase in nominal wages had slipped to 6.6%, while the rise in real wages remained at 2.7%.

#### (c) The external sector

With a smaller net inflow of foreign exchange, the overall balance of payments recorded its first deficit (US\$ 2.1 billion) since 1986; this was the result of lower export earnings and of the decline in net capital



inflows caused by portfolio reshuffling, which translated into a deficit of US\$ 4.55 billion on the current account and a surplus of US\$ 3.2 billion on the financial account. The poor performance of the current account was chiefly the consequence of a wider merchandise trade gap, which was in turn attributable to a marked deterioration of the terms of trade. International reserves fell by US\$ 2.1 billion over the year (2.5% of GDP), but were down by US\$ 2.9 billion from their October 1997 level, since the strongest attack on the peso had come in the final quarter of 1997.

When measured against the 1997 surplus of US\$ 3.2 billion, the turnaround in the balance of payments was equivalent to 7% of GDP; of this, nearly 2% was due to the worsening trade balance and more than 5% to shrinking capital flows. The financial account surplus was less than half as much as it had been in 1997 owing to a reduction in net flows of portfolio investment—due to fewer issues of bonds and American Depositary Receipts (ADRs)—together with an accumulation

of external assets by the private and banking sector and a cutback in net foreign investment.

The merchandise trade deficit amounted to US\$ 2.5 billion, which was the largest to be recorded in the 1990s, with exports falling by 12% and imports by 4%; this led to a deficit on current account of US\$ 4.5 billion, or 6.3% of GDP. This outcome was basically due to the deterioration in the terms of trade—particularly in the first three quarters, as in the final quarter this was partly offset by a steep decrease in the rate of import growth. The decline in exports was due to an abrupt drop in prices (17%), since volumes expanded by 6.2%. Non-traditional exports grew by 3.6% in value terms, thanks to a notable increase in volume (12%).

The Asian crisis was reflected in a shift in the destinations of export shipments. Volumes exported to Asia were reduced by slightly more than 10%, with their value falling from 35% to 29% in constant prices, whereas the volume exported to the rest of the world grew by 17.6%.

## Colombia

### 1. General trends

The Colombian economy was beset with difficulties in 1998, as unfavourable external shocks forced authorities to make macroeconomic adjustments in a context of fiscal and external disequilibria. The adjustments, especially those achieved through monetary policy, had an adverse effect on the productive and financial sectors and led to a sharp increase in unemployment. The economic slowdown and the subsequent financial losses were reflected in a modest increase in GDP of 0.6%, one of the lowest in recent decades.

THE INTERNATIONAL financial crisis had strong repercussions on the Colombian economy. The fiscal and external deficits, which had been easily financed in previous years, raised questions about the sustainability of the economic policies being applied, particularly in view of the tight liquidity situation prevailing on the external market. This was compounded by the deterioration in the terms of trade, caused mainly by sharp falls in the prices of oil, coffee and coal, the country's three main exports. It also became evident that the strong inflows of foreign currency expected from an increase in oil production would not materialize in the near future. As a result, widespread expectations of devaluation led to speculative attacks against the Colombian peso.

This speculation, which began in January and lasted until November, reduced the authorities' manoeuvring room. Faced with political uncertainty and public unrest, they opted to defend the national currency by adopting a highly restrictive monetary policy that caused the economy to cool down rapidly. The activity level fell by 3% in the last quarter of 1998, and this effect spilled over into the first quarter of 1999.

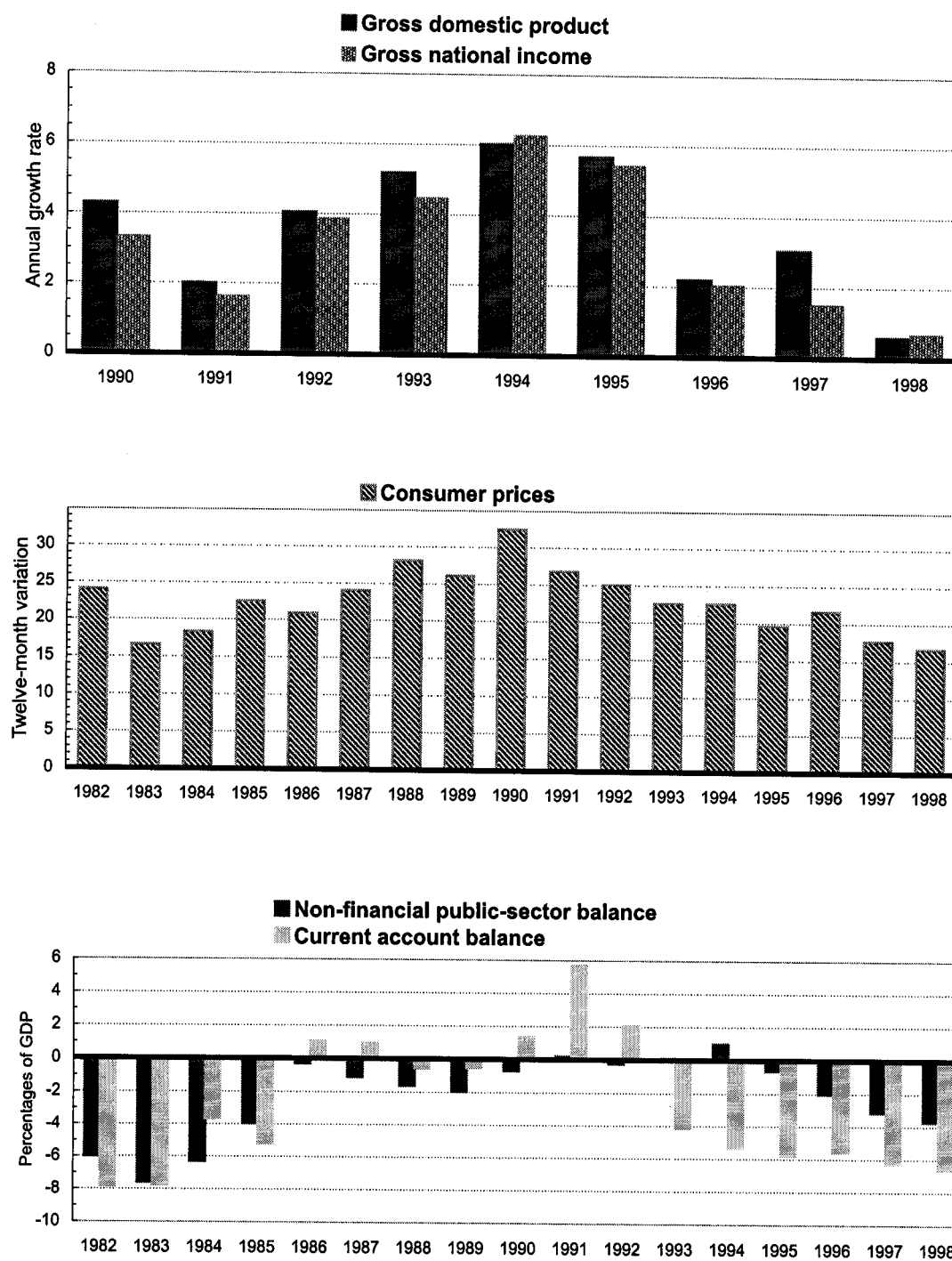
Other macroeconomic indicators presented a mixed picture. The fiscal deficit of the consolidated non-financial public sector was equivalent to 3.7% of GDP, and the balance-of-payments current account deficit was equivalent to 6.6% of the product; in both cases, there was a slight decline from the previous year's levels. The labour market continued to deteriorate, bringing the urban unemployment rate to over 15%. By contrast, the Banco de la República (the central bank) succeeded in

meeting its inflation target for the second year in a row; at year-end, inflation was just over 16%. Similarly, for the second consecutive year, the peso suffered a real devaluation, and this partially corrected the cumulative appreciation recorded over the decade.

On assuming power in August, the new Administration intensified the fiscal measures being applied and, in conjunction with the Banco de la República, adopted monetary and exchange-rate measures designed to mitigate macroeconomic imbalances. In order to prevent a further decline of the financial sector, it was forced to declare an economic emergency in November 1998. Another economic emergency was declared in January 1999, in order to cushion the effects of the earthquake that had devastated the coffee-growing region.

The outlook for 1999 is gloomy, with prospects of sluggish growth and soaring unemployment, which rose to 19.8% by June. Preliminary data available at mid-year suggest that economic activity remains weak, notwithstanding a considerable reduction in interest rates. Credit activity ground to a halt for reasons that had as much to do with the demand for credit as with the supply thereof. The financial sector continued to deteriorate, and fiscal accounts reflected lower income than expected, owing to a fall in tax revenue. Inflation has continued to decline, as has the balance-of-payments deficit. In the first half of 1999, the economic authorities have directed their policies towards reviving the economy and putting the financial sector on a sound footing, while continuing to focus on correcting accumulated imbalances.

Figure 1  
COLOMBIA: MAIN ECONOMIC INDICATORS



Source: ECLAC, on the basis of official figures.

## 2. Economic policy

The unfavourable external shocks sustained at the beginning of 1998 forced the authorities to abandon the expansionary monetary policy that had made possible the economic recovery of the previous year. An inflexible short-term fiscal policy shifted the burden of adjustment onto monetary policy, which was oriented primarily towards defending the exchange-rate band. As a result, the adjustment in monetary policy pushed interest rates up sharply, to the highest levels of the decade.

The new Administration intensified the cutbacks in fiscal spending, especially investment, and proposed a new tax reform, which was approved by Congress towards the end of the year. The Banco de la República, for its part, devalued the exchange-rate band in early September. Nevertheless, the restrictive monetary policy had already had a serious impact on the real economy, which entered a recession in the last quarter. In response to a serious deterioration in the financial sector portfolio, the Administration declared the economic emergency in November and took steps to avoid a full-blown crisis. With credit provided by multilateral agencies, the Government secured the necessary foreign exchange to finance the 1999 external deficit, thus easing pressure on the exchange-rate band. Once the speculative attacks had subsided, the central bank adopted a series of measures aimed at bringing interest rates down and giving new impetus to the economy. In mid-1999, however, further speculative pressures arose. To avoid a new wave of interest-rate hikes, the Banco de la República opted for a further devaluation of the exchange-rate band on 27 June.

### (a) Foreign exchange policy

In early 1998, the economic authorities had to intervene to protect the ceiling of the exchange-rate band, which had been designed with a 13% slope and a range of seven percentage points on either side of the central rate. The measures taken by the central bank in January and February were intended to afford private entities easier access to external financing (by reducing the re-

serve requirements for external loans and the time for which the corresponding deposit must be held), and to make domestic liquidity more expensive (by raising intervention interest rates on the money market), since currency sales (of over US\$ 400 million, in February) had not been sufficient to head off the attacks. In the wake of renewed speculative attacks in May, the Banco de la República reacted by suspending repo operations on the money market and treasury bond (TES) purchases on the secondary market. These measures caused a drastic contraction of liquidity and a sharp rise in the inter-bank interest rate, an effect that spread rapidly to the entire interest-rate structure.

In August, the Russian crisis further disrupted international markets, and this affected Colombia's foreign exchange market. This time, as part of a broader package of measures agreed on with the new Administration, the Banco de la República raised the level of the exchange-rate band by nine percentage points. It again eased controls on capital by reducing the deposit requirement on foreign borrowing from 25% to 10% and shortening its term from 12 to 6 months. The Administration's decision in October to issue dollar-denominated bonds<sup>1</sup> on the domestic market helped to ease pressure on the exchange-rate band. At the same time, the multilateral agencies agreed to lend Colombia over US\$ 2.2 billion in 1999 and a similar sum in 2000 to finance the external deficit. As a result, the speculative attacks subsided, and by year-end, the exchange rate was close to the mid-point of the band, reflecting a nominal devaluation of 19%. The average devaluation was higher (25%), partly reversing the appreciation of the peso recorded in earlier years. The foreign-exchange crises in Brazil and Ecuador in the first quarter of 1999 had only a minimal impact on the Colombian exchange rate, and thus the authorities were able to implement a policy of economic recovery. Following the renewed speculative attacks in June, the Banco de la República again adjusted the exchange-rate band upwards by nine percentage points, widened the span from 14 to 20 percentage points and reduced the slope from 13 to 10%.

<sup>1</sup> Since they can be purchased in pesos, these bonds reduce the amount of local currency that is available for speculative attacks. In the period October-December 1998, a total of US\$ 210 million of such bonds was placed on the market.

Table 1  
COLOMBIA: MAIN ECONOMIC INDICATORS

	1990	1991	1992	1993	1994	1995	1996	1997	1998 <sup>a</sup>
<b>Growth rates <sup>b</sup></b>									
Growth and investment									
Gross domestic product	4.3	2.0	4.0	5.2	6.0	5.7	2.2	3.1	0.6
Per capita gross domestic product	2.3	0.0	2.0	3.2	4.0	3.8	0.1	1.1	-1.3
Gross domestic product, by sector									
Goods	3.8	2.1	1.1	1.7	3.9	4.5	-0.2	1.2	0.0
Basic services	3.7	3.4	4.1	4.3	6.9	4.2	4.9	4.9	3.5
Other services	4.0	2.3	4.9	6.7	6.2	7.3	5.2	3.4	-0.5
Consumption	3.0	1.8	4.1	7.6	5.4	5.0	3.3	3.8	0.9
General government	3.1	3.2	10.6	7.3	11.1	7.7	10.4	4.6	0.9
Private	3.0	1.6	3.0	7.7	4.4	4.5	1.7	3.7	0.9
Gross domestic investment	-1.2	-8.7	43.0	30.7	34.0	5.0	-2.7	2.7	-6.8
Exports of goods and services	17.6	12.0	5.6	6.6	-0.3	14.7	4.2	8.1	8.8
Imports of goods and services	7.8	3.4	41.3	38.7	22.8	8.1	3.0	9.6	0.3
<b>Percentages of GDP <sup>c</sup></b>									
Gross national income	97.1	98.6	98.4	98.0	100.1	99.0	99.1	98.2	97.2
Gross domestic investment	12.0	11.1	14.9	17.6	22.6	22.8	22.0	23.2	21.6
National savings	13.6	15.3	15.9	14.5	18.0	17.2	16.8	16.0	14.7
External savings	-1.5	-4.2	-1.0	3.1	4.5	5.6	5.3	7.2	6.9
<b>Percentages</b>									
Employment and wages									
Labour force participation rate <sup>d</sup>	58.4	59.5	60.8	60.1	60.0	59.9	59.7	59.9	62.2
Open unemployment rate <sup>e</sup>	10.5	10.2	10.2	8.6	8.9	8.8	11.2	12.4	15.3
Real average wage (index: 1995=100) <sup>f</sup>	94.9	92.4	93.5	97.9	98.8	100.0	101.5	104.2	102.8
<b>Growth rates</b>									
Prices (December-December)									
Consumer prices	32.4	26.8	25.1	22.6	22.6	19.7	21.6	17.8	16.7
Wholesale prices	29.9	23.1	17.9	13.2	20.7	15.4	14.5	17.5	13.5
External sector									
Terms of trade (index 1995=100)	94.8	99.1	87.9	91.0	104.9	100.0	103.8	114.0	104.9
Nominal exchange rate (pesos per dollar)	502	633	679	787	827	913	1 037	1 141	1 426
Real effective exchange rate for imports (index: 1995 = 100)	133.6	134.9	120.0	114.5	99.9	100.0	92.7	86.8	92.5
<b>Millions of dollars</b>									
Balance of payments									
Current account	542	2 349	901	-2 102	-3 638	-4 630	-4 749	-5 881	-5 910
Trade balance (goods and services)	1 821	2 740	1 189	-1 458	-3 281	-3 813	-3 325	-4 193	-4 129
Exports	8 679	9 100	9 246	9 949	10 667	12 264	13 170	14 214	13 339
Imports	6 858	6 360	8 057	11 407	13 948	16 077	16 495	18 407	17 469
Capital and financial account <sup>g</sup>	68	-586	374	2 566	3 837	4 626	6 476	6 089	4 456
Overall balance	610	1 763	1 274	464	199	-4	1 727	208	-1 454
Variation in reserve assets	-610	-1 763	-1 274	-464	-199	4	-1 727	-208	1 454
<b>Percentages</b>									
External debt									
Gross debt (as a percentage of GDP)	44.7	42.0	39.1	37.2	31.8	31.0	34.4	33.9	37.8
Net interest (as a percentage of exports) <sup>h</sup>	15.3	12.4	9.9	7.4	14.6	15.3	16.0	16.6	19.7

Table 1 (concluded)

	1990	1991	1992	1993	1994	1995	1996	1997	1998 <sup>a</sup>
<b>Percentages of GDP</b>									
Non-financial public sector									
Current revenue	23.6	25.1	25.4	27.1	27.0	30.8	32.3	31.6	31.4
Current expenditure	16.7	18.2	18.5	19.0	19.3	23.6	24.1	24.4	26.3
Savings	6.9	6.9	6.9	8.1	7.7	7.2	8.2	7.2	5.1
Capital expenditure (net)	7.6	6.7	7.1	8.0	6.7	7.8	10.3	10.3	8.9
Financial balance	-0.7	0.2	-0.2	0.1	1.0	-0.6	-2.0	-3.1	-3.7
<b>Growth rates</b>									
Money and credit									
Monetary balances of banking system									
Net international reserves	...	94.1	29.9	-2.1	-7.2	17.8	20.2	25.9	10.9
Net domestic credit	...	19.6	31.2	14.6	62.5	24.4	33.2	21.5	10.1
To public sector	...	40.9	-12.9	27.2	-15.0	-19.7	-10.9	141.2	120.8
To private sector	...	17.1	37.6	57.8	36.0	35.8	25.3	25.0	13.3
Money (M1) <sup>i</sup>	...	28.1	39.1	32.8	22.4	19.6	16.4	22.2	1.9
Local-currency savings and time deposits	...	30.7	27.4	45.8	50.0	29.9	21.8	25.9	17.0
M2	...	29.9	30.9	41.7	41.8	27.3	20.5	25.0	13.6
<b>Annual rates</b>									
Real interest rates (annualized, %)									
Deposit rate	3.2	8.2	1.4	2.7	6.6	10.4	7.7	4.8	11.7
Lending rate	9.9	16.6	9.0	11.2	15.1	19.2	17.2	13.4	19.8
Equivalent interest rate in foreign currency <sup>j</sup>	4.0	9.8	-1.4	14.8	26.0	11.8	5.8	-2.9	13.1

Source: ECLAC, on the basis of official data.

<sup>a</sup> Preliminary figures. <sup>b</sup> Up to 1997, based on constant 1975 prices; subsequently, based on constant 1993 prices. <sup>c</sup> Based on constant 1995 dollars. <sup>d</sup> Percentages of the working-age population; seven metropolitan areas. <sup>e</sup> Percentages of the economically active population (EAP); seven metropolitan areas. <sup>f</sup> Manufacturing industry workers. <sup>g</sup> Includes errors and omissions. <sup>h</sup> Refers to net interest as shown on the balance of payments, divided by exports of goods and services. <sup>i</sup> In the private sector. <sup>j</sup> Interest rates on deposits, deflated by the variation in the exchange rate.

## (b) Monetary policy

Tight monetary policy was the main instrument used in dealing with the pressures generated on the foreign-exchange market. Monetary aggregates grew more slowly than projected for most of the year. Means of payment (M1) contracted by 3.9% in nominal terms, whereas in 1997 it had grown by 21.7%. Similarly, the broader monetary aggregate, M3 plus bonds, grew by a mere 7.8% compared with a 25% expansion in 1997.

As a result, interest rates shot up to their highest real levels of the decade. The average rate offered in the financial system for fixed-term deposits rose from 24% in January to 36% in June, and stayed at that level until December; lending rates rose from 33% to 45% in the

same period. These movements resulted in a marked slowdown in gross portfolio expansion, which, at an annual rate of 11.3%, was well below the previous year's figure (26.5%).

Once the speculative pressures had eased, a less restrictive policy was adopted, but by then, economic activity had slowed down considerably, and some financial institutions were facing serious difficulties. In October and November, the central bank took a series of measures to lower or eliminate reserve requirements and pay interest on the requirements set for different financial instruments. Between November 1998 and April 1999, the Banco de la República lowered its money-market intervention rates six times, which, with the simultaneous reduction of reserve requirements,

Table 2  
COLOMBIA: MAIN QUARTERLY INDICATORS

	1996				1997				1998 <sup>a</sup>				1999 <sup>a</sup>
	I	II	III	IV	I	II	III	IV	I	II	III	IV	I
Gross domestic product (change from same quarter of preceding year) <sup>b</sup>	4.4	2.3	2.0	-0.2	-0.3	2.9	4.2	5.4	5.6	2.0	0.1	-3.1	-5.8
Consumer prices (nationwide) (12-month variation, %)	20.2	19.7	21.6	21.6	19.0	18.8	18.2	17.8	19.3	20.7	17.8	16.7	13.6
Real effective exchange rate <sup>b</sup> (index: 1995=100)	98.5	94.9	91.7	85.8	84.8	82.8	86.0	93.8	92.4	88.1	89.4	100.2	96.4
Exports (millions of dollars)	2 387	2 753	2 539	2 911	2 429	2 109	2 961	3 025	2 601	2 896	2 664	2 660	2 427
Imports (millions of dollars)	3 246	3 409	3 483	3 539	3 143	3 901	4 062	4 271	3 958	3 950	3 689	3 037	1 613
M1 (change from same quarter of preceding year)	...	...	...	...	14.9	22.7	19.6	21.5	12.2	2.2	-1.0	-5.4	-1.7
Real interest rates (annualized, %)													
Deposit rate	-5.8	10.0	11.7	14.8	5.3	4.5	4.3	5.1	6.2	10.1	13.7	16.6	12.3
Lending rate	2.4	19.9	21.9	24.9	14.4	13.4	13.0	13.0	14.2	18.8	21.1	25	20.2

Source: ECLAC, on the basis of official figures.

<sup>a</sup> Preliminary figures. <sup>b</sup> Refers to exchange rate for imports.

pushed interest rates down considerably. The average deposit rate for fixed-term deposits fell by 18 percentage points between November 1998 and May 1999, but with the retreat in inflation, this did not generate a widespread fall in real interest rates. At the same time, sufficient resources were available to enable authorities to reduce interest rates on treasury securities.

The high interest rates and the slowdown in economic activity detracted from the performance of the financial sector, which posted a negative balance of 1.2 billion pesos in 1998, 85% of which represented losses sustained by the public financial sector. The share of non-performing loans in the total financial-sector portfolio rose from 6.4% in 1997 to 10.1% in 1998. The economic emergency declared in November was intended to deal with the worsening financial system and avoid a widespread crisis; the authorities also made arrangements to strengthen the Fondo de Garantías de Instituciones Financieras (financial institutions guarantee fund) and to alleviate the financial situation of debtors in the low-cost housing system and of savers in the cooperative system. Despite these measures, the financial situation deteriorated further, with losses in the

first four months of 1999 spiralling to 624 billion pesos. Under these circumstances, steps were taken to speed up the consolidation of institutions in the sector; some intermediaries were nationalized, and the number of establishments was reduced substantially, from 126 at the end of 1997 to 103 a year later.

### (c) Fiscal policy

In 1998, the central government deficit rose by the equivalent of 5% of GDP. The sharp cut-back in investment (-28%) did not offset the increased burden represented by the rise in interest rates (60%) and in other current expenditure (23%). In short, total central government expenditure increased by 19.3% in nominal terms. Tax and non-tax revenues were both affected by the economic slowdown, with the former growing by 12.8% and the latter declining by 66%, in nominal terms. The negative impact of the real fall in tax and non-tax revenues was partially offset by a 22.6% increase in capital inflows, which translated into a nominal 10.5% increase in total revenues.

Since interest payments rose from 2.3% of GDP in 1997 to 3.1% in 1998, the central government's primary deficit amounted to 1.9% of GDP in 1998. The estimated social security surplus of 1.7% of GDP plus a 0.6% deficit in the electricity sector, with the accounts of other public agencies remaining in balance, meant that the consolidated non-financial public sector deficit came to 3.7% of GDP. This was partly offset by a substantial quasi-fiscal central bank surplus of over 1% of GDP.

The central government deficit was financed with domestic credit (60%) and borrowing from abroad (40%), reflecting a change in composition compared with the previous year, when as much as 80% of financing was of domestic origin. External financing increased by 143% in 1998, while financing from

domestic sources increased by only 13.7%. This served the twofold purpose of avoiding increased pressure on the domestic market in a year when real interest rates were extremely high, and bringing in foreign currency to calm expectations of a devaluation.

The tax reform approved in December 1998, which was aimed at increasing tax revenues by two billion pesos, and the announced cut-backs in investment and other expenditures (another two billion pesos) are intended to reduce the fiscal imbalance in 1999. It is unlikely, however, that this target will be met, given the reduction in tax revenues generated by the recession. The economic emergency declared after the earthquake that struck the coffee-growing region in January will also result in an unforeseen increase in fiscal expenditure.<sup>2</sup>

### 3. The main variables

#### (a) Economic activity

The year 1998 opened with a strong surge in economic activity, with the recovery started in the previous year carrying over into the first quarter and contributing to over 5% growth. As the year progressed, however, the combination of external shocks and economic policy measures caused a slowdown in activity. By the last quarter, the economy had lost momentum (-3.1%) and entered into a recession that lasted throughout the first quarter of 1999 (-5.8%). The economy is expected to pick up in the second half of 1999, but given the depth of the recession, the overall result for the year is likely to be negative.

Aggregate demand was slack, reflecting a significant reduction in gross domestic capital formation (-6.7%). A drastic cutback in investment expenditure led to a 21.4% fall in gross fixed capital formation in the public sector. High interest rates and the slowdown in productive activity, added to a substantial increase in unemployment, had an adverse effect on final con-

sumption, which expanded by barely 0.9%, compared with 3.8% in 1997. These conditions also led to a substantial inventory build-up (30%). As a result, domestic demand declined by 0.8%, after having expanded by 3.6% in the preceding year. Exports were the only buoyant item of aggregate demand (8.8%), but were insufficient to offset the slowdown in domestic demand.

This unfavourable situation affected almost all branches of activity. Only mining and quarrying performed well, posting a 10% expansion that was largely attributable to the fact that oil production had reached the highest levels in the history of Colombia. Growth in the transport, storage and communications sector was also satisfactory (3.7%), while the other branches of activity were sluggish or saw their share decline. Construction, already in a crisis for three years, was especially hard hit by the rise in interest rates and the slowdown in domestic demand, and declined by a further 14.4% in 1998. The construction slowdown also affected building societies and savings and loan associations specializing in mortgage lending (80% of their activity).

2 The total damage caused by the earthquake was assessed at US\$ 1.86 billion by an ECLAC team that travelled to Colombia in March 1999.



For the first time in many years, financial institutions, insurance companies, real estate companies and corporate service companies posted negative figures (-2.6%), mainly as a result of the sharp drop (-12.4%) in financial intermediation. The manufacturing industry, also sensitive to changes in interest rates, declined by 0.5%, after having grown by 2.5% in 1997. By contrast, the agricultural sector recovered slightly, despite the adverse effects of El Niño in the first half of the year. This upturn is attributable to the strong performance of the coffee sector (12.5%) and a moderate increase in livestock production (2.2%).

### **(b) Prices, wages and employment**

Inflation, as measured by the variation in the consumer price index (CPI), continued to drop slowly but steadily in 1998. In the first half of the year, the damage caused by El Niño pushed up food prices, leading to an inflationary spike that temporarily pushed the rate up above 20% per year. Nevertheless, favourable weather conditions in the second half, combined with the effects of the tight monetary policy and recession in the real sector, helped to moderate price movements substantially. The year closed with inflation at 16.7%. Inflation based on the variation in the producer price index (PPI) fell from 17.5% in 1997 to 13.5% in 1998.

In January 1999, the method of calculating the CPI was modified, and the number of items included in the shopping basket was increased from 195 to 405. With the favourable performance of food prices and the effects of the recession, the downward trend in the CPI continued into the early months of 1999, and 12-month inflation to June stood at 9%.

The labour market situation continued to worsen, with the annual average rate of urban unemployment for the seven metropolitan areas rising from 12.4% in 1997 to 15.2% in 1998. The sluggishness of the economy in the last three years accentuated this trend, as job creation was insufficient to absorb the increase in the overall participation rate (labour supply). This trend was exacerbated by the crisis in construction and the dismal performance of manufacturing, both of which are labour-intensive sectors. To these conjunctural factors was added an unfavourable structural trend, as economic liberalization at the beginning of the decade had led to a shift in labour demand in favour of more highly skilled workers. In 1999, the unemployment rate continued to rise, and by June, it stood at 19.8%, the highest level since measurement of this indicator began in the early 1970s. Economic authorities have announced a series of measures designed to boost job creation and reduce labour costs.

The pay differential between manual workers and non-manual employees continued to widen. In 1998, real industrial wages rose by 1.2% for non-manual workers and fell by 1.3% for manual workers.

### **(c) The external sector**

External shocks had a strong negative impact on the balance of payments. The current account deficit again widened to US\$ 5.91 billion, or 6.6% of GDP. The balance of goods and non-factor services posted a deficit of US\$ 4.13 billion, while factor income amounted to US\$ 2.19 billion. Merchandise imports slipped by 5%, from US\$ 14.76 billion in 1997 to US\$ 14.03 billion in 1998, and exports fell by 6%, from US\$ 12.06 billion to US\$ 11.36 billion.

The value of merchandise exports declined following the steep drop in the international prices of Colombia's main exports, so much so that, although volumes of non-traditional exports expanded by 19.8% in 1998, their value declined by 12.8%. The average price of oil, for example, plummeted from US\$ 18.2 per barrel in 1997 to US\$ 11.5 in 1998. Although oil exports rose by 24.3% in terms of volume, this was not sufficient to offset the fall in prices, and thus, the value of oil exports declined by 15.1%.

The value of non-traditional exports, on the other hand, improved slightly (1.7%), and, for the first time in Colombian history, exceeded that of traditional exports. Industrial goods, including chemicals (US\$ 1.19 billion), foodstuffs (US\$ 960 million) and textiles and leathers (US\$ 850 million), accounted for two thirds of non-traditional exports. Flowers represented nearly half of non-traditional agricultural exports (US\$ 1.13 billion).

Imports displayed great buoyancy in the first half of the year, reflecting the vigorous economic activity in the early part of the year; however, they slowed down in the second half, in the wake of the economic recession. Imports by category of goods decreased in almost equal proportions.

The capital account posted an estimated positive balance of US\$ 3.94 billion, which represents a steep fall (40%) compared with the net inflow of US\$ 6.615 billion recorded in 1997. Long-term financial inflows were down by 36% in comparison with the previous year, but were still high (US\$ 5.38 billion). Most of this came in the form of net foreign investment (US\$ 3.19 billion), which was substantially lower than in 1997 (US\$ 5.57 billion). The remainder of the long-term financial flows was made up of net public-sector indebtedness, which rose from US\$ 890 million in 1997 to

US\$ 1.82 billion in 1998. On the other hand, there was a sharp drop in private-sector long-term financing, since the 1998 amount (US\$ 215 million) was less than one tenth of the amount recorded a year earlier (US\$ 2.29 billion). As might well be expected with a difficult external context, outflows of net short-term financial capital amounted to US\$ 1.44 billion.

Although net international reserves shrank by US\$ 1.45 billion, the balance of US\$ 8.74 billion at the end of 1998 was equivalent to 5.1 months of imports, which, relatively speaking, is still a reasonable figure. Colombia's external debt rose slightly, from US\$ 32.02 billion in 1997 to US\$ 33.92 billion in 1998, which is equivalent to 37.5% of GDP. Public debt as a percentage of total debt increased from 51% to 54%.



## Costa Rica

### 1. General trends

Vigorous expansion of economic activity in Costa Rica (6.2%) comfortably surpassed the growth projections of 5% made at the start of 1998. This was the successful outcome of a policy, applied during the first nine months of the year, that was explicitly designed to stimulate economic activity through a more flexible monetary stance, greater availability of credit, a substantial increase in real wages (a change of government in May did not alter this dynamic), and the boost provided by the investments and operations of the new Intel microprocessor plant.

**THE IMPORTANCE** of the Intel factory to the Costa Rican economy warrants special mention, not only because of the size of the investment, which began two years ago, but also because its export activities are now fully operational, and alone generated an extra US\$ 1 billion in foreign sales.

The expansion of gross domestic product (GDP) by more than the forecast amount had only a marginal impact on inflation and the exchange rate, while fiscal accounts improved. The consumer price index (CPI) rose by 12.4% (December–December), and devaluation amounted to 10.6%; both figures were above those projected at the start of the year.

The central government deficit eased to 3.2% of GDP from the previous year's level of 3.9%, thanks to public-sector revenues that grew in real terms by more than expenditure; lower real public-sector domestic debt service played a large part in this reduction.

The balance-of-payments deficit on current account was the most worrisome of the macroeconomic variables, not only because it rose slightly relative to GDP (from 2.3% in 1997 to 2.7% in 1998), but also because there was a trend towards capital flight and a drop in short-term capital inflows.

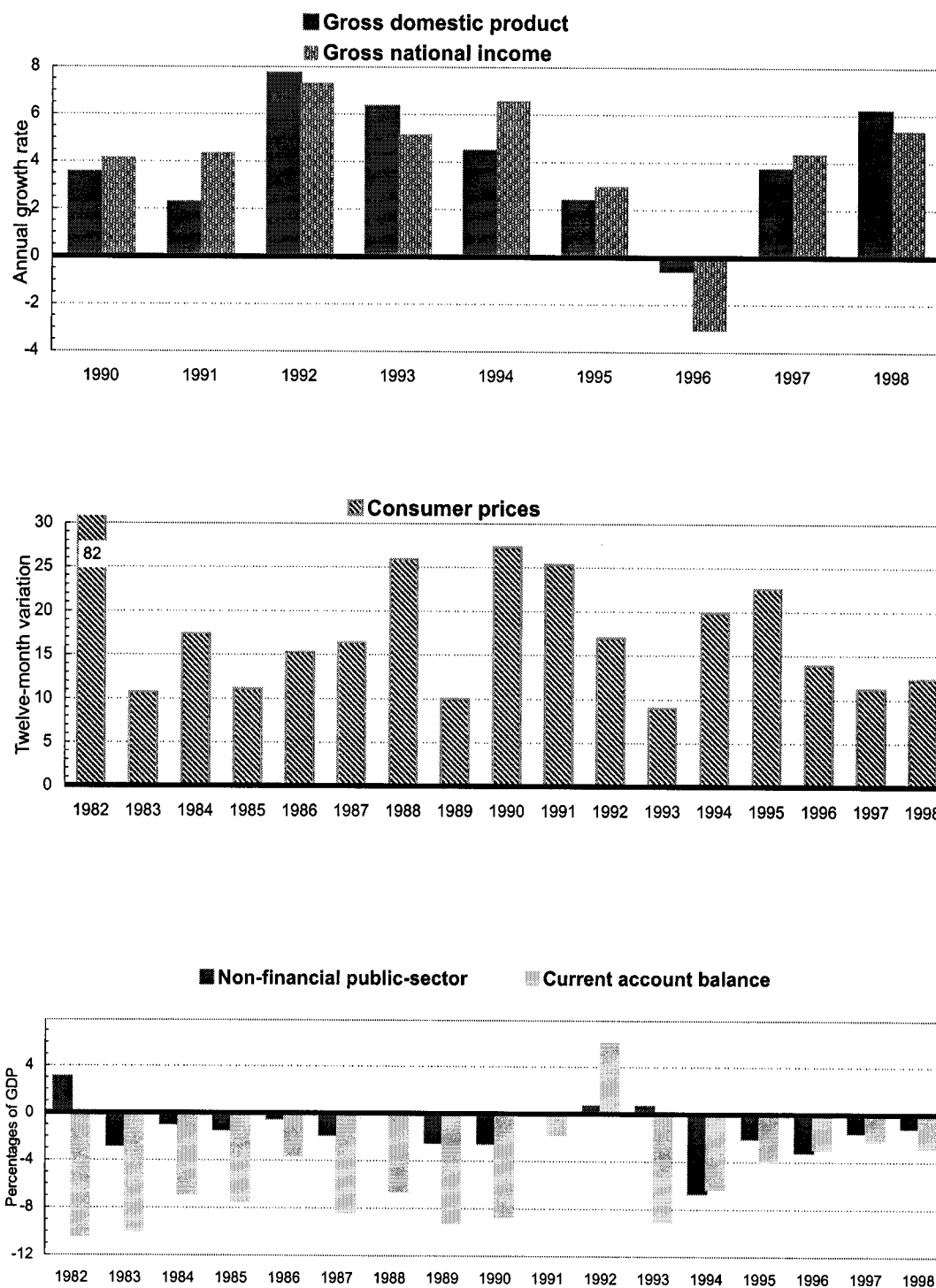
Reserve losses bordered on US\$ 150 million during the year, and there were multiple inflationary pressures arising from the pick-up in economic activity, real wage hikes and the effects of El Niño and Hurricane Mitch. These two phenomena, particularly the first, made it advisable to tighten monetary policy, especially in the credit sphere, late in the third quarter.

The Asian financial crisis did not cause serious problems during the year, thanks mainly to the small size of Costa Rica's capital market and to the fact that nearly all its exports go to the United States, or to other countries that have not yet been affected by the crisis. Nevertheless, the economy did suffer the effects of a certain amount of capital flight, which, however, was not entirely due to the uncertainty created by the financial crisis. This situation was offset by the substantial investments and export activity at the new Intel plant, together with a significant expansion of investments in tourism.

In principle, economic prospects for 1999 are good, considering that the loss of reserves has been contained and the rate of inflation has begun to slow down, thanks to the austerity measures adopted in 1998. The monetary programme for 1999 is predicated upon the following: real GDP growth of 4.5%; a public-sector deficit of 3.3%; a drop in inflation, to 10% (December–December); a neutral exchange-rate policy involving mini-devaluations to prevent the exchange-rate from getting out of line with the inflation rate, and a slight widening of the external deficit to 3.9% of GDP, which in turn assumes increased foreign capital flows during the year.

In the longer term, the government plan known as "*La solución de todos*", announced in early 1999, proposes three central goals to be achieved by 2001: single-digit inflation (the target is 7%), faster job creation (cutting unemployment from 5.6% to 4.7%) and poverty relief (reducing the proportion of poor families from 19.7% to 16.7%). A further goal is to cut the fiscal deficit to 1.1% of GDP by 2001.

Figure 1  
COSTA RICA: MAIN ECONOMIC INDICATORS



Source: ECLAC, on the basis of official figures.

## 2. Economic policy and structural reforms

### (a) Fiscal policy

The fiscal situation improved substantially in 1998 compared to the preceding year, with the central government deficit narrowing to 3.2% of GDP from 3.9% in 1997. Much of this improvement was due to the buoyancy of economic activity, which boosted central government revenues, while interest payments on the external debt stood still, thereby lightening current expenditure. In contrast, little progress was made towards controlling so-called "expenditure bombs", such as interest payments on domestic debt, pensions and Tax Credit Certificates (CATs).

The consolidated public-sector deficit, at 1.1% of GDP, was lower than that of central government, thanks to the surplus earned by decentralized State-owned enterprises, in spite of their higher investment spending. In fact, the Costa Rican Electricity Institute (ICE) and the Costa Rican Oil Refinery (RECOPE), among other public companies, either launched modernization programmes or else resumed postponed projects involving significant disbursements. An example was the Angostura hydroelectric project, which was restarted this year by ICE.

The positive balance achieved by central government resulted from increased receipts from indirect taxes, which grew by 20.4%, despite the fact that the sales tax was lowered from 15% to 13% in March. The greater revenue largely stemmed from economic growth and the initiatives taken over the past two years to make tax collection more efficient.

Public-sector expenditure, especially by central government, rose less than revenue because interest payments remained virtually flat. This was achieved, firstly, by replacing domestic with foreign debt at international interest rates that were well below national levels, and secondly, by keeping national lending rates relatively low for much of the year.

The substitution between domestic and foreign debt was made by issuing bonds worth US\$ 200 million on the international market in the second half of the year. As a result, domestic financing of central government came out at about one third of the 1997 figure, and external financing covered more than half the deficit, having made a negative contribution since 1993.

The bond flotation on the international market had the twin purpose of easing pressure on national interest rates and taking advantage of low international rates (those of the United States). Although these goals were fulfilled in 1998, between 30% and 50% of the bonds were bought by Costa Ricans, and this had repercussions on the level of international reserves; in other words, there was some capital flight through this channel. A further US\$ 300 million of debt is set to be placed on the international market in 1999, with a view to easing pressures on the local financial market, although this could also have some undesirable effects. These include further capital flight and uncertainty about the burden these bonds might actually represent in the future, depending on the course of the exchange rate and of international interest rates.

Although the above helped to trim the fiscal deficit from 3.9% to 3.2% of GDP, the changing structure of expenditure is not very encouraging: nominal capital expenditures were flat while transfers rose by 30% and wages by 21%.

Among transfers, for example, outlays relating to CATs went up by 40%, because a larger number of exporters availed themselves of this incentive; this coincided with a significant expansion in foreign sales and with the fact that 1999 is the last year in which CATs can be applied for. The fiscal problem caused by CATs will tend to decline in the future, as they will cease to be issued in 1999; as the certificates have a maturity of 18 months, they are set to expire in 2001.

Additional measures to reduce the public-sector deficit included elimination of the incentive allowing firms to deduct up to 50% of investments in tourist projects from income tax. In addition, zero-coupon bonds were issued, with interest being payable on expiry rather than quarterly as is usually the case.

### (b) Monetary policy

Monetary policy was expansionary, as measured by the sharp rise in credit (40% between 1997 and 1998). Nonetheless, M1 money supply (checking accounts plus notes and coins) grew by 12.3%, while M2 (liquidity in local currency, including savings accounts and time deposits) increased by 18.3%, which is not excessive, given that nominal GDP growth was 19.2%.

Table 1  
COSTA RICA: MAIN ECONOMIC INDICATORS

	1990	1991	1992	1993	1994	1995	1996	1997	1998 <sup>a</sup>
<b>Annual growth rates <sup>b</sup></b>									
Growth and investment <sup>b</sup>									
Gross domestic product	3.6	2.3	7.7	6.3	4.5	2.4	-0.6	3.7	6.2
Per capita gross domestic product	0.4	-0.8	4.4	3.0	1.3	-0.5	-3.2	1.1	3.6
Gross domestic product, by sector									
Goods	2.1	3.0	6.9	5.5	3.5	2.7	-2.6	3.0	6.7
Basic services	6.6	3.3	11.9	9.4	7.6	5.3	3.9	6.5	10.2
Other services	4.3	1.2	7.5	6.4	4.5	1.2	0.1	3.5	4.3
Consumption	3.8	-0.9	7.4	6.4	3.6	1.3	-1.1	2.7	4.3
General government	2.0	-0.9	2.9	6.0	1.2	1.6	3.6	1.5	2.4
Private	4.1	-1.0	8.2	6.5	4.0	1.3	-1.8	2.9	4.6
Gross domestic investment	7.3	-13.4	39.0	13.1	-5.7	-4.2	-16.6	11.5	22.8
Exports of goods and services	7.9	8.9	12.2	11.3	7.9	7.1	10.2	4.1	13.1
Imports of goods and services	10.8	-3.4	26.9	15.1	2.0	3.3	4.4	5.6	18.3
<b>Percentages of GDP<sup>b</sup></b>									
Gross national income	94.6	96.6	96.8	96.2	98.3	99.0	96.5	97.3	97.1
Gross domestic investment	23.5	20.0	25.7	27.4	25.0	23.4	19.7	21.2	24.6
National savings	15.7	18.4	19.8	19.3	21.2	21.9	18.1	19.7	20.8
External savings	7.7	1.6	6.0	8.2	3.7	1.5	1.6	1.4	3.8
<b>Percentages</b>									
Employment and wages									
Labour force participation rate <sup>d</sup>	53.5	52.2	51.5	52.6	53.1	53.9	52.2	53.8	55.3
Open unemployment rate <sup>e</sup>	4.6	5.5	4.1	4.1	4.2	5.2	6.2	5.7	5.6
Real average wage (index: 1995=100)	89.8	85.6	89.2	98.3	102.0	100.0	97.9	98.7	103.3
<b>Growth rates</b>									
Prices (December-December)									
Consumer prices (nationwide)	27.3	25.3	17.0	9.0	19.9	22.6	13.9	11.2	12.4
Wholesale prices <sup>f</sup>	27.9	22.3	12.7	6.6	...	...	...	...	...
Industrial producer prices	...	...	10.4	6.2	19.9	21.9	13.3	10.1	8.8
External sector									
Terms of trade (index: 1995=100) <sup>c</sup>	71.7	76.6	81.0	84.5	93.9	100.0	94.9	100.6	103.9
Nominal exchange rate (colones per dollar)	91.6	122.4	135.0	142.0	157.0	179.8	207.8	232.6	257.2
Real effective exchange rate for imports (index: 1995=100)	98.6	108.3	103.1	103.1	103.6	100.0	99.0	101.2	102.5
<b>Millions of dollars</b>									
Balance of payments									
Current account	-494	-99	407	-679	-520	-358	-267	-215	-291
Trade balance (goods and services)	-383	-43	-356	-583	-533	-267	-229	-137	-97
Exports	1 963	2 190	3 061	3 482	3 815	4 462	4 840	5 492	6 955
Imports	2 346	2 232	3 417	4 065	4 348	4 729	5 069	5 629	7 052
Capital and financial account <sup>g</sup>	-47	262	544	703	416	580	212	431	143
Overall balance	-541	163	137	24	-105	222	-55	216	-148
Variation in reserve assets (- indicates an increase)	197	-416	-137	-24	105	-222	55	-216	148
<b>Percentages</b>									
External debt									
Gross debt (as a percentage of GDP)	68.7	70.8	59.2	50.9	45.9	43.1	36.8	33.9	33.8
Net interest (as a percentage of exports) <sup>h</sup>	9.6	5.7	3.1	3.2	1.3	1.7	1.4	0.4	1.0

Table 1 (concluded)

	1990	1991	1992	1993	1994	1995	1996	1997	1998 <sup>a</sup>
<b>Percentages of GDP</b>									
Consolidated non-financial public sector									
Current revenue	26.1	27.6	28.2	28.2	26.1	28.6	28.7	29.7	30.1
Current expenditure	23.9	23.7	22.2	22.2	26.6	26.0	26.9	25.7	25.6
Saving	2.2	3.8	5.9	6.0	-0.6	2.7	1.8	4.1	4.5
Capital expenditure (net)	4.8	3.9	5.3	5.4	6.1	4.7	5.0	5.6	5.6
Financial balance	-2.5	-0.1	0.7	0.6	-6.6	-2.1	-3.2	-1.5	-1.1
Domestic financing	2.2	-1.6	-1.3	0.3	5.7	3.0	4.4	2.7	-0.8
External financing	0.3	1.7	0.6	-0.9	0.9	-1.0	-1.2	-1.2	2.0
<b>Growth rates</b>									
Money and credit									
Monetary balances of bankings system									
Net international reserves	-19.8	156.5	23.0	4.9	4.6	41.6	8.9	21.1	-0.9
Net domestic credit	30.4	4.7	24.3	31.5	27.6	3.3	42.4	16.9	40.5
To public sector	30.7	4.9	-4.3	2.7	28.6	30.8	127.1	30.9	23.3
To private sector	30.2	8.9	48.0	36.1	15.7	30.9	18.7	26.5	48.8
Money (M1)	7.5	29.0	36.0	7.8	31.1	-0.4	17.5	43.2	12.3
Local currency savings and time deposits	44.4	22.2	40.9	40.1	10.6	17.3	34.6	-1.1	23.4
M2	24.9	25.3	38.6	25.2	18.7	9.6	27.8	15.1	18.3
Dollar deposits	39.5	67.1	0.2	10.3	20.9	29.6	33.1	24.5	42.3
<b>Annual rates</b>									
Real interest rates (annualized, %)									
Deposit rate	-4.9	1.5	-1.0	7.3	-1.7	1.3	3.1	-0.1	0.9
Lending rate	4.0	10.8	9.8	19.3	11.1	11.6	11.0	8.2	9.6
Equivalent interest rate in foreign currency <sup>i</sup>	-0.4	-2.8	15.1	6.4	7.9	5.0	3.7	1.8	1.6

Source: ECLAC, on the basis of official figures.

<sup>a</sup> Preliminary figures. <sup>b</sup> Based on colones at constant 1966 prices. <sup>c</sup> Based on constant 1995 dollars. <sup>d</sup> Percentages of the working-age population. <sup>e</sup> Percentages of the economically active population (EAP). <sup>f</sup> In 1993, the wholesale price index was replaced by an industrial producer price index. <sup>g</sup> Includes errors and omissions. <sup>h</sup> Refers to net interest as shown on the balance of payments, divided by exports of goods and services. Since 1992, these export figures include the maquila industry. <sup>i</sup> Interest rate on deposits, deflated by the variation in the exchange rate.

The 26.8% expansion in total liquidity was caused above all by substantial foreign-currency deposits, which grew by 42.3%.

Factors permitting the growth of credit (especially in dollars) included a reduction in the reserve requirement, which was standardized, as from March, at 15% for local-currency deposits and 5% for those in foreign currency. In fact, a large part of the credit expansion arose from the substitution of foreign borrowing by domestic credit denominated in dollars. Some banks, especially the Banco Nacional de Costa Rica, doubled their lending, and managed to attract a portfolio of exporters that had previously obtained financing with external funds.

Public-sector banks had more funds available for lending purposes, not only as a result of the lower reserve requirements but also because clients tended to choose these institutions in preference to cooperative and farmers' banks, some of which were experiencing financial difficulties. The abundance of credit further fuelled the availability of funds via an increase in the banking multiplier (about 1 to 1.4). Finally, the tendency of the public to increase their dollar deposits—due more to the uncertainty engendered by the international financial crisis than to a more attractive interest rate on such deposits—also served to increase the funds available for lending in this currency.



Table 2  
COSTA RICA: MAIN QUARTERLY INDICATORS

	1996				1997				1998 <sup>a</sup>				1999 <sup>a</sup>
	I	II	III	IV	I	II	III	IV	I	II	III	IV	I
Gross domestic product <sup>b</sup> (change from same quarter of preceding year)	-1.7	-2.0	-0.4	1.3	0.7	4.8	4.9	4.5	5.9	6.2	6.3	6.4	...
Consumer prices (12-month variation, %)	18.3	19.2	17.3	13.8	14.8	13.6	11.9	11.2	11.2	10.8	12.7	12.4	10.7
Exports (millions of dollars)	933	894	920	982	1 014	1 155	1 037	1 129	1 219	1 394	1 385	1 530	1 669
Imports (millions of dollars)	1 026	1 028	1 113	1 132	1 136	1 250	1 236	1 332	1 458	1 507	1 544	1 723	1 658
Real effective exchange rate <sup>b</sup> (index: 1995=100)	98.0	98.6	99.2	100.2	99.5	100.4	101.7	103.2	101.9	102.4	101.5	104.1	104.8
Real interest rates (annualized, %)													
Deposit rate <sup>c</sup>	8.7	0.5	2.4	0.7	-0.2	-1.3	-0.1	1.2	1.1	1.5	0.1	1.0	2.1
Lending rate <sup>d</sup>	16.4	8.3	10.4	8.9	7.9	6.9	8.3	9.9	9.7	10.0	9.2	9.6	11.6
Money (M1) (change from same quarter of preceding year)	...	...	...	...	9.8	28.4	35.6	43.2	44.8	23.6	21.8	12.3	11.9

Source: ECLAC, on the basis of official figures.

<sup>a</sup> Preliminary figures.

<sup>b</sup> Refers to exchange rate for imports.

<sup>c</sup> Refers to 180-day deposits.

<sup>d</sup> Refers to short-term loans.

Real interest rates trended downwards during the first three quarters, and this encouraged a vigorous expansion of demand for credit in both local and foreign currency.

Domestic credit expanded by 40.5%, particularly lending to the private sector, which grew by 48.8% in 1998 as against 26.5% in 1997. The sectors most favoured were commerce, which absorbed 30% of the total (in 1997, it had received 20%); consumer goods (25%); services (17%), and manufacturing industry (11%), leaving just 16% for all other activities. Since 1997, however, the housing sector had enjoyed much greater access to credit than in previous years.

In keeping with the improved government accounts, domestic credit absorbed by this sector grew much less than lending to the private sector. Moreover, part of the amount recorded as credit to the public sector is strictly on the books, as it relates to interest owed by the government.

Rising inflationary pressures and a loss of international reserves led the authorities to change the monetary policy in September. One of the most important provisions adopted as from October, which will last until December 1999, requires banks to create contingency reserves if credit expands by more than 26%. Another equally important measure was the decision not to lower the reserve requirement from 15% to 10% as had been planned.

### (c) Foreign exchange policy

The exchange rate, which operates under a crawling-peg system, reflected a devaluation of 10.6% between 1997 and 1998, as measured by the average nominal exchange rate for the year (which rose from 232.6 to 257.2 colones per dollar). Even so, the adjusted real exchange rate rose marginally, by only 1%.

### 3. The main variables

#### (a) Economic activity

The investment boom that had begun in 1997 was the component of domestic demand that gave the greatest impetus to the economy in 1998 (gross fixed investment grew by 17.2% in 1997 and by 22.9% in 1998). Investment in machinery and equipment was the most buoyant category (29.9%), as reflected in a dramatic rise in capital goods imports (36.9%). The private sector (and particularly Intel) accounted for the lion's share of this growth (25.9%), although public-sector investment also rose significantly (14.8%). On the other hand, private consumption and government expenditure were much less active components of domestic aggregate demand (growing by 4.6% and 2.4%, in that order).

The other component of global demand—exports of goods and services—grew faster than it had in the previous five years (13.1% at constant prices), also reflecting the start of operations at the Intel plant.

The manufacturing sector expanded by 7.2%, and was only bettered by construction and certain services, such as electricity and water, together with transport, storage and communications. Both manufacturing and construction benefited from the greater availability of domestic credit at lower interest rates, and from an inflow of foreign investment to free-trade zones.

Within the manufacturing sector, cement production increased by 11.1%, on the back of robust growth in construction; sugar, textiles, leather and footwear, which are more closely related to export activity, also grew strongly. Oil refining fell back drastically, owing to changes being made in the production process at the RECOPE plant, which remained closed.

Agriculture experienced a strong recovery, with output up by 7% following the previous year's 0.9% contraction; El Niño had both good and bad effects that ultimately offset each other. The first five months of the year mainly saw damage to basic grain harvests and livestock; at the same time, however, traditional (but not non-traditional) agricultural export products benefited from better weather conditions in producing areas. In October, Hurricane Mitch caused some damage to coffee plantations, although this, too, was mitigated by favourable conditions for banana and sugar production.

On the other hand, production of all basic grains fell (rice, -10.2%; maize, -8.4%; beans, -12.8%). This

was mainly due to weather problems, but also to a loss of competitiveness with imports that has been developing in recent years.

#### (b) Prices, wages and employment

The consumer price index (CPI) rose slightly faster than in 1997 measured on a December-December basis (12.4% in 1998 as against 11.2% the year before), but when inflation is measured in terms of annual averages, the opposite is the case: prices rose by an average 11.7% in 1998 compared to 13.2% in 1997. The difference reflects an acceleration in inflation during the second half of the year, caused by pressures arising from the rapid growth of economic activity, abundant liquidity, and easy access to consumer credit.

The repercussions of weather phenomena on certain commodity crops drove up food prices, which in due course fed through into the CPI. The index would have risen faster, however, had it not been for significant compensatory factors, such as the fall in the price of oil and, hence, in fuel prices.

Real average wages and salaries rose very sharply (6.5%), although at least two percentage points of this was due to the education grant, known as the "salario escolar", which is a relatively new component of the total wage. The public sector was particularly favoured by this wage policy (8.2%), especially employees of autonomous institutions, whose wages rose by 9.6% in real terms. The minimum wage also recovered significantly, although by a smaller amount (3.4%).

Unemployment, meanwhile, eased down marginally, from 5.7% to 5.6%. In fact, this indicator fell in the urban sector, thanks above all to construction. Unemployment in rural areas edged higher, from 5.6% to 5.7% during the year, partly as a result of El Niño and Hurricane Mitch.

#### (c) The external sector

Both exports and imports showed striking buoyancy (increasing by 27.5% and 25.8%, in that order), thanks, in the case of imports, to the growth of the economy. The terms of trade were favourable, although less so than in the preceding year. In contrast to 1997, external financial resources flowing into the country generally declined. Although this was not true of foreign

direct investment (FDI), it was the case with short-term capital, and the result was a US\$ 148 million drain on international reserves. As a consequence of this, the balance-of-payments current account deficit, which was up from the previous year, became the main concern.

One of the most striking aspects of the behaviour of exports is the drastic structural change they have undergone in recent years: traditional exports, which in 1990 still represented nearly 50% of the total, accounted for less than 20% in 1998; non-traditional exports, on the other hand, have gained an overwhelming predominance (80% of the total), with sales by Intel being the main contributing factor. Invoicing in free-trade zones in 1998 was up by 107.3% from the previous year, and amounted to US\$ 1.847 billion.

The slide in coffee prices did not unduly harm exports of this product, as contracts had probably been closed beforehand. Whereas the international price of coffee fell by 29.5% on average for the year, the volume of coffee exported changed very little, and the

value of external sales slipped by just 2.8%. In the case of bananas, whose sale price went down marginally, the outlets on the international market improved considerably; thus, the volume of sales grew by 9.7%, resulting in a sharp recovery from the previous year and an 8% increase in value exported. Finally, despite increased shipments, the value of sugar exports declined owing to a slightly lower international price.

Imports grew strongly (25.8%), mainly in response to a huge expansion of capital-goods purchases (36.9%), a substantial part of which related to investments by Intel. Apart from this, easier access to credit, wage increases and a stable real exchange rate also encouraged consumer goods imports, which expanded by 20.2%.

The terms of trade improved by 2.5% with respect to the previous year, thanks to the fact that the fall in the prices of traditional agricultural commodities on the international market did not seriously affect Costa Rica. Moreover, although the price of non-traditional exports also fell on the international market, this was more than offset by a drop in import prices (4.5%).

## Cuba

### 1. General trends

In 1998, Cuba's economic recovery slowed down for the second year in a row. The year's mediocre GDP growth of 1.2% was basically due to a reduced sugar-cane harvest, as the rest of the economy grew by 4%. The non-financial public-sector deficit was up slightly at 2.4% of GDP, and the liquidity overhang increased, though without affecting the purchasing power of the local currency. Inflation remained in low single digits (2.7%)—slightly less than in 1997—and the parallel exchange rate strengthened marginally, from 22.8 pesos to the dollar in 1997 to 22.3 in 1998.

**AS AGAINST** this, the balance-of-payments current account deficit widened again, mainly because of an increase in the goods and services trade gap. As the international prices of oil and imported foodstuffs fell faster than those of sugar and nickel, the terms of trade improved. The merchandise trade deficit widened, however, with the volume of goods sold dropping from its 1997 level and purchases rising considerably.

Increasing inflows from international tourism, family remittances from abroad and foreign investment were the positive features in the external sector. Despite a decline in official donations, current transfers rose on the strength of higher family remittances. The factor-services account was negative (at a level similar to that of the previous year), and the surplus on capital account was not high enough to finance the current account deficit. This entailed a further shrinking of Cuba's paltry foreign exchange reserves.

During the year, Cuba faced hardships arising from the weather, including the drought in the eastern provinces and the damage caused by Hurricane Georges. Apart from this, the country had to deal with the cumulative effects of the economic embargo (the cost of which is estimated by Cuban authorities at over US\$ 60

billion up to 1998) and with the need to consolidate and complete the reform process.

Official forecasts for 1999 see output growing by between 3% and 4%, based on a revival of the sugar sector, increasing family remittances from abroad and inflows from international tourism and foreign investment. Growth of between 2% and 4% is expected on a broad front across the main goods-producing sectors. Sugar production is expected to top 3.6 million tons, with tourist services growing by 20% to meet the target of two million visitors by the year 2000, in a continuation of the upward trend of recent years. In the mining sector, production of nickel and crude oil grew by 12% and 25%, in that order.

One of Cuba's basic challenges is to regain the investment levels of the 1980s, so as to bolster economic recovery. Although, the level and efficiency of investment did improve in 1998, the scarcity of foreign exchange continues to be the main obstacle to recovery. The country's increasing openness to foreign investment should encourage capital formation in a variety of productive activities. Subsidies to public-sector firms need to be aimed increasingly at investment rather than at covering current deficits.

## 2. Economic policy and structural reforms

### (a) Fiscal policy

The fiscal deficit widened to 2.4% of GDP from 2% in 1997, owing to faster growth in expenditure (2.8%) than in revenue (2.2%).

Receipts from the country's main tax, on circulation and sales,<sup>1</sup> were up by 5.7%, partly as a result of the increased demand for cigars generated by the previous year's price cuts. However, revenue from the levy on services was down by 1.5% owing to lower prices in public-sector restaurants.

In 1998, the rate at which State firms were incorporated into the new tax regime increased substantially, as 71% of them showed a financial return.<sup>2</sup> This resulted in higher receipts from both the tax on profits (34.9%) and the tax on labour use (26.5%).

The Government continued to give priority to providing the population with basic services, and this generated higher current expenditure on welfare (17%), housing and community services (22.1%), public health (7.7%) and education (5.6%). In keeping with the strong social emphasis of its economic policy, Cuba's social indicators continued to be outstanding in comparison to the regional average, despite the economic difficulties the country has been experiencing since 1989.<sup>3</sup>

Social security spending rose by 2.1%, and continues to be a heavy burden for the non-financial public sector (7.2% of GDP). In addition, transfers to public-sector enterprises, which represent the largest expense item in the budget (12.5% of GDP), went up by nearly three percentage points. Current expenditures on defence and public order were trimmed by 1.3%, as part of the saving and austerity measures introduced by the Government in response to the current economic crisis. The deepest cuts were made in extraordinary expenditures (down by 80%) and public investment, which declined again to just 7.5% of GDP (compared to 15% at the start of the decade).

### (b) Monetary, foreign exchange and trade policy

During the past two years, the reform process has focused on modernizing the financial sector. The new banking structure (see box) is designed to break with the tradition of providing soft loans to the public sector by cutting subsidies to State enterprises and creating the necessary conditions for more effective financial intermediation. To this end, the reforms are aimed at encouraging greater use of commercial credit on market terms and tightening up discipline in accounts settlement among productive entities.

The Central Bank improved its risk-analysis methodology in connection with lending—in both local and foreign currency—to the State sector. In 1998 the banking system made short-term loans totalling more than US\$ 1 billion to the enterprises, to finance working capital; this was double the figure for the 1996-1997 biennium.

The liquidity overhang grew by 2.8% (equivalent to 9.71 billion pesos) as of December 1998. This was the result of a larger volume of transactions being carried out in the State-operated foreign-currency exchange network (CADECA), where net purchases of foreign currency put more cash into circulation,<sup>4</sup> and of advance payments being made to pensioners and retired people during the December holidays.<sup>5</sup>

Another unresolved problem of the Cuban economy which reflects a lack of financial discipline and the inefficiency of bank collection efforts, is the accumulation of overdue accounts owed by public-sector enterprises. In 1998 the Consejo Nacional de Cobros y Pagos was set up, as part of the Central Bank, in order to reduce the default rate among these enterprises. Its aims include the setting up of a regulatory framework to strengthen financial discipline among productive entities, with a view to speeding up money turnover and fund transfers and averting possible quasi-fiscal transactions.

1 In general terms, the circulation and sales tax is withheld by wholesaler intermediaries who pay it into the budget. It is levied on final consumption goods.

2 It should be borne in mind that in 1993, only 29% of State enterprises were showing a profit.

3 For example, the infant mortality rate dropped to 7.1 per 1,000 live births.

4 The net impact of CADECA operations should be transitory, as its foreign-currency income will be used to import goods and services which will later be sold to the public at higher prices in the official stores.

5 This situation was corrected in January 1999, when the liquidity overhang decreased.

Table 1  
CUBA: MAIN ECONOMIC INDICATORS

	1990	1991	1992	1993	1994	1995	1996	1997	1998 <sup>a</sup>
<b>Growth rates <sup>b</sup></b>									
Growth									
Gross domestic product	-2.9	-10.7	-11.6	-14.9	0.7	2.5	7.8	2.5	1.2
Per capita gross domestic product	-4.0	-11.5	-12.2	-15.4	0.5	2.1	7.4	2.0	0.7
Gross domestic product, by sector									
Goods	-3.5	-16.2	-19.2	-16.7	4.2	7.1	11.7	6.0	1.9
Basic services	-8.2	-10.4	-13.2	-17.2	-0.9	6.9	7.0	4.6	1.2
Other services	-1.5	-6.1	-5.5	-13.4	-1.2	-1.3	5.2	-0.6	0.7
Total consumption	-3.9	-11.7	-13.2	-5.8	0.8	0.7	2.5	-0.4	1.9
General government	-0.5	-10.4	-5.2	-1.1	-1.9	-0.4	1.9	-2.0	1.8
Private	-6.0	-12.5	-18.7	-9.6	3.2	1.6	3.1	0.9	2.0
Gross domestic investment	-2.9	-45.9	-58.3	-39.7	5.8	58.0	10.1	28.7	7.3
Exports of goods and services	-3.6	-3.5	-5.9	-24.9	-1.0	-1.4	28.0	7.2	6.7
Imports of goods and services	-5.7	-37.3	-44.5	-6.4	-0.4	7.0	20.1	13.4	18.0
<b>Millions of dollars</b>									
Balance of payments									
Current account	-2 545	-1 454	- 420	- 388	- 242	- 518	- 167	- 250	- 333
Trade balance	-2 076	-1 138	- 215	- 382	- 211	- 639	- 419	- 518	- 608
Exports of goods and services	5 940	3 563	2 522	1 992	2 197	2 926	3 708	3 875	4 046
Imports of goods and services	8 017	4 702	2 737	2 373	2 408	3 565	4 127	4 393	4 654
Capital account	2 621	1 421	419	404	240	596	175	270	323
<b>Percentages of GDP</b>									
Gross domestic investment	26.7	16.2	7.6	5.4	5.7	8.8	9.0	11.3	11.9
Government income and expenditure									
Total income	62.4	67.4	62.1	63.0	66.4	60.0	53.7	53.2	53.7
Total expenditure	72.4	90.6	94.8	96.5	73.9	63.5	56.2	55.2	56.1
Financial balance	-10.0	-23.2	-32.7	-33.5	-7.4	-3.5	-2.5	-2.0	-2.4
External sector									
Current account	-13.0	-8.9	-2.8	-2.6	-1.3	-2.4	-0.7	-1.1	-1.4
Trade balance	-10.6	-7.0	-1.4	-2.5	-1.1	-2.9	-1.8	-2.3	-2.6
Gross debt	34.6	40.0	42.9	58.2	47.3	48.3	45.9	44.2	45.2
Currency									
Liquidity	25.4	40.4	56.1	73.2	51.8	42.6	41.8	41.1	41.8
Currency outside banks	11.9	20.4	27.4	30.2	18.8	16.3	17.4	17.5	17.8
Regular savings deposits	13.5	20.0	28.7	43.0	33.0	26.2	24.3	23.6	24.0

Source: ECLAC, on the basis of official figures.

<sup>a</sup> Preliminary figures. <sup>b</sup> Calculated on the basis of pesos at constant 1981 prices, and at the official exchange rate of 1 peso to the dollar.

## Box 1

**CUBA: STRUCTURE AND FUNCTIONS OF THE NEW BANKING SYSTEM**

The Central Bank of Cuba is responsible for the regulation and oversight of national financial institutions and agencies of foreign banks operating in the country. It is in charge of issuing and safeguarding the stability of national currency; it implements national monetary policy and acts as the governing body of the banking system. The Banco Nacional de Cuba (BNC) has been relieved of its central banking duties but continues to operate as a commercial bank. It is also responsible for recording, monitoring and servicing the foreign debt that the State and the Bank itself have contracted with foreign creditors under State guarantee. The Banco de Crédito y Comercio (BANDEC) provides full banking services and has adopted the territorial structure that the Banco Nacional de Cuba had before the banking system was reorganized. The Banco Popular de Ahorro (BPA) provides a complete range of banking services and has extended its operations to include the business sector. The Banco Financiero Internacional (BFI) operates as a commercial bank dealing mainly in foreign currencies.

The Banco Internacional de Comercio provides banking services to national, foreign and mixed Cuban-foreign entities, as well as to individuals, both Cuban and foreign. It operates in foreign currency, mainly in the areas of foreign trade and financing, and the purchase and sale of foreign exchange. The Banco Metropolitano provides services to the accredited diplomatic corps, temporary or permanent foreign residents and holders of foreign currency. The Banco de Inversiones provides investment and advisory services to Cuban firms in promoting investment projects and hedging exchange risks. Financiera Nacional (FINSA) engages in financial activities of a non-banking nature. Casas de Cambio (CADECA) performs services such as exchanging pesos for foreign currency, exchanging bankers' cheques, handling credit card transactions and providing other services in foreign currency. Compañía Fiduciaria undertakes all types of confidential assignments, acting as a fiscal agent, estate executor and legal administrator. It also provides fiduciary services.

RAFIN engages in non-banking financial activities, such as financial intermediation between Cuban or foreign firms and organizations and foreign currency fund management. It finances foreign trade operations, provides financial planning and economic and financial advisory services, and conducts "offshore" transactions in duty-free zones and industrial parks. FINALSE is a non-bank financial institution which finances foreign-trade operations and provides financial planning and economic and financial advisory services, and accounting and factoring services. It also engages in investment finance and leasing operations. FIMEL is a non-bank financial institution that finances import-export operations. It provides financial planning, business management and economic and financial advisory services. It also offers investment financing and undertakes leasing operations. PANAFIN S.A. is a non-bank financial institution which finances imports of fuel, foodstuffs and chemical products. It also provides services relating to the restructuring of export pre-financing and to factoring.

**(c) Structural reforms**

The enactment, in 1995, of new legislation on foreign investment has drawn capital flows to the island. By 1998, as many as 345 joint ventures had been set up with foreign capital. These have played a decisive role in tourism, oil drilling, nickel mining and telecommunications, and total disbursements in the period 1990-1998 are estimated at US\$ 2.5 billion. Cuba's most frequent partners in joint ventures have been Spain (70), Canada (66) and Italy (52). A further 18 mixed Cuban-foreign enterprises were set up in the first quarter of 1999; to date, bilateral treaties on mutual protection of investments have been signed with 37 countries.

The real-estate, financial and energy sectors continued to open up to foreign investment in 1998; however, for the moment there are no plans for foreign investment in the sugar industry. In the real-estate sector, 13 joint ventures have been set up with foreign

capital for the construction and remodelling of office buildings, housing, commerce and ancillary services, and another 40 projects are at the negotiation stage.

In the energy sector, the first project entirely financed with foreign capital is being developed by a Panamanian company. It involves the construction of a power plant to provide electricity to some 100,000 inhabitants of Isla de la Juventud. In addition, two joint ventures have been set up with French and Canadian capital to upgrade electric power plants and to make use of gas from oil wells, which up to now has been wasted.

In 1999, about 100 government agencies started a progressive business training programme, whose basic aim is to improve the efficiency of resource use and encourage self-management, as well as provide incentives to the most productive workers. The idea is to combine central planning decisions with decentralized business management by giving greater authority to productive entities.

### 3. The main variables

#### (a) Economic activity

The 3.9% expansion of global supply was mainly the result of an increase in imports of goods and services (18%), as the GDP recovery that had begun in 1994 was held up for the second year running. The meagre 1.2% increase in GDP was primarily driven by tourist services and exports of certain goods, such as nickel, tobacco, fish, shellfish and other industrial products. The 24% drop in the 1997-1998 sugar-cane harvest played a decisive part in the sluggish growth of GDP, because of its linkages with the rest of the national economy.

On the demand side, domestic absorption and exports both grew (by 2.7% and 6.7%, in that order), while gross investment rose faster (7.3%) than consumption (1.9%). The impetus of investment stemmed from activities pertaining to the emerging private sector (particularly Cuban-foreign joint ventures) which operate with their own financing in foreign currency.

As regards consumption, demand in the dollarized segment was also particularly strong, with the value of sales in foreign currency rising to over US\$ 800 million. It is estimated that over 56% of the population had access to foreign exchange in 1998, which they obtained by various means, including purchase in the *bureaux de change* network in exchange for Cuban pesos, increased family remittances from abroad, an extension of incentives in convertible pesos, the activities of the small authorized private sector, the informal economy and the growth of international tourism.

Sectors recording positive growth in 1998 included tourism (20%), financial services (10%) and construction (5.7%), whereas agriculture declined by 5.2%. Manufacturing industry saw its growth rate slip to 3.3%, owing to the fall in sugar production, while mining expanded for the fifth year in a row, driven mainly by a further rise in nickel output (12%).

The flow of international tourism grew to 1.4 million visitors, who generated gross earnings of US\$ 1.8 billion. The hotel occupancy rate went up to 64%, compared with 54% in 1997.

Although GDP in 1998 was equivalent to three quarters of what it was in 1989, agricultural production barely topped half its pre-crisis level. The immediate

effects of this were higher food imports, a cut in exports of agricultural origin such as sugar, and high subsidy payments to the sector. Despite recent achievements in urban agriculture, the problems faced by the farming sector and sugar-based agro-industry suggest the need to intensify the efforts at structural reform that were initiated in 1993, with a view to making fundamental changes in the organizational framework of the sector.

The drop in agricultural production was also caused by weather disturbances arising from El Niño and Hurricane Georges. Sugar-cane production declined, although livestock and crops, other than sugar cane showed signs of some recovery. Within the livestock segment, beef and pork production went up, but as far as poultry is concerned, meat and egg production were down owing to reduced feed imports. Milk production also fell. As regards crops other than sugar cane, output increased in the following categories: ground provisions<sup>6</sup> (4%), vegetables (40%), tobacco (22%) and beans, along with fruits such as mango, guava, papaya and pineapple. On the other hand, rice production fell as a result of the drought. The gross fish catch was up again thanks to the use of new management techniques and worker incentives; the shrimp harvest, in particular, went up by 23%.

Construction grew, basically on the strength of repair and maintenance work, and production in the energy sector also increased. Crude oil output was up by 12% (1,678 million tons); 22 risk-exploration contracts are currently in force, involving ten firms from Canada, France, United Kingdom, Sweden and Spain.

Electric power generation increased slightly, by 1% (14,290 GWh), as a result of higher national crude oil and gas production. Energy efficiency also improved, with energy consumption growing more slowly than GDP for the first time in recent years. Nearly all areas of production used energy products more efficiently, the exceptions being the cement, steel and sugar industries.

Telecommunications services continued to grow strongly, thanks to the expansion of international tourism and long-distance calls between Cubans abroad and their relatives on the island. However, the impact of the suspension of telecommunications services between Cuba and the United States is bound to be felt in 1999.

6 Translator's note: "Ground provisions" are non-grain staple foods that include plantains, cassava and tubers.



### **(b) Prices, wages and employment**

The consumer price index (CPI) went up by 2.7% overall; this was the net result of higher prices in the informal market and lower ones in the agricultural sector and in State-run restaurants. Prices in the controlled market remained virtually unchanged.

The nominal average wage went up by 1.4%, to 217 pesos per month. This modest increase, linked to a virtual standstill in labour productivity, led to a lower real wage, measured in terms of the annual inflation rate.

Despite the modest growth of output, jobs were created for some 43,200 people, bringing the open unemployment rate down to 6.5% from the previous year's figure of 6.8%. However, it is estimated that the number of own-account workers in the small private sector suffered a further decline. The highest unemployment rates occurred among young women and in the eastern provinces.

### **(c) The external sector**

The widening of the trade gap in goods and services was due to the fact that imports grew more than exports. The rise in the value of merchandise imports was the result of an increase in volumes purchased to make up for the shortfall in the supply of agricultural products caused by the weather disturbances, together with a drop in international food prices.

The value of goods exports declined owing to a decline in volumes and prices. Sugar exports fell and nickel exports rose; in both cases, prices were lower than in 1997. This drop in the prices of the two main export commodities was related to international financial disturbances. Sugar prices dropped to below eight cents a pound, and nickel prices fell to US\$ 4,000 per ton.

As a special effort has been made to promote efficient import substitution, Cuban products have become more visible among items sold for the international tourist industry and in foreign-currency shops, although their share still remains limited.

As a result of the policy aimed at diversifying Cuba's foreign trade, most of its merchandise trade is now directed towards markets in Latin America, the Caribbean, Canada and Western Europe. The American continent's share grew from 33% in 1997 to 36% in 1998, while Europe's share went up from 41% to 48% in the same period. Asia's share of Cuba's foreign trade fell back, and Spain and Canada remained its chief trading partners. Trade with the Caribbean islands grew to 8% of the total.

Cuba and Chile have signed a limited five-year agreement to lift tariffs on some 1,000 products, with the aim of boosting trade between the two countries. In addition, Cuba has been admitted as a full member of the Latin American Integration Association (LAIA), and it participated as an observer in negotiations for the new Lomé Convention between the European Union and the countries of Africa, the Caribbean and the Pacific.

The balance of factor services in 1998 was negative (minus US\$ 495 million), equivalent to that of the previous year, and the current account deficit grew by 33% to US\$ 333 million. Although the capital account surplus was higher than in 1997 (US\$ 323 as against US\$ 270 million), it was not high enough to finance the large current account deficit. Thus, Cuba's already meagre foreign exchange reserves were further eroded.

The public-sector external debt rose from US\$ 10,146 million to US\$ 10.5 billion. At 44% of GDP and 2.6 times the value of goods and services exports in 1998, this is nearly double the regional average, and reflects the relative overindebtedness of the Cuban economy. The bulk of the debt consists of liabilities accumulated prior to 1986, the year in which interest payments and amortization of the external debt were largely suspended. This moratorium has made it necessary to rely on short-term credits at high interest rates. Cuba's main creditors include France, Argentina, Japan and Spain.

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## Ecuador

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### 1. General trends

In 1998 Ecuador's economy recorded its worst result of the decade. GDP growth was practically nil (0.4%), inflation surged to 43.4%, the non-financial public-sector deficit climbed to 6.2% of GDP, and the balance-of-payments current account deficit grew to over 10%.

A SERIES OF factors contributed to this unfavourable result. The El Niño weather pattern, apart from causing loss of human life, inflicted serious damage on agriculture and infrastructure. The steep fall in oil prices widened both the fiscal and external deficits. The international crisis, which in 1997 had not yet had much of an effect on Ecuador's economy, brought external private financing to a halt in the second half of 1998 and early 1999. This heightened currency and monetary instability and culminated in a deep financial crisis. The economic situation became even more critical as a result of political conditions which made it difficult for the interim Administration in office since February 1997 and, later, the new Government that took over in August 1998 to implement a coherent and politically viable macroeconomic policy.

On the other hand, there were also a number of political factors that had a favourable effect on the country's economy, including the peace agreement with Peru and constitutional reforms that gave greater stability to the legislative and executive branches and more independence to the Central Bank of Ecuador.

Domestic and external imbalances became more pronounced in the first quarter of 1999. Strong pressure on the exchange rate, which resulted in heavy losses of international reserves and a need for higher interest rates, led the authorities to abandon the currency band and introduce a dirty float. The exchange rate's reaction was highly volatile and the sucre depreciated steeply, all of which triggered a marked upsurge in inflation. In view of the critical situation in the financial system, the authorities declared several days' bank holiday and a partial freeze on financial deposits. This had a sharp recessionary impact on economic activity.

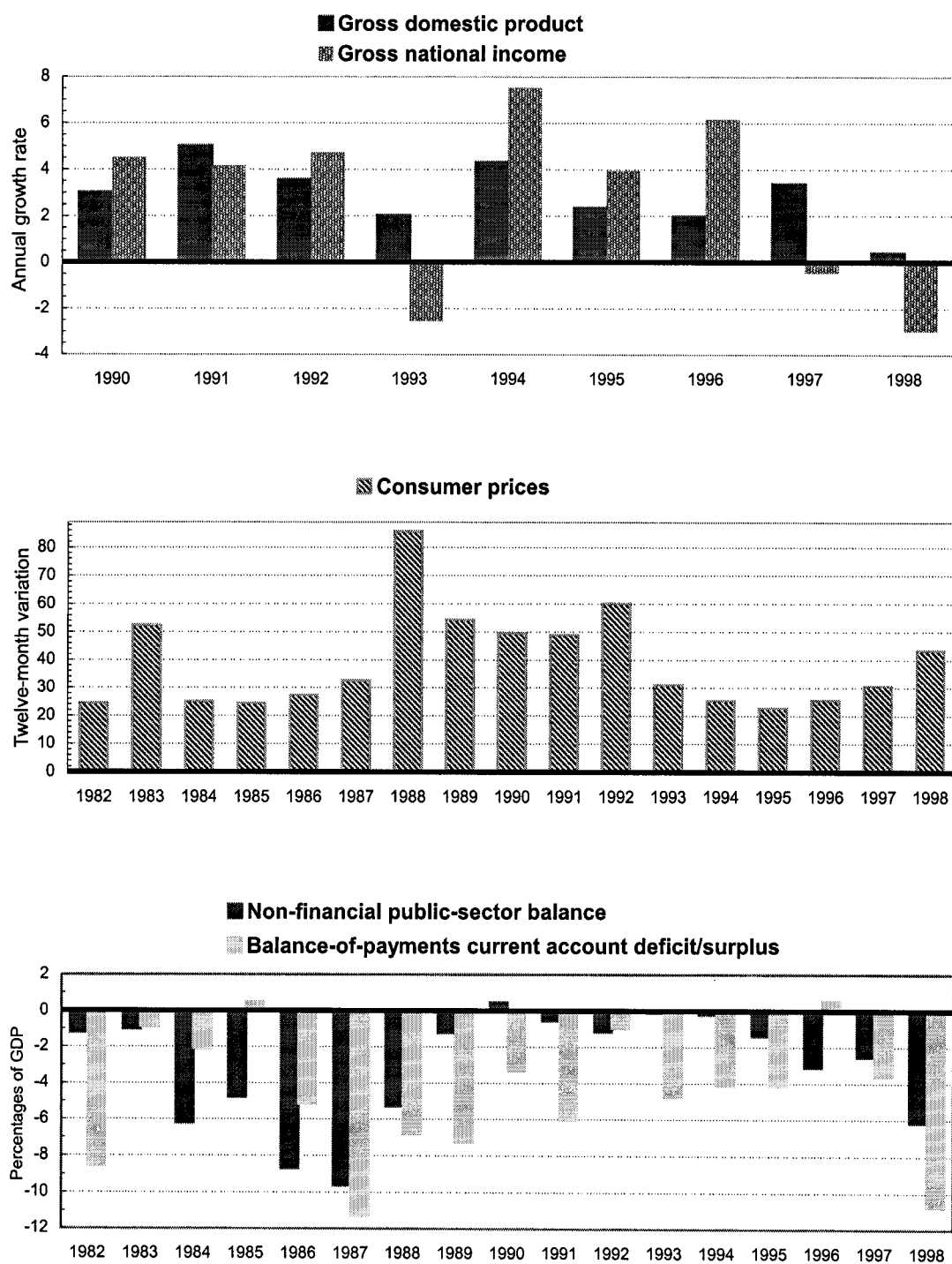
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### 2. Economic policy

Throughout 1998, priority continued to be given to price stability. This was based on an exchange-rate band for the sucre that was designed to guide inflationary expectations gradually downward and to keep the real exchange rate relatively stable, without sacrificing some measure of flexibility in the nominal exchange

rate. This policy, along with the structural reform programme, had already been called into question earlier on because of the various adverse domestic and external impacts (armed conflict with Peru, political instability) that the economy had suffered since 1995.

Figure 1  
ECUADOR: MAIN ECONOMIC INDICATORS



Source: ECLAC, on the basis of official figures.

Table 1  
ECUADOR: MAIN ECONOMIC INDICATORS

	1990	1991	1992	1993	1994	1995	1996	1997	1998 <sup>a</sup>
<b>Growth rates <sup>b</sup></b>									
Growth and investment									
Gross domestic product	3.0	5.0	3.6	2.0	4.3	2.3	2.0	3.4	0.4
Per capita gross domestic product	0.7	2.6	1.3	-0.2	2.1	0.2	-0.1	1.3	-1.6
Gross domestic product, by sector									
Goods	1.1	5.2	3.9	2.8	6.0	2.8	1.8	3.7	-1.0
Basic services	3.1	5.4	5.3	4.1	4.0	2.1	3.0	3.7	1.6
Other services	2.5	3.8	2.4	2.9	2.9	2.2	3.2	2.4	0.6
Consumption	2.4	1.8	1.5	2.0	2.5	2.2	1.6	2.0	1.8
Government	2.1	-2.2	-3.2	-1.2	0.0	1.9	-1.0	-0.3	0.2
Private	2.5	2.5	2.3	2.5	2.9	2.2	1.9	2.4	2.0
Gross domestic investment	-15.2	29.9	-1.2	-4.1	6.6	8.5	-11.6	17.1	9.7
Exports of goods and services	10.2	10.5	9.6	4.2	8.7	5.0	3.6	4.3	-3.2
Imports of goods and services	-3.7	16.0	1.0	0.8	6.0	9.8	-5.9	8.8	5.5
<b>Percentages of GDP <sup>c</sup></b>									
Gross national income	94.2	93.4	95.0	90.6	93.4	94.2	97.8	93.7	90.0
Gross domestic investment	16.6	20.2	19.1	17.9	18.1	18.7	16.2	18.2	19.8
National savings	10.6	12.0	14.7	10.0	13.7	14.0	17.7	14.5	9.9
External savings	6.0	8.1	4.4	7.8	4.4	4.7	-1.5	3.7	9.9
<b>Percentages</b>									
Employment and wages									
Labour force participation rate <sup>d</sup>	48.8	56.8	58.9	58.0	55.6	55.8	55.8	57.3	58.4
Unemployment rate <sup>e</sup>	6.1	8.5	8.9	8.9	7.8	7.7	10.4	9.3	11.5
Real average wage (index: 1995=100)	65.4	68.4	74.2	83.5	90.9	100.0	105.4	103.0	98.9
<b>Growth rates</b>									
Prices (December-December)									
Consumer prices	49.5	49.0	60.2	31.0	25.4	22.8	25.6	30.7	43.4
Wholesale prices	45.5	48.0	54.7	39.2	18.2	...	...	...	...
External sector									
Terms of trade (index: 1995=100) <sup>b</sup>	141.1	121.7	116.3	106.4	108.9	100.0	109.6	111.9	99.6
Nominal exchange rate (sucres per dollar) <sup>f</sup>	768	1 046	1 534	1 919	2 197	2 565	3 190	3 998	5 447
Real effective exchange rate for imports (index: 1995=100)	121.6	114.8	116.0	103.4	98.1	100.0	100.4	96.2	94.7
<b>Millions of dollars</b>									
Balance of payments									
Current account	-360	-708	-122	-678	-682	-735	109	-714	-2 119
Trade balance (goods and services)	897	495	905	449	455	297	1 200	314	-1 280
Exports	3 262	3 407	3 718	3 712	4 580	5 257	5 748	6 087	5 003
Imports	2 365	2 912	2 813	3 263	4 125	4 960	4 548	5 773	6 283
Capital and financial account <sup>g</sup>	-591	-302	-844	54	-126	207	-189	765	1 709
Overall balance	-951	-1 010	-966	-624	-808	-528	-80	51	-410
Variation in reserve assets (- indicates an increase)	-195	-78	-22	-490	-449	233	-245	-237	225
<b>Percentages</b>									
External debt									
Gross debt (as a percentage of GDP)	114.4	108.9	101.1	95.3	87.9	77.7	76.6	76.4	83.2
Net interest (as a percentage of exports) <sup>h</sup>	33.2	29.0	22.0	21.0	17.9	14.2	14.7	14.3	19.7

Table 1 (concluded)

	1990	1991	1992	1993	1994	1995	1996	1997	1998 <sup>a</sup>
<b>Percentages of GDP</b>									
Non-financial public sector									
Current revenue	27.1	25.4	25.8	24.9	24.4	25.5	24.4	23.8	20.3
Current expenditure <sup>i</sup>	19.5	18.6	19.6	18.2	18.1	20.3	19.9	20.0	20.6
Saving	7.6	6.8	6.2	6.7	6.3	5.2	4.5	3.7	-0.3
Capital expenditure	7.1	7.4	7.3	6.8	6.5	6.6	7.6	6.3	5.9
Financial balance	0.5	-0.6	-1.2	-0.1	-0.2	-1.4	-3.1	-2.6	-6.2
Domestic financing	...	...	...	...	-1.3	1.7	0.5	0.4	4.8
External financing	...	...	...	...	1.5	-0.3	2.6	2.2	1.4
<b>Growth rates</b>									
Money and credit									
Monetary balances of banking system									
Net international reserves	279.9	80.0	65.4	50.7	46.6	4.4	68.1	11.5	-3.6
Net domestic credit	21.5	44.6	50.6	54.6	74.6	59.7	32.9	48.4	62.4
To private sector	42.9	66.9	62.3	76.9	78.2	51.7	23.8	48.0	42.8
Money (M1)	55.7	46.5	44.4	49.4	35.7	12.7	35.4	29.7	36.2
Local-currency savings and time deposits	80.8	68.6	60.8	52.1	64.6	41.1	39.7	20.0	28.9
M2	67.4	57.6	53.3	51.0	52.2	30.2	38.3	23.2	31.4
Dollar deposits	37.2	69.5	139.0	79.5	112.6	143.1	69.8	80.4	72.3
<b>Annual rates</b>									
Real interest rates (annualized, %)									
Deposit rate	-7.8	-4.7	-7.9	1.0	6.9	16.7	12.9	-2.3	2.6
Lending rate	-3.7	-1.2	-1.7	13.2	15.1	26.8	22.3	9.6	10.3
Equivalent interest rate in foreign currency <sup>j</sup>	0.2	-1.9	4.1	17.6	11.6	13.6	15.5	4.5	-7.2

Source: ECLAC, on the basis of official figures.

<sup>a</sup> Preliminary figures. <sup>b</sup> Based on constant 1990 dollars.

<sup>c</sup> These entries measure the impact of the variation in each aggregate on GDP growth. The coefficients were obtained by multiplying each aggregate's annual growth rate by the level of that same aggregate as a percentage of GDP.

<sup>d</sup> Percentages of the working-age population; urban areas. <sup>e</sup> Percentages of the economically active population (EAP); urban areas.

<sup>f</sup> Up to 1992, refers to the exchange rate on the regulated market. From 1993 on, refers to the exchange rate on the open market. <sup>g</sup> Includes errors and omissions.

<sup>h</sup> Refers to net interest as shown on the balance of payments, divided by exports of goods and services.

<sup>i</sup> In 1994 and 1995, includes expenditures related to staff reductions. <sup>j</sup> Interest rate on deposits, deflated by the variation in the exchange rate.

These shocks were compounded by others of an external nature, such as the El Niño weather pattern, the steep fall in oil prices and the financial crisis that affected various regions and countries of the world. These developments made themselves felt through inflationary pressures, rising interest rates, fiscal problems and a widening external deficit. In response to this situation, the economic authorities took the same approach as they had the year before and concentrated on curtailing the fiscal deficit and maintaining the currency-band mechanism.

However, due above all to a lack of political backing, neither the Administration that held office up to August 1998 nor the elected Government that followed it managed to reduce the non-financial public-sector

deficit to the target level of around 2.5% of GDP. In addition, the authorities twice had to make an upward adjustment in the exchange-rate band during the course of the year, as had also been necessary on four other occasions since its introduction at the end of 1994. The use of international reserves to defend the currency band offset the fiscal deficit's expansionary effects on monetary liquidity, and this, together with Central Bank intervention in the money market, led to a rise in interest rates.

Given these circumstances, the financial system slid into a serious crisis in the final quarter of 1998 which required bailout measures that brought an end to the authorities' tight monetary policy together with intervention in a series of financial institutions. The inter-

Table 2  
ECUADOR: MAIN QUARTERLY INDICATORS

	1996				1997				1998 <sup>a</sup>				1999 <sup>a</sup>
	I	II	III	IV	I	II	III	IV	I	II	III	IV	I
Gross domestic product (change from same quarter of preceding year) <sup>b</sup>	2.4	-0.2	2.3	3.5	2.9	4.2	3.7	2.7	1.6	0.2	0.1	-0.1	-3.2
Consumer prices (12-month variation, %)	24.8	22.6	24.9	25.4	29.9	31.1	30.6	30.7	30.5	35.9	37.8	43.4	54.4
Real effective exchange rate <sup>b</sup> (index: 1995=100)	100.1	99.6	100.5	101.5	97.5	97.0	95.9	94.3	90.5	92.7	94.3	101.2	118.1
Exports, f.o.b. (millions of dollars)	1 123	1 173	1 265	1 338	1 273	1 322	1 362	1 308	1 156	1 084	941	960	937
Imports, c.i.f. (millions of dollars)	958	966	955	1 053	1 096	1 114	1 280	1 393	1 307	1 425	1 473	1 298	783
International reserves (millions of dollars)	1 559	1 571	1 690	1 831	1 920	2 226	2 231	2 093	1 940	1 878	1 642	1 698	1 178
Real interest rates (annualized, %)													
Deposit rate	8.3	23.6	12.5	7.1	0.3	-2.1	-3.9	-3.3	1.9	2.1	4.6	2.0	5.3
Lending rate	16.6	33.2	24.1	19.2	10.7	10.8	9.0	7.7	9.5	8.2	12.6	10.9	12.9
Money (M1) (change from same quarter of preceding year)	...	...	...	...	38.8	40.3	40.6	29.7	25.0	20.2	12.6	36.2	39.2

Source: ECLAC, on the basis of official figures.

<sup>a</sup> Preliminary figures. <sup>b</sup> Refers to exchange rate for imports.

ruption of foreign leading operations caused by the Brazilian crisis led to a further shedding of international reserves and, given the loss of confidence in the foreign exchange regime, the authorities were forced to abandon the currency band, which had been economic policy-makers' main price stabilization tool in recent years. In April a set of measures was approved to contain the fiscal deficit, which will serve as a basis for efforts to negotiate an agreement with the International Monetary Fund (IMF).

#### (a) Fiscal policy

Fiscal policy faced a series of problems on both the expenditure and revenue sides caused, in particular, by the ravages of El Niño and the fall in oil prices, which

led to the biggest non-financial public-sector deficit since 1987 (6.2% of GDP) and a central government fiscal deficit of 2.7%. Steps to curb this deficit were hindered for much of the year by the fact that the interim Administration failed to gain the necessary congressional support. Consequently, by the time its term of office came to an end the projected non-financial public-sector deficit for the year was close to 7% of GDP. The new Government took steps to reduce the deficit in the fourth quarter, including the elimination of the subsidy on LPG, a cut in the subsidy on electrical power and a rise in the tax on diesel fuels. To alleviate the social impact of these measures, a "solidarity" bond was introduced for single mothers and elderly people with low incomes.

Taking the year as a whole, the disastrous weather conditions led to a significant increase in capital expen-

diture, especially on infrastructure, while expenditure on wages and salaries rose more sharply than total spending. Interest payments on the public debt continued to represent a heavy burden, absorbing about 25% of total current expenditure by the non-financial public sector. On the income side, fiscal performance was hurt considerably by the fall in oil prices as earnings from oil exports plummeted. Thanks to the periodic adjustment of domestic gasoline prices, revenues from the sale of petroleum products partly offset this fall but, even so, oil revenues as a whole declined from 6.4% to 4.6% of GDP.

Among non-oil tax revenues, the best performances came from the value added tax (VAT), which rose from 3.9% to 4.2% of GDP (largely due to improvements in tax collection), and import duties, which went up from 2.1% to 3.0% of GDP. The increase in revenues from import duties was the result of the introduction of a tariff surcharge of between 2% and 5% in March and import growth. However, as the other categories of non-oil revenues did not grow as much (in fact, the operating surplus of public-sector firms practically disappeared altogether), non-financial public sector revenues as a whole declined from 23.8% to 20.3% of GDP.

Efforts to curb spending focused on the capital expenditure of public-sector firms, which was reduced from 2.5% to 1.0% of GDP. However, given the growth of spending on other items, total non-financial public-sector expenditure rose slightly, from 26.3% to 26.5% of GDP. Most of the deficit was financed domestically, through mainly bond issues and an increase in accounts payable.

At the end of the year, the income tax was replaced by a 1% tax on financial transactions, which was intended to boost fiscal revenues and curtail evasion. In February 1999, a safeguard clause was again applied on imports under which tariffs between 2% and 10% were levied. In April, following serious social strife, new fiscal measures were approved—including the reintroduction of the income tax, the elimination of VAT exemptions and the application of a tax on gross corporate income—aimed at cutting the deficit to 3.5% of GDP in 1999.

### **(b) Foreign exchange policy**

The foreign exchange system, whose main elements had been introduced in 1994, was maintained in 1998. This regime includes a currency band which has had a gradient of 21% since 1997, in line with expectations of domestic and external inflation, and a band-

width around the central parity of 10%. By buying and selling dollars under a daily auction system, the authorities tried to limit the volatility of the exchange rate and keep it near the centre of the band. For much of the year this policy achieved its aim, although in March the band was raised by 7.5% and the slope was trimmed to 20% as a reaction to the inflationary impact of El Niño. The rate remained close to the central parity until external credit flows were halted when the Russian crisis broke out in August 1998, causing the domestic demand for dollars to rise.

In September, even before the exchange rate reached the ceiling of the band, the authorities made a further adjustment, raising the central rate by 15% and widening the band around it also to 15%. To expand the supply of dollars, the reserve requirement on dollar deposits was lowered to 2%. Although external financing resumed towards the end of the year, exchange-rate volatility increased in reaction to domestic and external macroeconomic instability.

As a result, the sucre depreciated sharply from September onward, having traded above its real end-1997 value for most of the year. On average for the year as a whole, there was a slight appreciation of 1.5%.

The Brazilian crisis of early 1999 interrupted foreign financing flows once again, and the exchange rate hit the ceiling of the currency band. At first, the authorities tried to defend the band by selling off foreign exchange reserves and raising interest rates, but by mid-February the situation had become untenable and the band was replaced by a dirty float. In the context of a marked scarcity and high demand for dollars (the latter being due to the need to pay off foreign loans and a lack of confidence in the sucre), the nominal exchange rate shot up to 12,000 sucres to the dollar, compared to 7,000 at the end of 1998. This further weakened the already fragile banking system, and, in an effort to defend it and to slow down the upsurge in inflation, the authorities declared several days' bank holiday and imposed a partial freeze on bank deposits. This measure temporarily calmed the demand for dollars, and by May the exchange rate had fallen back to below 9,000 sucres per dollar. Nevertheless, in June it rebounded, topping the 11,000-sucre mark once again.

### **(c) Monetary policy**

In the price stabilization scheme in force during 1998, monetary and exchange-rate policy complemented each other and interest rates were used to defend the currency band. Monetary policy was kept tight for most of the year, and the main monetary aggregates

grew at rates below inflation. The reduction in international monetary reserves facilitated this policy and, consequently, the drawing down of deposits held by the non-financial public-sector with the Central Bank—a reflection of the difficult fiscal situation—did not result in monetary expansion.

The evaporation of foreign credit caused problems for banking institutions, and towards the end of the year a growing number of them therefore had turn to the Central Bank in order to maintain their liquidity. This had a strong expansionary impact that was only partly countered by a greater use of Monetary Stabilization Bonds (BEMs). In this way, the liquidity squeeze was reversed, and by year's end the currency in circulation plus banks' cash holdings (money creation) had grown by 44.2%, which was closely in line with rate of inflation. This process was also reflected in the behaviour of the money supply (M1), which, following year-on-year growth of only 12.6% to September, had expanded by 36.2% by the end of the year. The relative preference for liquidity was seen in an increase of just 24% in quasi-money,<sup>1</sup> which amounted to a sharp retreat in real terms.

In the context of accelerating inflation and growing currency instability, nominal interest rates tended to rise throughout the year. In real terms, reference lending rates reached 12.6% and 10.9% in the third and fourth quarters, respectively. The upswing in interest rates slowed down the economic recovery and worsened the situation in the financial sector, which was also hurt by the damage caused by El Niño to the production sector and its ability to pay, as well as by the financial mismanagement of some banks. In these circumstances, the private banking sector's local-currency loan portfolio grew by a meagre 1% in nominal terms, whereas its portfolio in dollars went up by 23%. By the end of the year, non-performing loans amounted to 8% of the dollar portfolio and 13% of the portfolio in sucres.

The Economic and Financial Restructuring Act, whose aim is to revitalize the production sector and stabilize the banking system, entered into force in December. It was hoped that the provisions of this law would make it possible to reschedule non-performing loans that were considered recoverable over a longer term by enabling the banks to sign them over to the National Finance Corporation in exchange for Economic Reactivation Bonds (BREs), small amounts of which could be used for reserve-requirement purposes. However, as

this mechanism did not allow the banks to increase their liquidity as much as they wished, the demand for BREs was limited.

The same legislation also provided for the creation of the Deposit Guarantee Agency, whose task is to restructure financial institutions that are unable to meet their commitments and to guarantee savers' deposits, subject to certain exceptions. At the beginning of 1999, the situation in the financial system was further complicated by the interruption of foreign lending and the disincentive to financial intermediation created by the new tax on financial transactions. In fact, between the beginning of 1998 and March 1999, no fewer than nine banks, including some of the biggest in the country, had to undertake some sort of restructuring programme with the help of public funds.

In January 1999, in an effort to curtail the liquidity growth generated by bailout operations, the authorities raised the reserve requirement on sucre deposits from 12% to 16%. However, in March, the worsening banking crisis led to a sharp increase in money creation (whose year-on-year growth amounted to 107% by the end of the month), and the authorities then decided to impose a partial freeze on deposits in order to restrain the upsurge in inflation, avoid a bank run and curb the demand for dollars.

#### (d) Structural reforms

In mid-1998 constitutional reforms were put into effect whose aim was to improve the workings of both the executive branch and Congress. These reforms limit the power of Congress to dismiss ministers and concentrate the power to introduce tax and public spending bills in the hands of the President. They also enhance the workings of Congress by doing away with mid-term elections. In addition, the Central Bank charter was amended in order to give greater independence to its board of governors (which has replaced the old Monetary Board) and concentrate the management of monetary and exchange-rate policy in its hands.

Other measures were also taken to enhance public-sector efficiency, such as the creation of the Ecuadorian Customs Corporation, the initiation of operations at the Internal Revenue Service, and the replacement of certain organizations (including the National Development Council and the National Secretariat for Administrative Development) by smaller agencies.

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1 Includes quasi-money denominated in foreign currency, calculated using a set reference exchange rate for the whole period.



In April 1998, a second attempt to auction off a 35% stake in the two companies into which the Empresa Ecuatoriana de Telecomunicaciones (EMETEL) has been converted ended in failure because not enough bids were received. Progress was made in restructuring the electricity sector during the course of the year, with a new institutional structure be-

ing set up, together with the corresponding regulations. At the beginning of 1999, the State-owned Ecuadorian Electrification Institute (INECEL) was split into six generating firms and one electric power transmission company in preparation for their subsequent partial privatization.

### 3. The main variables

#### (a) Economic activity

In defiance of a GDP growth target initially set at 4%, adverse macroeconomic factors and the impact of El Niño brought economic activity to a virtual standstill, with GDP growing on the order of 0.4% and per capita GDP slipping back by 1.6%. The fall in export volumes—the most dynamic component of total demand for most of the 1990s—played an important role in this result. With an expansion of just 2%, household demand did nothing more than keep pace with population growth, and actually shrank in real terms in the fourth quarter. Gross fixed capital formation grew more vigorously, by 6.3%, with part of the increase being attributable to the need to replace infrastructure destroyed by El Niño. As a result, aggregate supply and demand grew by 1.4%, with the gap between demand and domestic output being bridged by an expansion of imports. Owing to a marked downturn in the terms of trade, gross national income shrank by 3%.

Among the different branches of economic activity, financial services, oil and agriculture all posted negative results due, respectively, to the banking crisis, liquidity problems at Petroecuador (the State oil company), attacks on the trans-Andean oil pipeline from Colombia and cracks in the trans-Ecuadorian pipeline and, finally, the impact of El Niño in the first half of the year. The destruction of plantations resulted in smaller harvests of important crops such as bananas, coffee and cocoa, but livestock production and fishing were up slightly. Construction was the only sector to display any appreciable expansion, thanks to the reconstruction work that was necessary, while the meagre growth of manufacturing, commerce and government services—below 1%—reflected the stagnation of economic activity in general.

In the first quarter of 1999, economic activity slumped still further in the wake of the banking crisis

and the freezing of a large percentage of financial deposits, and GDP was down by 3.2% from the level reached in the first quarter of the preceding year.

#### (b) Prices, wages and employment

There were two flare-ups of inflation during 1998. At the start of the year, disastrous weather conditions forced up the prices of many agricultural products and transport services, and in October the consumer price index (CPI) jumped again owing to the discontinuation of a number of subsidies, as mentioned earlier. As a result, the year ended with inflation at 43.4%, which was far above the target figure of around 25%. In the first half of 1999, the drastic depreciation of the sucre and the rise in gasoline prices had a further sharp impact on the CPI, which by June was showing a year-on-year increase of 53.1%.

In the context of a higher-than-expected rise in inflation, a sluggish economy and a policy of cost containment, minimum and average real wages were down sharply in 1998, falling by 7% and 4%, respectively.

Economic stagnation translated into weak labour demand, and this drove up unemployment, which by the end of 1998 had climbed to 11.5% (compared to 9.3% the year before). Job creation tended to be concentrated in informal commerce and, as a result, in the 12-month period starting in November 1997 the informal sector's share of urban employment rose from 40% to 42.3%.

#### (c) The external sector

The merchandise trade balance recorded an unusually large deficit of 4.8% of GDP in 1998, owing to a 20% drop in exports and a 10% rise in imports. Crude oil exports dropped by 44% in value terms due partly to

a slight reduction in volume but above all to a very steep fall in prices. In fact, oil slipped from first to third place among the main export products, being overtaken by bananas and shrimp, even though sales of these two products themselves were down by 19% and 4%, respectively. The shrinkage of exports was widespread among the other traditional products as well, such as coffee, cocoa and tuna, and also among non-traditional products. In some cases this was mainly a consequence of the damage of plantations caused by El Niño, but, apart from this, the financial crisis also adversely affected the demand for certain products, including bananas, and the prices of others, such as shrimp. The few cases in which exports grew slightly included flowers and canned fish. Imports, for their part, grew more slowly than in 1997, the fastest growing items being transport equipment (47%) and, partly because of problems with agricultural production, consumer non-durables (17%), while other items grew less or, like fuels and lubricants, declined.

Given the increase in the deficits on both factor and non-factor services, the current account deficit widened appreciably to 10.8% of GDP, compared to 3.6% the year before.

This substantial deficit was partly financed by an increase in remittances from Ecuadorians living abroad and by foreign direct investment, which climbed to US\$ 830 million, with the increase being concentrated in the oil industry. In addition, US\$ 860 million in funds (including refinanced loans) were made available by multilateral agencies, chiefly for the reconstruction of infrastructure damaged by El Niño and to help finance the balance of payments. Even so, there was an overall deficit of US\$ 790 million. This translated into a smaller —US\$ 470 million— loss of reserve assets, however, thanks mainly to the availability of exceptional financing amounting to US\$ 250 million. Nonetheless, international monetary reserves had fallen to US\$ 1.7 billion by the end of 1998 and to US\$ 1.3 billion by the end of June 1999.

The public external debt rose by nearly US\$ 750 million to a total of US\$ 13.2 billion, while the private external debt rose by US\$ 640 million to US\$ 3.16 billion. The financing agreement being negotiated with IMF during the first half of 1999 was expected to pave the way for a partial restructuring of the foreign debt (Paris Club).



## El Salvador

### 1. General trends

The growth rate of the gross domestic product (GDP) of El Salvador in 1998 was 3.2%, which was slightly less than in 1997 (4.2%) and much lower than the annual average of 6.8% achieved during the four-year economic recovery (1992-1995) that followed the signing of the Chapultepec Peace Agreement. One of the factors that played a role in this regard was the negative growth of the agricultural sector (-0.9%), which in turn was due partly to lower international prices for certain commodities, such as coffee, and partly to the direct and indirect effects of El Niño and Hurricane Mitch.

**AS A RESULT** of this modest growth rate, the real increase in per capita GDP was only 1.2%. The Ecuadorian economy did perform quite well in a number of areas, however, including the increase in its reserves, higher fixed investment (nearly 6%), an upswing in tax revenues, price stability (the annual inflation rate was 2.5%), and stability in the exchange rate and the fiscal deficit (2% of GDP, or almost the same as the year before).

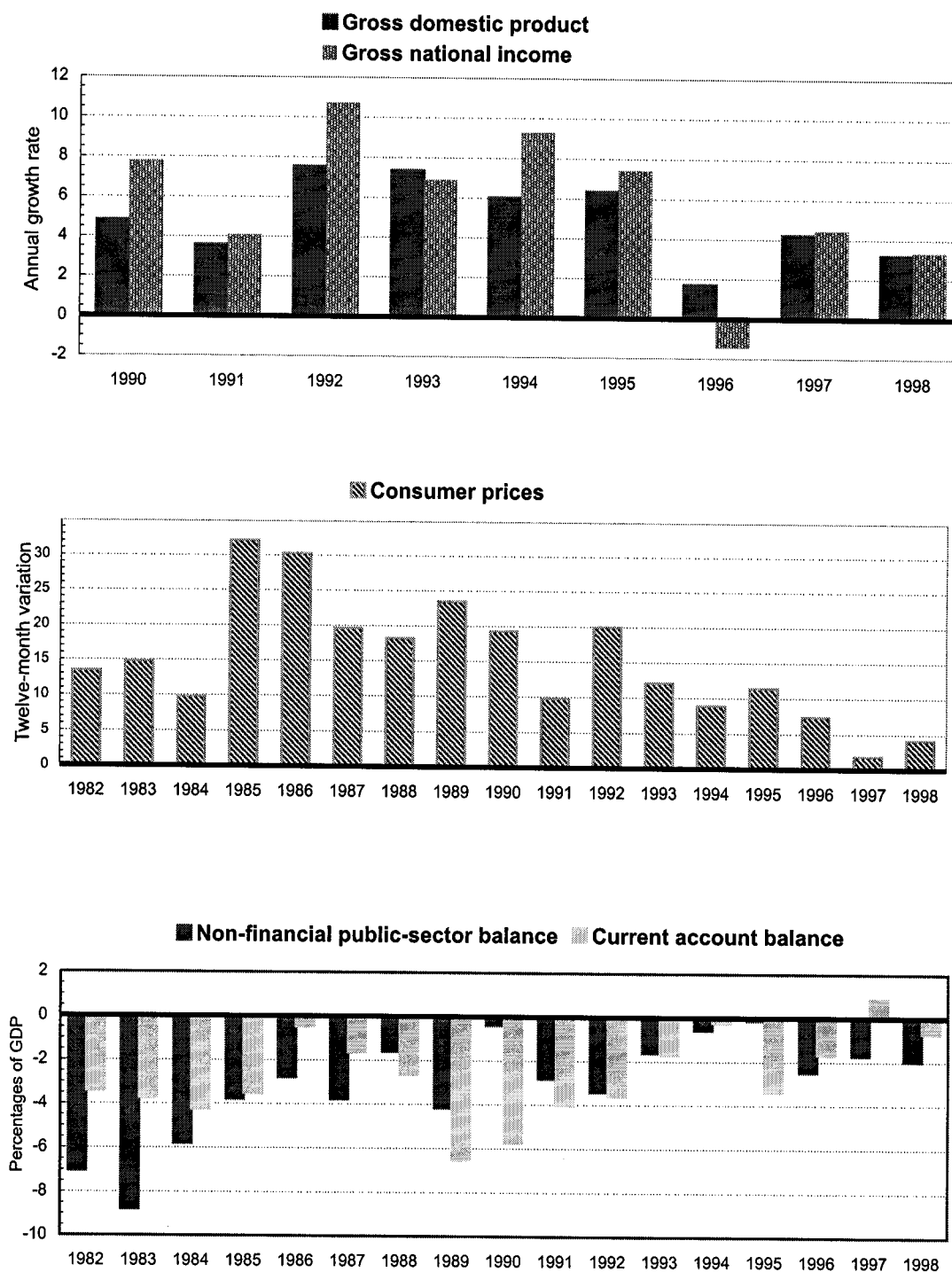
Factors that helped boost economic activity included exports of non-traditional and *maquila* products to other Central American countries; capital inflows, particularly from the sale of energy distributors and the telecommunications company; an increased supply of credit to various sectors of the economy; and lower interest rates.

The expansion of production was fueled primarily by manufacturing and by the transport, storage and communications industries, but mining and quarrying activities and construction also made some contribution to its growth. Other services turned in a weak performance (1.8%), however, and this heading includes commerce, which makes up about 45% of GDP.

Like the other Central American countries, El Salvador was hit by Hurricane Mitch in early November. There were grievous losses of human life and a great deal of damage was sustained by important export crops and by livestock herds and facilities. Since most of the year had passed (more than 10 months of economic activity) before the disaster struck, most of the impact of the hurricane will be seen in the figures for 1999.

The outlook for 1999 is centred on preserving the stability of macroeconomic variables, prices, the exchange rate and the financial system. Growth of between 3.5% and 4% is expected in the real sector of the economy, but the achievement of this goal may be threatened by the effects of the hurricane, particularly in primary sectors. The buoyancy of the external sector will depend on the behaviour of the country's main trading partners both within and outside the Central American subregion. Increased inflows of family remittances are also expected, which will help to keep the current account of the balance of payments at acceptable levels.

Figure 1  
EL SALVADOR: MAIN ECONOMIC INDICATORS



Source: ECLAC, on the basis of official figures.

## 2. Economic policy and structural reform

The behaviour of the main economic indicators was generally in accordance with the goals defined in the December 1998 monetary and financial programme. The overall objective of preserving macroeconomic stability in order to promote sustained economic growth was maintained throughout the year. The authorities also held to their specific economic policy objectives with respect to foreign-exchange and price equilibria and to improving the stability of the financial system.

Controlling the financial and currency markets remained a priority, and measures were therefore taken to sterilize excess liquidity in the economy. In order to reinforce these measures and forestall exchange-rate and price fluctuations, the monetary authorities phased in, on a temporary basis, an additional three percentage-point increase in the legal reserve requirement applying to both local and foreign-currency deposits.

The Government's main economic policy successes were low inflation (an average annual rate of 2.5%), a balance-of-payments current account deficit of only 0.7% of GDP, a non-financial public sector (NFPS) deficit of 2% of GDP and, with the help of an increase in net international reserves, a stable exchange rate.

The pillars of the strategy underlying these accomplishments were foreign investment, the privatization of State assets and a reduction of the country risk premium in order to improve competitiveness.

Under the country's structural reform programme, the economic liberalization process continued, with measures being adopted to carry forward the privatization of the financial, telecommunications, electric power distribution and pension systems.

### (a) Fiscal policy

The goal of fiscal policy was to broaden the tax base and adopt spending criteria based on the efficient use of resources and the prioritization of expenditures. In order to curb spending, measures were implemented to rein in public-sector investment, particularly by the central government. With regard to revenues, progress was made in developing oversight programmes, implementing the tax code and carrying out tax reforms, mainly with respect to the value added tax and income tax systems.

In the area of NFPS investment, the annual national investment programme, which is designed to stimulate a recovery in production activity and promote social development, was implemented. Social expenditure was focused on health, education and support for local development, and steps were taken to ensure the continuity of existing policies regarding the modernization of the public sector and the social security system.

In 1998 the tax burden amounted to 11.2%, which was slightly more than in 1997. Current NFPS revenues were 4.6% higher than the year before. Tax receipts increased by 7.4% and non-tax revenue by 24.6% (the increase totalled 104% for the central government, considered separately). Privatizations led to a significant upswing in capital revenues, which jumped from 40.3 million colones in 1997 to 725.1 million in 1998. Grants and donations from abroad fell by 50% and current expenditure climbed by 10.8%, with much of this increase being accounted for by transfers. This combination of factors resulted in a 19% increase in the value of the NFPS deficit, bringing the latter up to 2% of GDP, which was somewhat higher than the 1997 level (1.8%), but below the target level provided for by the Government's monetary and financial programme (2.4%). With the downturn in grants and donations from official sources, a smaller proportion of the deficit was financed by means of external borrowing and issues of short-term treasury bills in dollars (known as "Letes"). Because of the revenues generated by privatizations, domestic financing played a greater role in covering the deficit than external financing did.

The central government deficit was equivalent to 1.2% of GDP, slightly less than the programmed level of 1.3%. Outlays on wages and transfers to the private sector were higher. In terms of revenues, the most significant change was in capital income, which, as a consequence of privatization operations, surged by more than 2,000% from 33 million colones in 1997 to the record figure of 724 million in 1998.

One of the major events of the year in relation to fiscal issues was the adoption on 11 September of an amendment to the Municipal Economic and Social Development Fund (FODES) Establishment Act. Under the new legislation, beginning in fiscal 1998 the FODES will receive government funding on an annual basis equivalent to 6% of the nation's net current bud-

Table 1  
EL SALVADOR: MAIN ECONOMIC INDICATORS

	1990	1991	1992	1993	1994	1995	1996	1997	1998 <sup>a</sup>
<b>Growth rates <sup>b</sup></b>									
Growth and investment									
Gross domestic product	4.8	3.6	7.5	7.4	6.1	6.4	1.7	4.2	3.2
Per capita gross domestic product	1.6	0.4	4.2	4.0	2.9	3.4	-1.0	1.6	0.7
Gross domestic product, by sector									
Goods	3.8	3.8	8.8	-1.4	4.1	6.0	1.7	5.1	4.3
Basic services	6.2	-2.9	9.1	6.8	5.9	5.5	2.9	7.6	6.6
Other services	5.3	2.8	6.3	4.3	6.2	6.9	1.7	3.9	2.5
Consumption	15.0	3.1	7.5	7.7	7.5	9.2	1.6	2.2	2.7
Government	-38.0	3.1	0.9	1.0	3.0	7.9	2.8	2.8	3.6
Private	27.1	3.0	8.3	8.4	8.0	9.3	1.5	2.2	2.6
Gross domestic investment	-16.2	17.3	28.1	10.0	14.2	15.2	-22.1	5.8	14.7
Exports of goods and services	23.9	-0.5	6.5	30.1	8.4	13.9	8.7	20.2	1.8
Imports of goods and services	41.5	5.6	17.1	21.3	15.0	21.1	-6.1	9.2	5.6
<b>Percentages of GDP <sup>c</sup></b>									
Gross national income	104.0	105.3	108.6	109.1	112.5	113.7	110.1	110.4	110.6
Gross domestic investment	12.6	14.3	16.9	17.4	18.7	20.0	15.7	15.9	17.6
National savings	9.5	11.3	14.8	15.6	18.2	17.6	14.1	16.4	17.1
External savings	3.1	3.0	2.0	1.7	0.5	2.4	1.6	-0.6	0.5
<b>Percentages</b>									
Employment and wages									
Labour force participation rate <sup>d</sup>	...	51.6	52.2	...	53.4	52.4	51.3	50.9	53.4
Open unemployment rate <sup>e</sup>	...	8.7	9.3	9.9	7.7	7.6	7.7	8.0	7.5
Real minimum wage (index: 1995=100) <sup>f</sup>	97.0	100.0	101.5	101.5	99.6	100.0	96.4	92.2	95.3
<b>Growth rates</b>									
Prices (December-December)									
Consumer prices	19.3	9.8	20.0	12.1	8.9	11.4	7.4	1.9	4.2
Wholesale prices	19.7	-3.2	8.0	1.4	5.0	9.2	4.0	...	...
External sector									
Terms of trade (index: 1995=100) <sup>c</sup>	69.3	70.6	61.1	63.7	81.0	100.0	95.1	106.1	105.1
Nominal exchange rate (colones per dollar)	7.67	8.08	8.44	8.70	8.74	8.76	8.76	8.76	8.76
Real effective exchange rate for imports (index: 1995=100)	126.3	125.4	124.7	112.5	105.7	100.0	92.2	91.9	91.7
<b>Millions of dollars</b>									
Balance of payments									
Current account	-261	-212	-195	-118	-18	-322	-172	96	-84
Trade balance (goods and services)	-651	-717	-950	-1 011	-1 212	-1 624	-1 338	-1 180	-1 526
Exports	973	898	975	1 138	1 639	2 049	2 204	2 708	2 742
Imports	1 624	1 614	1 925	2 149	2 851	3 673	3 542	3 888	4 268
Capital and financial account <sup>g</sup>	288	65	61	177	131	471	337	267	387
Overall balance	27	-148	-134	59	113	148	165	363	303
Variation in reserve assets (- indicates an increase)	-165	70	-92	-112	-113	-148	-165	-363	-303
<b>Percentages</b>									
External debt									
Gross debt (as a percentage of GDP)	49.0	43.9	43.1	28.4	25.4	22.8	24.4	23.8	22.2
Net interest (as a percentage of exports) <sup>h</sup>	10.9	10.1	8.0	8.0	4.4	3.1	4.1	3.2	2.4

Table 1 (concluded)

	1990	1991	1992	1993	1994	1995	1996	1997	1998 <sup>a</sup>
<b>Percentages of GDP</b>									
Non-financial public sector									
Current revenue	12.5	13.0	13.6	14.3	16.0	17.1	17.4	15.4	15.5
Current expenditure	12.8	13.8	13.4	13.6	14.0	13.9	15.5	13.5	14.5
Saving	-0.3	-0.8	0.2	0.8	2.0	3.2	1.8	1.9	1.1
Capital expenditure (net)	2.5	4.1	6.7	4.5	4.0	4.2	4.5	3.8	3.1
Financial balance	-0.4	-2.8	-3.4	-1.6	-0.6	-0.1	-2.5	-1.7	-2.0
Domestic financing	-1.1	0.8	0.6	-0.3	-1.5	-1.2	0.1	-0.3	2.4
External financing	1.5	2.0	2.8	2.0	2.1	1.3	2.3	2.0	-0.4
<b>Growth rates</b>									
Money and credit									
Monetary balances of banking system									
Net international reserves	92.6	1.7	26.1	13.7	10.3	-6.1	31.9	32.3	35.8
Net domestic credit	10.4	22.7	37.5	45.5	26.2	39.5	14.1	8.2	4.5
To public sector	37.5	23.2	14.3	3.8	-27.5	-27.6	9.5	-3.1	...
To private sector	6.2	12.8	31.0	37.5	27.1	55.4	14.4	19.2	12.9
Money (M1)	22.1	6.1	31.8	12.4	10.3	4.4	17.5	-1.9	9.2
Local-currency savings and time deposits	32.0	29.1	31.2	48.6	25.3	33.7	13.5	12.7	11.2
M2	27.9	20.0	31.4	35.9	25.9	29.5	15.6	11.0	11.0
Dollar deposits	-3.1	-34.4	99.0	1.7	58.3	21.9	48.3	40.4	15.8
<b>Annual rates</b>									
Real interest rates (annualized, %)									
Deposit rate	-0.5	5.9	-6.2	2.7	4.3	2.8	6.2	6.9	7.6
Lending rate	2.2	9.2	-2.5	6.4	9.3	7.1	10.6	11.0	12.2
Equivalent interest rate in foreign currency <sup>i</sup>	-11.4	15.5	-0.8	22.4	12.5	14.3	14.0	11.7	10.3

Source: ECLAC, on the basis of official figures.

<sup>a</sup> Preliminary figures. <sup>b</sup> Based on constant 1990 colones. <sup>c</sup> Based on constant 1995 dollars. <sup>d</sup> Percentages of the working-age population. <sup>e</sup> Percentages of the economically active population. <sup>f</sup> Real minimum wage in the manufacturing and services sectors in San Salvador. <sup>g</sup> Includes errors and omissions. <sup>h</sup> Refers to net interest as shown on the balance of payments, divided by exports of goods and services. <sup>i</sup> Interest rates on deposits, deflated by the variation in the exchange rate.

getary revenues. The funds will be transferred by the Municipal Development Institute of El Salvador (ISDEM) to the country's 262 municipalities and will be supplemented with resources from the Social Investment Fund for Local Development (FISDL). Another significant event was the amendment of the Free Trade Zone and Marketing Act to protect sensitive areas of the country's economy, such as agriculture and, more specifically, sugar producers and growers of fibres such as henequen.

A draft budget of 17.0793 billion colones was adopted for 1999, which was a 3% increase over the amount approved for 1998.

## (b) Monetary and foreign exchange policy

The monetary policy of the Central Reserve Bank continued to focus on controlling and reducing excess liquidity on the money market in order to provide monetary stability for economic agents and avoid inflationary pressures. The effectiveness of this policy was reflected in an inflation rate comparable to that of an industrialized country.

In order to keep the exchange rate stable, the authorities maintained their policy of sterilizing excess liquidity through open-market operations. In April, one of the main monetary policy instruments—the monetary administration certificate (CAM)—was replaced



Table 2  
EL SALVADOR: MAIN QUARTERLY INDICATORS

	1996				1997				1998 <sup>a</sup>				1999 <sup>a</sup>
	I	II	III	IV	I	II	III	IV	I	II	III	IV	I
Gross domestic product (change from same quarter of preceding year)	2.0	1.2	1.3	2.8	3.6	4.5	4.1	3.7	2.8	3.0	2.9	4.9	5.0
Consumer prices (12-month variation, %)	10.6	11.0	8.8	7.4	7.4	4.9	2.1	1.9	1.5	3.2	1.5	4.2	1.9
Exports (millions of dollars)	...	...	...	...	...	...	...	...	712	640	570	524	644
Imports (millions of dollars)	...	...	...	...	...	...	...	...	947	1 023	997	993	991
Real effective exchange rate <sup>b</sup> (index: 1995=100)	93.6	92.2	90.6	92.3	90.9	91.6	92.1	93.3	92.3	91.1	91.1	92.2	91.9
Real interest rates (annualized, %)													
Deposit rate	5.5	3.3	2.9	13.1	3.7	5.0	8.8	10.0	9.3	6.8	7.6	6.7	7.9
Lending rate	10.3	7.3	6.7	18.0	8.1	9.4	12.9	13.7	13.7	11.6	12.2	11.1	12.6

Source: ECLAC, on the basis of official figures.

<sup>a</sup> Preliminary figures. <sup>b</sup> Refers to the exchange rate for imports.

with new, discounted certificates (CAM-D) which have both the discount and the brokerage withholding tax built in. In September, liquidity and the fixed exchange rate came under pressure owing to the inflow of funds from the sale of State-owned enterprises and the performance of the capital account. To avoid an appreciation of the colón, the Central Reserve Bank withdrew dollars from the market, increasing net international reserves by 20.7% (from US\$ 1.462 billion in 1997 to US\$ 1.765 in 1998), and kept a tighter lid on inflation. Thus, the growth of the money supply was controlled through open-market operations and higher effective reserve requirements. The Central Reserve Bank raised the reserve requirement applying to local and foreign-currency deposits by three percentage points, but this measure was applied gradually (the requirement was raised by 0.3 points once every two weeks, in 10 steps until the rate of 3.0 points was reached) and was temporary in nature (from November 1998 to March 1999).

Nominal interest rates on loans and deposits, in both local and foreign currency, declined over the

course of the year, but real interest rates have remained relatively high (considering that the average inflation rate for the year was 2.5%) and this, in conjunction with the levels of liquidity existing in the economy, have made higher levels of credit available to the private sector. Average deposit rates (180-day deposits) were 11.4% in 1994 and 10.4% in 1998. The basic lending rate for periods of up to one year was 16.0% in 1997 and 15.0% in 1998.

As part of the effort to modernize the financial system, steps were taken to improve the efficiency of the regulatory system for banking, insurance, securities and pensions; to strengthen the oversight and monitoring system (the Superintendency of the Financial System); to develop the securities market; and to consolidate the new pension system.

### (c) Trade policy

The objectives of the tariff reduction programme remained unchanged: a floor of 5% and a ceiling of 10% for intermediate goods and a 15% ceiling for final goods,

both by July 1999. Tariffs on raw materials and capital goods had already been cut to zero in December 1996.

Trade negotiations between Mexico and the Northern Triangle countries (El Salvador, Guatemala and Honduras) made significant progress, but some differences remain in connection with services, technical standards and non-tariff barriers. Negotiations with Panama and Chile have begun, and in 1998 a free trade agreement with the Dominican Republic was approved, as was the corresponding list of exceptions and rules of origin, which came into force in January 1999.

#### (d) Structural reforms

One of the most significant advances in the area of structural reforms was the start-up of operations by the country's five new pension fund management companies (AFPs). Under this new individually-funded system, it is hoped that investments made by the AFPs in the securities market will boost domestic saving.

The privatization process culminated in 1998 with the sale of the National Telecommunications Administration (ANTEL) and the State's electric power distribution companies.

### 3. The main variables

#### (a) Economic activity

GDP growth in 1998 was 3.4%, or one percentage point below the 1997 level. Although the figures for the past two years fall short of the 6.8% average growth rate for 1992-1995 (a period during which the country was going through an economic and political normalization process), they represent an appreciable improvement over the 1996 growth rate of only 1.7%.

The sectors which performed best in 1998 were manufacturing (8%); transport, storage and communications (6.9%); banking and insurance (5.5%); mining and quarrying (5.5%); and construction (4.4%). The agricultural sector, which has not managed to achieve a satisfactory recovery in the years since 1995, actually registered a slight decline in 1998 due partly to weaker international prices for commodities such as coffee and partly to the direct and indirect impacts of El Niño and Hurricane Mitch.

Damage caused by the hurricane to agriculture, fisheries and the livestock industry is estimated at US\$ 158 million (40.7% of the total losses, estimated at US\$ 388 million); the affected area covers about 100,000 hectares.

In the crop-farming sector, production of coffee for export decreased by 7.1%, but sugar-cane output was up by 17%. As for crops intended for domestic consumption, maize production was higher (6.8%), but output of beans, husked rice and sorghum was down (-32.5%, -25.4% and -15.2%, respectively).

The branches of manufacturing activity with the greatest increases in value added were the *maquila* services sector (20%), paper and paper products (13.2%), basic metal products and metal manufactures (11.6%), beverages (11.3%), transport equipment and miscellaneous manufactures (10.9%), and machinery and equipment (8.9%).

On the demand side, there was a steep upturn in gross domestic investment (15%), which was buoyed by increases in fixed capital formation (6%), especially in the private sector, and strong growth in inventories. The rate recorded for real public investment — 1.8% — was the net result of a contraction in central government investment and a significant increase in NFPS investment (both measured in current colones) due to the allocations made for local government works and for road surfacing, repair and improvement programmes.

#### (b) Prices, wages and employment

Inflation, as measured by the consumer price index (CPI), amounted to 4.2% (December to December), with an annual average rate of 2.5% for 1998. The largest rise among the components of the index was in food prices (6.9%) owing to the impact of Hurricane Mitch and a shortage of fruits and vegetables in late 1998; this was counteracted by downward trends in the subcategories of housing, clothing and related services, and miscellaneous items. External factors that exerted an influence in this respect included the fall in oil prices,

which gave a boost to production activities that use hydrocarbons.

In addition to the positive trend in economic activity, the real sector benefited from the slower cumulative rate of inflation, since the country ended the year with a rate below the target figure of 4.5% provided for in its monetary programme. El Salvador continues to have one of the lowest inflation rates in Latin America.

The National Minimum Wage Council directed that, as of 1 May 1998, the nominal minimum wage be raised to 1,260 colones in urban areas (a 9% increase, equivalent to 105 colones) and to 648 colones in rural areas. This translates into an increase in the minimum wage for agricultural workers of 6.4% in real terms, compared with a 4.3% decrease in 1997.

The latest data from multi-purpose household surveys show that in 1998 the national unemployment rate remained around 7%, which was substantially lower than the average of 8.4% recorded between 1992 and 1997. At 31.8%, the figure for total underemployment was much more alarming, however.

### (c) The external sector

The external sector generally performed well, thanks to foreign exchange inflows from foreign investment, loans, increased exports of non-traditional and *maquila* products, and family remittances. On the other hand, merchandise exports were flat, imports were up sharply, and the deficit on trade in goods and services rose to its highest level of the decade (US\$ 1.526 billion in 1998, compared with US\$ 1.18 billion in 1997).

The balance-of-payments current account showed a deficit of US\$ 83 million, equivalent to 0.7% of GDP. The aforementioned trade deficit of US\$ 1.526 billion was 29.3% higher than in 1997, mainly owing to a 37.8% drop in the value of coffee exports, which slid from US\$ 518 million in 1997 to US\$ 322 million in 1998. On the other hand, sugar and shrimp exports increased by 18.5% and 9.8%, respectively, and family remittances were up by 11%, rising from US\$ 1.2 billion in 1997 to US\$ 1.332 billion in 1998.

The 1.5% overall increase in the volume of exports in 1998 was chiefly attributable to the increase in exports of *maquila* products (12.5%) and of non-traditional products to countries outside Central America. The principal negative factor was the steep

drop in traditional exports (30%). The *maquila* industry remains the largest single element in the export structure, accounting for 48.6% of the total, followed by non-traditional exports to Central American countries, with 25%, and traditional coffee exports, with 13.2%. Imports were up by 5.6% despite falling international oil prices. The most significant change in the import structure was the 11% increase registered for the *maquila* sector.

The trade balance for transactions within Central America yielded a small surplus. Exports to other Central American countries expanded by 6.4%, and imports from them were up by 3.6%. The largest share of the import structure corresponds to the rest of the world, with 84.9%, followed by the *maquila* sector with 21.5%; Central America accounted for 15.1% of total imports.

The balance of payments showed an overall surplus of US\$ 303 million which was mainly attributable to inflows of foreign direct investment (FDI) from privatized firms. Nonetheless, the positive balance recorded for net transfers (US\$ 1.508 billion) was not sufficient to finance the deficit on trade in goods and services. The largest movements on the financial account were the result of the massive inflows of external private capital generated by the privatization of electric power companies, fixed and wireless telecommunication services, and initial investments in the country's newly created AFPs. The sale of the country's electric power distribution firms yielded a total of US\$ 586 million, which was shared among three enterprises: Energía de El Salvador (ENERSAL), a Venezuelan-owned corporation, acquired the Compañía de Alumbrado Eléctrico de San Salvador (CAESS) and the Empresa Eléctrica de Oriente (EEO) for US\$ 297 million; Applied Energy Services (AES) of El Salvador, a firm owned by United States interests, bought the Compañía de Luz Eléctrica de Santa Ana (CLESA) for US\$ 109 million; and the Chilean-owned firm Electricidad de Centroamérica acquired Distribuidora Eléctrica del Sur (DELSUR) for US\$ 180.1 million.

As of December 1998, the external debt totalled US\$ 2.632 billion (22% of GDP and 96% of total exports of goods and services), which was 2% less than the previous year's figure. This is a fairly acceptable ratio, especially when it is compared with those of other Latin American economies such as Argentina, Mexico or Peru, whose external debts average as much as 38% of GDP.

## Guatemala

### 1. Recent trends

The salient features of the Guatemalan economy in 1998 were increased output growth, low inflation and an increased deficit on the balance-of-payments current account; there were also abundant inflows on the financial account, in the form of non-recurrent revenues relating to the privatization of State-owned electricity and telephone companies. In late October, the country was devastated by Hurricane Mitch, which left a trail of physical destruction and large numbers of victims.

**GROSS DOMESTIC** product (GDP) grew by 4.9% in 1998, compared to 4.3% the year before, thanks to the adoption of more growth-oriented monetary and fiscal policies. Increased domestic credit was reflected mainly in higher levels of private consumption, which, in turn, generated a sharp rise in imports. Although export performance was satisfactory, the trade gap widened significantly. In general, economic activity benefited from the continued growth of international private-sector remittances, and expansion in the maquila and tourism industries. Average inflation was lower than in 1997, and the real exchange rate remained virtually unchanged.

In the framework of the Peace Accords, which provide for an increase in the tax burden and in public investment in social sectors, tax receipts grew as the directive on the tax burden was implemented. At the same time, outlays on both current and investment expenditure rose substantially, causing the central government deficit to grow to 2.4% of GDP. Gross fixed investment remained buoyant for the second year in a row, driven partly by projects undertaken in the public sector.

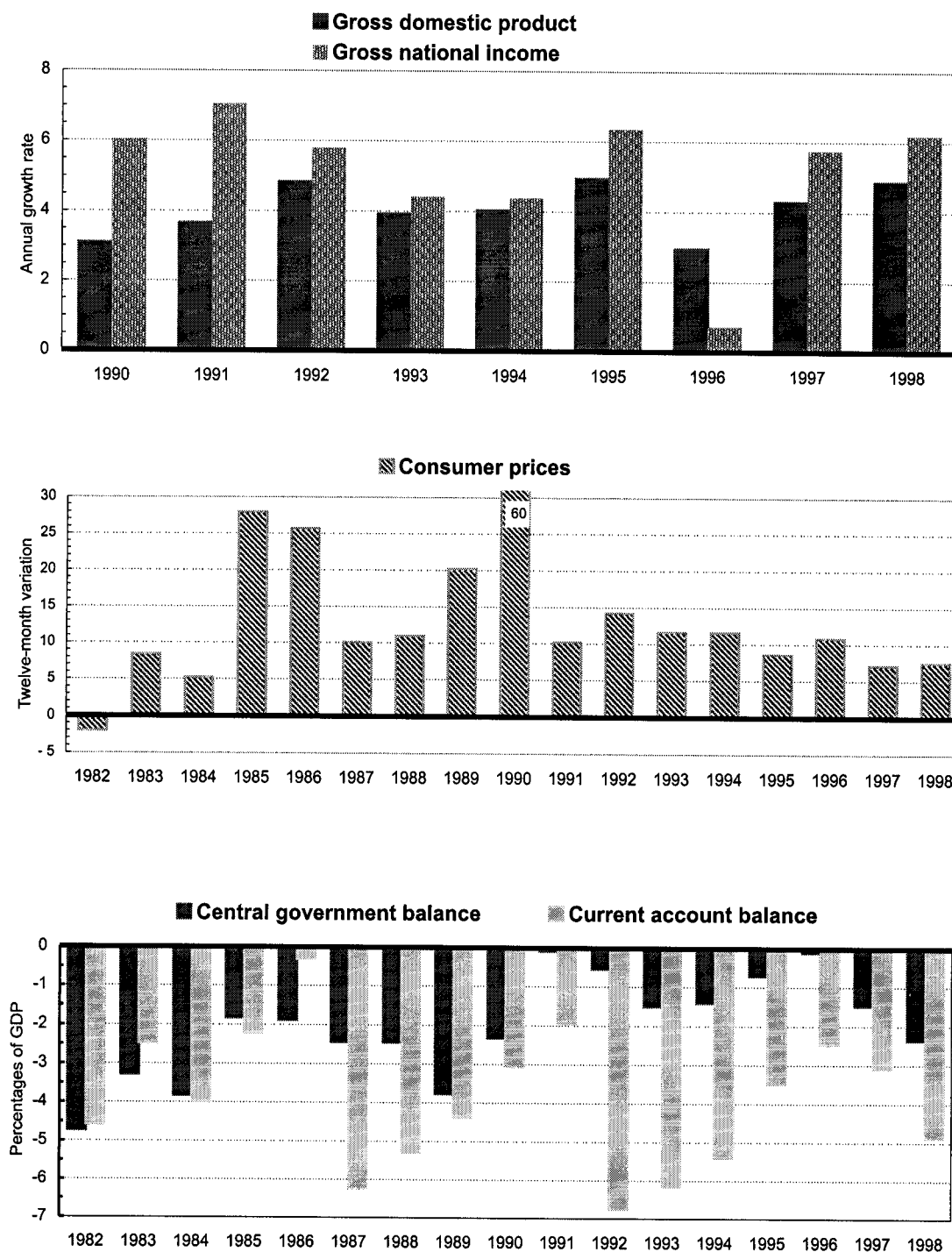
For 1999—which, being an election year, will be a time of political uncertainty—the authorities are expecting GDP growth of 3.9%, inflation of between 5% and 7% and a central government deficit—in terms of the extended budget—of no more than 3.8% of GDP. The real exchange rate is also expected to remain unchanged.

### 2. Economic policy and reform

The main goals of economic policy in 1998 were to achieve economic growth of 5% and keep inflation in single digits; to this end, a December-December target of between 6% and 8% was set. The goal established in the Peace Accords, of raising the gross tax burden to 10%, was also ratified, although the target was later trimmed to 9.8%. In fact, at the end of the tax year, the ratio stood at 9.5%.

In the absence of an agreement with the International Monetary Fund (IMF), the current Administration's economic policy in 1998 was directed towards meeting the targets, established in the Peace Accords, of increasing both the tax burden and social investment. The policy agenda was also directed at combining growth and stability; this also entails deepening trade liberalization and downsizing the State through an active policy of concessions and privatizations.

Figure 1  
GUATEMALA: MAIN ECONOMIC INDICATORS



Source: ECLAC, on the basis of official figures.

Table 1  
**GUATEMALA: MAIN ECONOMIC INDICATORS**

	1990	1991	1992	1993	1994	1995	1996	1997	1998 <sup>a</sup>
<b>Annual growth rates<sup>b</sup></b>									
Growth and investment									
Gross domestic product	3.1	3.7	4.8	3.9	4.0	4.9	3.0	4.3	4.9
Per capita gross domestic product	0.5	1.0	2.1	1.2	1.3	2.2	0.3	1.6	2.1
Gross domestic product, by sector									
Goods	2.8	2.8	4.3	2.2	2.5	3.8	2.6	3.4	3.9
Basic services	6.1	5.4	8.9	6.0	4.5	7.9	4.2	8.2	7.1
Other services	2.8	4.1	4.4	5.0	5.3	5.3	3.0	4.1	5.1
Consumption	2.5	3.6	5.1	4.5	4.7	4.8	2.5	4.1	7.8
General government	3.3	1.7	5.6	8.0	3.0	1.3	0.0	5.5	32.9
Private	2.4	3.8	5.0	4.1	4.8	5.2	2.8	4.0	5.1
Gross domestic investment	-1.3	22.6	29.6	-5.7	1.5	-1.2	-15.0	16.0	-4.8
Exports of goods and services	6.5	-4.9	8.3	9.6	3.4	12.6	8.7	10.2	8.5
Imports of goods and services	-0.7	7.2	37.1	4.2	5.0	7.6	-6.9	19.5	19.8
<b>Percentages of GDP<sup>c</sup></b>									
Gross national income	97.0	100.0	100.8	101.2	101.5	102.8	100.5	101.9	103.0
Gross domestic investment	12.2	14.5	17.9	16.4	16.1	15.1	12.3	13.8	12.4
National savings	10.1	12.9	12.1	10.7	10.7	11.6	9.7	10.3	6.8
External savings	2.1	1.6	5.8	5.7	5.4	3.5	2.6	3.5	5.6
<b>Percentages</b>									
Employment and wages									
Open unemployment rate <sup>d</sup>	6.0	4.0	1.5	2.5	3.3	3.7	3.7	5.0	5.9
Real average wage (index: 1995=100)	77.0	72.1	82.9	88.7	89.3	100.0	112.6	112.8	108.5
<b>Growth rates</b>									
Prices (December-December)									
Consumer prices (nationwide)	59.6	10.2	14.2	11.6	11.6	8.6	10.9	7.1	7.5
External sector									
Terms of trade (index: 1995=100) <sup>e</sup>	75.2	84.2	83.8	87.6	94.9	100.0	89.4	96.7	96.1
Nominal bank exchange rate (quetzales per dollar)	4.49	5.03	5.17	5.60	5.80	5.81	6.05	6.07	6.39
Real effective exchange rate for imports (index: 1995=100)	123.6	110.0	109.0	110.2	104.6	100.0	95.2	90.4	91.5
<b>Millions of dollars</b>									
Balance of payments									
Current account	-233	-184	-706	-702	-700	-511	-391	-547	-916
Trade balance (goods and services)	-244	-341	-955	-947	-938	-920	-767	-1 013	-1 599
Exports	1 568	1 689	1 898	2 024	2 287	2 801	2 767	3 175	3 418
Imports	1 812	2 029	2 853	2 970	3 224	3 721	3 534	4 188	5 018
Capital and financial account <sup>e</sup>	-10	815	692	901	694	354	567	834	1 158
Overall balance	-243	631	-14	200	-6	-157	176	287	243
Variation in reserve assets (- indicates an increase)	42	-551	52	-121	-47	157	-176	-287	-243
<b>Percentages</b>									
External debt									
Public debt (as a percentage of GDP)	31.2	25.5	21.6	18.3	16.6	14.4	13.1	12.0	12.3
Net interest (as a percentage of exports) <sup>f</sup>	10.7	5.7	7.5	4.9	4.2	3.4	4.8	3.2	1.6

Table 1 (concluded)

	1990	1991	1992	1993	1994	1995	1996	1997	1998 <sup>a</sup>
<b>Percentages of GDP</b>									
Central government sector									
Current revenue	7.9	9.0	10.1	9.1	7.7	8.5	9.0	9.0	10.4
Current expenditure	8.5	7.6	7.8	7.5	6.9	6.6	6.5	6.5	8.1
Saving	-0.6	1.5	2.4	1.6	0.8	1.9	2.5	2.5	2.2
Capital expenditure	1.7	1.5	2.9	3.1	2.3	2.6	2.6	4.0	4.6
Financial balance	-2.3	-0.1	-0.5	-1.5	-1.4	-0.7	-0.1	-1.5	-2.4
<b>Growth rates</b>									
Monney and credit									
Monetary balances of banking system									
Net international reserves	...	...	57.6	19.2	-15.8	-13.9	22.4	66.4	13.8
Net domestic credit	20.5	15.1	11.2	5.8	39.6	18.3	10.9	18.2	12.1
To public sector	-1.1	94.7	-31.0	-34.4	-47.4	-74.9	...	...	...
To private sector	16.6	18.4	35.1	15.3	14.2	32.3	12.2	18.5	27.3
Money (M1)	33.9	18.3	5.4	21.1	34.9	22.8	12.8	31.3	13.4
Local-currency savings and time deposits	13.7	64.1	27.4	3.4	20.1	6.6	12.2	20.8	11.6
M2	21.7	44.1	19.5	9.0	25.3	12.7	12.4	25.1	12.4
<b>Annual rates</b>									
Real interest rates (annualized, %)									
Deposit rate	-23.9	13.1	-3.4	1.0	-1.7	-0.8	-2.9	-3.5	-1.3
Lending rate	-20.6	22.0	4.6	11.8	10.2	11.6	10.7	8.7	9.1
Equivalent interest rate in foreign currency <sup>g</sup>	-1.7	22.7	6.2	1.9	12.8	2.4	7.0	2.5	...

Source: ECLAC, on the basis of official figures.

<sup>a</sup> Preliminary figures.

<sup>b</sup> Based on quetzales at constant 1958 prices.

<sup>c</sup> Based on constant 1995 dollars.

<sup>d</sup> Percentages of the economically

active population (EAP).

<sup>e</sup> Includes errors and omissions.

<sup>f</sup> Refers to net interest as shown on the balance of payments, divided by exports of

goods and services.

<sup>g</sup> Interest rate on deposits, deflated by the variation in the exchange rate.

### (a) Fiscal policy

The main economic policy goals set out in the Peace Accords are of a fiscal nature. This explains why the Administration's objectives included strengthening tax collection and rationalizing public spending. Priority was given to productive infrastructure projects and social investment, especially in the areas of health, education and low-income housing. In addition, the question of whether the central bank should be involved in efforts to preserve monetary stability was again a subject of analysis.

In 1998, the central government deficit rose to 2.4% of GDP, despite an increase in tax receipts of about 15.1%. Public revenues from value added tax

grew by 17.2%, on the back of significantly higher imports, and revenue from income tax, including the tax on commercial and farming enterprises, grew by 26.3%. Despite a lowering of tariffs, import duties rose by 11.3%, while taxes on petroleum-based fuels went up by 34.9%.

While total central government revenue grew by 19%, expenditure expanded disproportionately (34%), as a result of increases of 38% and 31% in current and capital outlays, which generated the fiscal deficit mentioned above.

The public-sector payroll grew by 30%, as a result of a 10% wage hike, payments relating to early-retirement incentives and the creation of new jobs (mainly for teachers, police and health workers). These

Table 2  
GUATEMALA: MAIN QUARTERLY INDICATORS

	1996				1997				1998 <sup>a</sup>				1999 <sup>a</sup>
	I	II	III	IV	I	II	III	IV	I	II	III	IV	I
Consumer prices (12-month variation, %)	18.3	19.2	17.3	13.8	11.5	9.0	8.3	7.1	6.1	7.5	5.6	7.5	3.9
Real effective exchange rate <sup>b</sup> (index: 1995=100)	99.6	96.6	94.6	90.2	90.6	89.5	90.2	91.5	90.8	90.4	90.8	93.9	99.9
Real interest rates (annualized, %)													
Deposit rate	-3.3	-2.2	-3.4	-2.5	-5.0	-3.2	-2.8	-3.1	-1.0	-2.4	-1.5	-0.2	...
Lending rate	9.5	11.4	10.5	11.6	8.7	9.5	9.3	7.3	9.4	7.8	8.7	8.7	...

Source: ECLAC, on the basis of official figures.

<sup>a</sup> Preliminary figures. <sup>b</sup> Refers to exchange rate for imports.

outlays were consistent with the increase in social needs and the commitments undertaken in the framework of the Peace Accords. The 34.4% rise in spending for the purchase of goods and services was basically due to job creation.

Interest payments on the public debt were up by 61% from the previous year's figure, owing to an increase in debt principal, higher interest rates, an exchange-rate differential and a change in the method of recording implicit interest on Certibonos. As a result, interest accounted for 12 cents of every quetzal of tax revenue.

Real investment expenditure grew by 22.3%. The 41.7% rise in the category of "other capital expenditure" —which had already more than doubled in 1997— includes transfers to other State agencies and local governments, but mainly consists of increased transfers to social funds, which in turn are responsible for implementing direct investment projects.

#### (b) Monetary policy

Monetary policy was implemented in two distinct stages during 1998. During the first, covering the period up to July, liquidity was greater as a result of a decline in effective bank reserve levels (reserve requirement and compulsory investment), the expiry of public-sector bonds and the withdrawal of deposits maintained by entities in the non-financial public sector at the Banco de Guatemala, which serves as the central bank. As a result, interest rates remained stable at

relatively low levels; this stimulated consumption and private-sector borrowing, but it also led to a greater outflow of funds abroad. Although the pace of economic activity picked up, there was also increasing pressure on the external sector, as outflows rose on both the trade and the private capital accounts, making it necessary to change the course of monetary policy. As a result, during the second stage (from August on), monetary policy was aimed at containing credit and liquidity by raising the interest rate.

Initially, the strategy consisted of simultaneously reducing the balance of Banco de Guatemala open-market transactions and effective bank reserves. The liquidity resulting from the lower bank reserves was to be neutralized by temporarily resorting to the use of part of the international monetary reserves, which were to be restored once the sale of State assets was finalized. It was therefore vital that fiscal policy should continue to support monetary policy.

Other measures that were adopted in the same framework included holding the reserve requirement on bank deposits at 14%, reducing the rate of compulsory deposit investment from 17.5% to 5.6% between December 1997 and June 1998, and, during the same period, raising the rate of compulsory investment on bank bonds, which had reached 19.6% by June. In addition, the reserve regime was extended to all liabilities of banks in the system, and the reserve rate of 19.1% on such liabilities, a reduced level established as a temporary measure in 1997, was adopted on a permanent basis.



The net effect of this was a process of monetization that is estimated at between 700 and 800 million quetzales. As expected, these surpluses were neutralized through the sale of reserves amounting to a net US\$ 186 million during the first half of 1998.

Interest rates began to rise in mid-September, once the liquidity squeeze resulting from the reorientation of monetary policy began to exert increasing upward pressure on short-term money-market rates (repo operations). The weighted average of lending rates ended the year at 18%, after fluctuating around 16% up to August, while rates on saving and investments edged up from 6% to 7%.

Private-sector credit, especially consumer lending, remained at a high level throughout 1998, although in the final months of the year, the annual rate of variation declined as liquidity tightened.

The value of bonds traded by the Government fell by 43% (1.919 billion quetzales), while time-deposit certificates issued by the Banco de Guatemala declined by 19% (580 million quetzales). This cutback in the use of monetary regulation instruments enabled the Banco de Guatemala to cut its operating losses from 850 million quetzales in 1997 to 409 million in 1998, and consequently, the quasi-fiscal deficit shrank from 0.8% of GDP to 0.3%.

Means of payment (M1) grew moderately in nominal terms (13%), while quasi-money expanded by slightly under 12%. This easing in the growth of monetary aggregates is explained by the use of international monetary reserves to supply the foreign-currency market in the face of repeated demand pressures during the course of the year.

### **(c) Foreign exchange and trade policies**

Foreign exchange policy reaffirmed the goal of keeping the real exchange rate neutral with respect to international trade. In fact, exchange rate movements clearly reflected the two phases of the economy during 1998. Up to July, the quetzal depreciated by just 2.4% in nominal terms, but between August and December, it declined by a further 8%.

The external imbalance affected both the level of reserves and the exchange rate. Had it not been for the injection of foreign currency into the market, the exchange rate would probably have suffered a much greater adjustment than the 8.3% it had reached by the end of 1998.

As regards foreign trade policy, the tariff reduction programme proceeded, and the average effective tariff was brought down to 5.7%. Tariffs were set at 17% for

final consumption goods, 12% for capital goods produced in Central America and for intermediate goods, and 7% for raw materials produced in the region. On 1 January 1999, a final reduction of two additional percentage points was applied.

Negotiations for setting up a free trade area between Mexico and the countries of the Northern Triangle of Central America (Guatemala, El Salvador and Honduras) proceeded throughout 1998 and into the first half of 1999. The free trade agreement between Central America and the Dominican Republic, signed in April 1998, did not come into force in January 1999 as anticipated because legislative ratification was still pending. Conversations were held with Chile with a view to signing a similar agreement, and in early 1999, Guatemala signed a partial-scope agreement with Cuba giving tariff preferences to 386 Guatemalan and 260 Cuban products.

### **(d) Public external debt policy**

The public external debt—including that of the Banco de Guatemala—grew by US\$ 233 million in 1998, to an outstanding balance of US\$ 2.368 billion. The debt of the non-financial public sector increased by 15%, while that of the Banco de Guatemala declined by 25%.

Servicing the public external debt entailed making payments abroad totaling US\$ 162 million, including US\$ 58 million for interest and commission payments. Total amortization and interest amounted to slightly over 9% of the value of exports. It may be inferred that much of this outlay was paid out of international cooperation funds earmarked for supporting the peace process.

Of the US\$ 1.9 billion put up initially for this purpose by the international community (Brussels, January 1997), the amount eventually forthcoming was trimmed to US\$ 1.589 billion. By the end of 1998, contracts and agreements relating to cooperating institutions and specific projects had been signed for a value of US\$ 885 million, although only US\$ 383 million had been disbursed. The remaining US\$ 704 million were under negotiation.

### **(e) Structural reforms**

The key components of the privatization programme being promoted by the current Administration were implemented in 1998. In January, Empresa Eléctrica de Guatemala S.A. (EEGSA) signed a US\$ 30 million contract providing for the sale of two generating plants

to a subsidiary of a United States company. In September, 80% of EEGSA shares were transferred to a foreign consortium that had won the public auction (held two months earlier) with a bid of US\$ 520 million.

In October, a 95% stake in the largest State-owned firm, Empresa de Telecomunicaciones de Guatemala (Telgua), was awarded to Luca S.A. (majority Guatemalan ownership) for US\$ 700 million, payable with a

US\$ 200 million down payment and installments of US\$ 150 million and US\$ 350 million at 18 and 36 months respectively.

Other important changes in the telecommunications field included the opening up of the market for telephone services, via the signing of at least 14 interconnection contracts with private operators and the awarding of new frequencies for mobile cellular telephony.

### 3. The main variables

#### (a) Economic activity

Guatemala's GDP grew by 4.9% in 1998, thereby exceeding the 4.3% growth of the previous year. Private consumption rose by 5%, while public-sector consumption went up by 33%. Gross fixed capital formation also performed well, although its growth rate (11.8%) was down from the 1997 figure (19.9%). Export performance was similar, posting an expansion of 8.5% compared to 10.2% in 1997.

The 3.2% growth of the agriculture sector surpassed the previous year's rate of 2.8%. This greater buoyancy came mainly from larger harvests of export crops, except coffee, where the volume of exportable production declined from 5.5 to 4.6 million quintals. This drop was due to adverse weather conditions arising from El Niño.

Although harvesting of the 1998-1999 sugar-cane crop began two weeks late, sugar production for the 1997-1998 season reached a record level of 39 million quintals, thus surpassing the previous season's figure of 33 million by 18%.

Construction was again one of the economy's most active sectors, as it grew by over 9% for the second year in a row, once again as a result of the sustained growth of public investment in expansion and repair of the road system and the implementation of new real estate projects, particularly in the hotel, commerce and housing sectors. The damage caused to the country's physical infrastructure by Hurricane Mitch also led to new investments being made for reconstruction work in the closing months of the year.

Growth in the manufacturing industry rose to 3.5% in 1998, thus surpassing the 1997 level of 2.7%, owing

to an expansion of domestic demand and positive trends in exports, especially to the Central American market. The maquila industry performed well in 1998, growing by 30% in terms of value added and posting increases in both the number of firms involved and the number of jobs created.

For the third year running, mining and quarrying activities grew by over 20% in real terms, driven mainly by increased oil production and greater investments in the sector.

#### (b) Prices, wages and employment

The average annual increase in the consumer price index (CPI) fell to 6.6% from the previous year's 9.2%. Measured on a December-December basis, however, inflation rose from 7.1% to 7.5%. Prices had been dropping up to October, but then rose by two percentage points in November and December, in the wake of damage caused by Hurricane Mitch to agricultural output, especially of vegetables and legumes.

Food and beverage prices ended the year with a rise of 7%, having gone up by just 1.2% before October. The most dramatic increase was that of vegetables and legumes, where prices were up by 48% in December compared to the same month in 1997. Education, housing, and household articles were the only categories where prices went up by more than 7.5%.

Economic growth in 1998 allowed for a very slight improvement in employment conditions. Open unemployment stood at 5.9%, while equivalent unemployment, which includes underemployment, dropped to 40.6% (about 1.6 million people).

On the wages front, minimum wages went up by 12%, and public-sector workers received an annual increase of 10%. According to information provided by the Guatemalan Social Security Institute, average nominal wages and salaries rose by only 2.5%, which represented a reduction in real terms of 3.8%, the first fall in at least seven years.

### (c) The external sector

In 1998, there was a substantial imbalance in the balance-of-payments current account, although it was easily offset by the financial account. The overall balance allowed for the addition of US\$ 243 million to the country's international monetary reserves, which grew to an unprecedented US\$ 1.367 billion.

The current account posted a deficit of US\$ 916 million, which represented an increase of more than two thirds over the previous year's figure of US\$ 547 million. A decisive factor behind this result was the merchandise trade gap, which widened by 50% from the 1997 figure.

The trade gap was attenuated partly by a net inflow of private transfers amounting to US\$ 818 million (as against US\$ 692 million in 1997). In addition, tourism showed a positive balance of US\$ 145 million.

Export growth, measured in f.o.b. terms, slowed from 16% in 1997 to 9% in 1998, as the value of exports amounted to US\$ 2.831 billion (US\$ 2.598 billion in 1997). Coffee exports slipped by 5%, as volumes exported shrank from 5.5 to 4.6 million quintals. Apart

from weather problems, the suspension of operations by the country's two main exporting companies at the end of the year also caused difficulties in regard to the 1998-1999 coffee harvest, which was left temporarily without financing.

Sugar exports grew by 22% despite an 8% fall in price, since the exportable production expanded by one third from 22.3 to 29.7 million quintals. Despite the impact of Hurricane Mitch, banana exports grew by 8% in volume and nearly 10% in value terms. Crude oil production grew by 30%, from 6.5 to 8.5 million barrels, although the average international price plummeted by more than 50%, from nearly US\$ 15 to around US\$ 7.25 per barrel. As a result, the value of oil exports fell by more than one third from the 1997 level.

Growth of non-traditional exports, meanwhile, accelerated to 16%, which compared very favourably with the increase of only 2% recorded in 1997. The maquila industry achieved a surplus of US\$ 275.5 million.

Exports to the Central American market amounted to US\$ 764 million, up 12% from the previous year. The rate of growth slowed down, however, owing to the meagre increase in demand from El Salvador, the main buyer of Guatemalan products in the subregion.

For the second year in a row, imports grew by more than 20%; in 1998, they amounted to US\$ 4.637 billion in c.i.f. terms. Significant increases were posted in all three categories of merchandise imports: capital goods, 32%; consumer goods, 18%, and intermediate goods and raw materials, 16%.

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## Haiti

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### 1. General trends

Haiti's gross domestic product (GDP) grew at 3.1% per year in 1998,<sup>1</sup> which was above the initial forecast. Nonetheless, wide variations among sectors and ongoing domestic political problems continue to obstruct the execution of government and external cooperation programmes. (The Prime Minister resigned in May 1997, and his replacement was not appointed until January 1999). There were some improvements, however, as inflation was brought down to a single digit (8.2%) by the end of the fiscal year, the central government current account was kept under control, and the exchange rate was stabilized at an average of 16.9 gourdes per dollar.

**TOTAL INVESTMENT** was up by 7.4%, driven mainly by government actions in rural infrastructure and some social projects. Private enterprise helped to capitalize the most buoyant sectors, which were led by the maquila textile industry producing for the United States market. The virtual stagnation of capital formation over the preceding biennium was thus reversed.

The Government signed a shadow programme with the International Monetary Fund (IMF) that enabled it to continue implementing the stabilization policy it had adopted when the embargo ended. Despite control measures that led to an 11% increase in tax receipts and an attempt to curb budgeted expenses, the fiscal deficit, at 2.4% of GDP, was higher than anticipated. Much of this imbalance arose from outlays made in the framework of the government's investment programme, which went over budget by US\$ 530 million. Funds disbursed from external cooperation programmes amounted to US\$ 645 million, slightly less than the previous year. The goal of monetary policy was to curtail the expansion of liquidity, and this led to a rise in nominal interest rates.

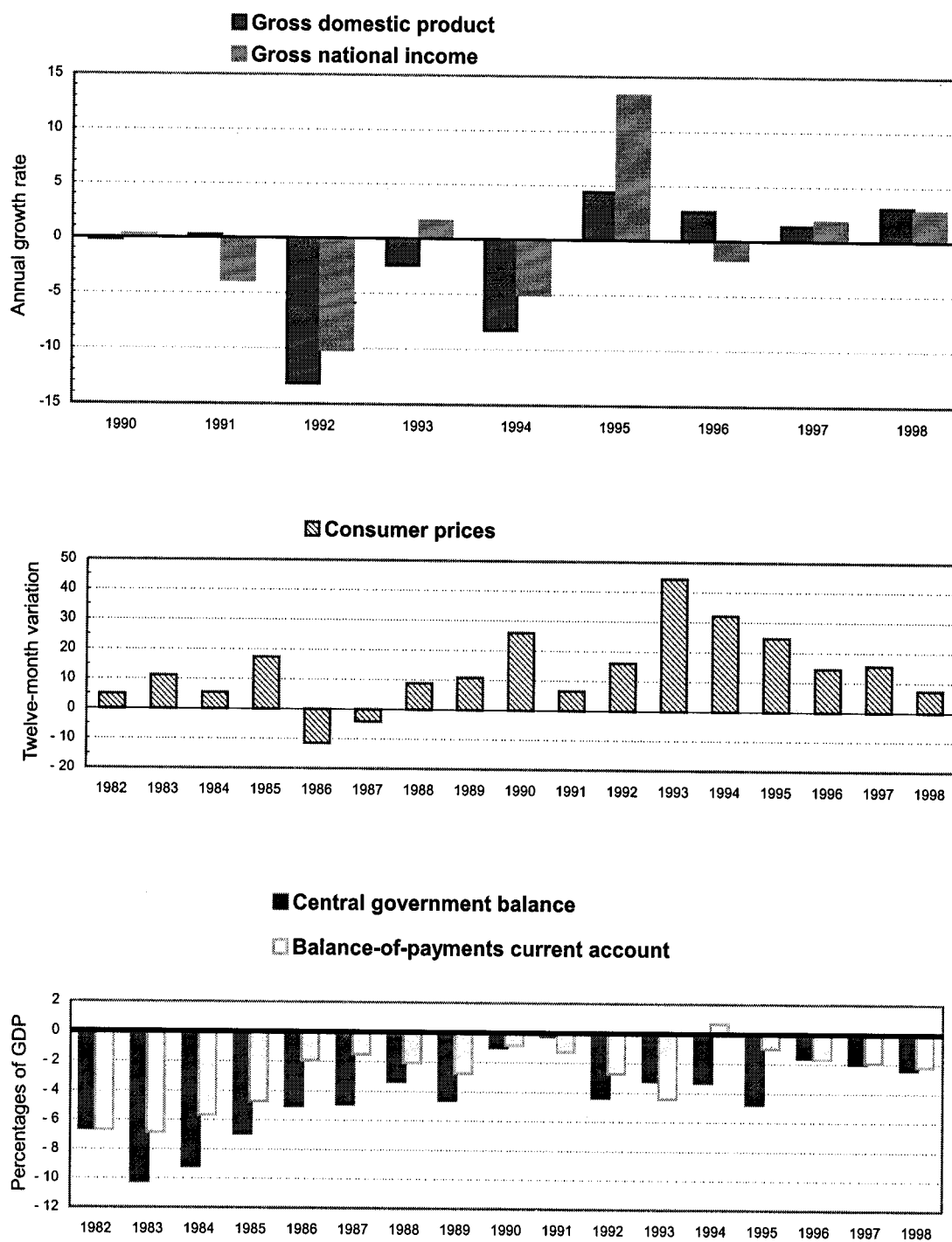
The goods and services trade gap widened to US\$ 532 million; although this was offset to a large degree by current transfers (US\$ 467 million), the deficit on current account grew by US\$ 77 million. Capital inflows increased during the year, both in the form of direct investment and in loans to the private sector, almost doubling the level of funds that had been available in 1997. As a result, the overall balance of payments added US\$ 34.5 million to the country's international reserves.

Despite these achievements, the State still has not succeeded in dealing adequately with unemployment, the loss of purchasing power of nominal wages and the lack of opportunities for entering the formal economy. In constant-value terms, per capita GDP is still 25% below what it was in 1990. It is expected that during the coming year, some macroeconomic indicators will move in a positive direction, thus favouring monetary and fiscal stabilization despite ongoing problems of governance and the absence of a legislative body. The Parliament was dissolved by the President of the Republic in January 1999 and still had not been reconvened at the start of the second half of the new fiscal year.

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1 This refers to the fiscal year running from 1 October 1997 to 30 September 1998.

Figure 1  
HAITI: MAIN ECONOMIC INDICATORS



Source: ECLAC, on the basis of official figures.

## 2. Economic policy

Despite political disagreement between the executive and legislative branches on the proposal to modernize State-owned enterprises, other institutional reforms moved ahead. At the same time, the Administration and the Central Bank made a concerted effort to achieve macroeconomic balance; a fiscal policy directed toward current operations and a tight monetary policy both played a part in this endeavour.

Foreign trade policy focused on promoting effective integration and boosting trade with members of the Caribbean Community (CARICOM). The authorities are considering lowering tariffs from 15% to 5% in order to enhance the competitiveness of Haitian products.

### (a) Fiscal policy

Fiscal policy provided for tighter control over current government operations in 1998; however, an increase of nearly 75% in capital outlays led to an overall deficit which, at 2.4% of GDP, was higher than the 1997 figure.

Tax revenues grew by 11% in nominal terms, while the tax burden eased slightly, to 9% of GDP. Direct corporate taxes decreased, but taxes paid by individuals went up considerably (19%). Indirect taxes, which rose by 15%, were higher than inflation. This was partly due to the strengthening of surveillance at ports and border crossings in order to prevent tax evasion and improve receipts from imports of automobiles and other goods that are subject to the duties that came into force in 1997. The General Tax Bureau worked to improve the tax-collection apparatus by implementing the Automated System of Customs Data Entry, Control and Management (ASYCUDA), a system used to verify the volume of commercial transactions that go through customs, together with the corresponding turnover tax.

The growth of overall expenditure was contained to slightly over 8%, a figure that is lower than average inflation for the year, thanks to joint enforcement of controls by the Ministry of Finance and Economic Affairs and the Central Bank, in the framework of protocols signed by the two institutions. The controls included eliminating from the payroll 1,400 government employees who had been appointed to non-existent posts and trimming the payroll via a programme of early or voluntary retirement that was taken up by 5,286 public-sector employees and led to a

cut of nearly 11% in public-sector staffing. By the time the reform process was concluded, payroll expenses had been reduced by 8% from the budgeted amount.

Restrictions persisted throughout 1998, as the budget was frozen at the previous year's level, given Parliament's failure to adopt a new one, and foreign financing was cut back. The purchase of capital goods and equipment (40% of the investment budget), which was financed by borrowing from the Central Bank to the tune of 618 million gourdes, proved burdensome for the Government. In addition, amortization payments on the external debt amounted to US\$ 24 million (422 million gourdes). A significant share of the government deficit (nearly 41%) was covered with unspecified domestic funds, sometimes by deferring payments, and another 45.5% was met with foreign grants.

### (b) Monetary and foreign exchange policy

The monetary authorities sought to curtail the expansion of liquidity that was, essentially, a result of increased private-sector credit (particularly credit in dollars, which grew steadily during the year, so that lending to the private sector as a whole rose by 16%). To this end, credit to the Government was restricted, so that it grew only slightly in respect of the 1997 figure; this measure was taken in the context of a 1997 agreement on harmonization of the budgets for current spending and investment. Towards the middle of the fiscal year, the Central Bank once again issued BRH bonds at nominal rates of around 24% and at 91-day terms. Nominal interest rates thus went up, and given the gradual slowdown in domestic prices, so did real interest rates.

A higher return on local-currency investments, together with a 12% reserve requirement established during the preceding period on foreign-currency deposits, made the latter less attractive. Thus, one of the most noteworthy results of monetary policy was its success in controlling the potential effects of dollarization. The nominal exchange rate was held at an average of 16.85 gourdes per dollar, which means there was a 5.7% real appreciation against the United States currency.

Dollar deposits still grew by 26%, however, forcing broad money supply (M3) to expand by slightly over 12%, to match the growth rates of net international reserves, domestic credit and local-currency time de-

Table 1  
HAITI: MAIN ECONOMIC INDICATORS

	1990	1991	1992	1993	1994	1995	1996	1997	1998 <sup>a</sup>
<b>Annual growth rates<sup>b</sup></b>									
Growth and investment									
Gross domestic product	-0.1	0.3	-13.2	-2.4	-8.3	4.4	2.7	1.4	3.1
Per capita gross domestic product	-8.5	-1.8	-14.8	-4.2	-9.9	2.5	0.8	-0.5	1.2
Gross domestic product, by sector									
Goods	-1.3	-2.4	-13.3	-5.9	-10.0	-1.5	3.5	1.5	3.8
Basic services	3.0	-7.4	-12.1	-2.4	-13.2	13.1	5.3	-0.2	1.2
Other services	1.6	3.2	-10.7	1.1	-4.4	7.2	1.0	0.5	2.0
Consumption	-1.0	-1.8	0.6	14.5	-8.1	18.7	-2.4	2.3	4.4
Gross fixed capital formation	-3.9	-3.6	-40.1	-7.4	-7.1	88.8	-1.6	-1.5	7.4
Exports of goods and services	13.2	9.1	-47.8	4.2	-15.8	50.9	37.0	5.8	21.8
Imports of goods and services	5.2	-0.3	-18.9	60.4	-10.4	78.2	3.1	4.0	13.9
<b>Percentages of GDP<sup>c</sup></b>									
Gross national income	102.7	98.6	102.8	106.9	110.8	119.5	114.2	114.7	114.3
Gross domestic investment	12.0	11.5	8.0	7.6	7.7	13.8	13.2	12.9	13.4
National savings	13.6	10.1	7.0	4.4	8.1	14.1	11.3	11.2	10.6
External savings	-1.7	1.4	1.0	3.2	-0.4	-0.3	1.9	1.7	2.7
<b>Percentages</b>									
Employment and wages									
Real minimum wage (index: 1995=100)	115.6	100.3	96.1	74.0	53.2	100.0	82.9	71.3	63.4
<b>Growth rates</b>									
Prices (December-December)									
Consumer prices	26.1	6.6	16.1	44.4	32.2	24.8	14.6	15.6	7.4
External sector									
Terms of trade (index: 1995=100) <sup>c</sup>	116.4	97.8	92.9	94.1	96.8	100.0	93.4	101.1	105.3
Nominal bank exchange rate (gourdes per dollar)	7.40	7.70	9.10	12.80	13.00	15.30	15.75	16.68	16.77
Real effective exchange rate for imports (index: 1995=100)	123.5	116.3	117.5	141.3	113.4	100.0	85.0	73.0	67.0
<b>Millions of dollars</b>									
Balance of payments									
Current account	-22	-30	-42	-68	14	-23	-46	-60	-77
Trade balance (goods and services)	-197	-234	-184	-227	-141	-545	-498	-495	-532
Exports	318	341	148	163	139	257	329	364	462
Imports	515	575	332	390	281	802	827	859	994
Capital and financial account <sup>d</sup>	-13	58	14	27	-47	208	-1	90	112
Overall balance	-35	29	-28	-41	-33	185	-47	30	35
Variation in reserve assets (- indicates an increase)	39	-12	-4	1	-8	-176	49	-50	-29
<b>Percentages</b>									
External debt									
Gross debt (as a percentage of GDP)	32.2	34.4	56.9	55.8	42.5	38.6	33.6	33.1	31.2
Net interest (as a percentage of exports) <sup>e</sup>	7.9	7.7	5.5	7.9	6.1	11.9	3.2	3.7	2.5

Table 1 (concluded)

	1990	1991	1992	1993	1994	1995	1996	1997	1998 <sup>a</sup>
<b>Percentages of GDP</b>									
Central government									
Current revenue	9.2	8.4	7.0	5.5	2.6	6.4	7.4	9.1	8.9
Current expenditure	10.5	8.7	10.8	8.4	5.7	10.9	9.1	9.8	9.3
Savings	-1.3	-0.4	-3.7	-2.9	-3.1	-4.5	-1.8	-0.7	-0.4
Capital expenditure	0.3	0.2	0.6	0.6	0.2	0.8	0.3	1.4	2.1
Financial balance	-1.0	-0.3	-4.4	-3.2	-3.3	-4.8	-1.6	-2.0	-2.4
<b>Growth rates</b>									
Money and credit									
Monetary balances of banking system									
Net domestic credit	7.0	-7.7	26.4	26.3	27.9	-2.1	13.2	18.1	12.3
To central government	9.4	14.1	16.1	7.7	30.9	-4.6	21.7	-2.9	2.5
To private sector	3.5	-18.3	4.6	40.0	8.7	59.2	17.0	43.4	16.0
Money (M1)	1.2	5.1	24.8	26.7	21.1	25.9	0.6	11.8	3.4
Local-currency savings and time deposits	13.8	7.2	28.6	35.1	25.8	8.5	1.9	16.3	12.6
M2	7.4	6.2	26.8	31.3	23.8	15.9	1.3	14.2	8.5
<b>Annual rates</b>									
Real interest rates (annualized, %)									
Deposit rate <sup>†</sup>	-5.5	-19.1	-22.0	-18.7	-3.2	-9.1	...	...	...
Lending rate <sup>†</sup>	-4.1	-17.8	-13.6	-9.5	1.9	2.1	...	...	...
Equivalent interest rate in foreign currency <sup>‡</sup>	-8.4	3.1	-11.6	-25.7	-11.7	7.0	...	...	...

Source: ECLAC, on the basis of official figures.

<sup>a</sup> Preliminary figures.<sup>b</sup> Based on gourdes at constant 1976 prices.<sup>c</sup> Based on constant 1995 dollars.<sup>d</sup> Includes errors and omissions.<sup>e</sup> Refers to net interest as shown on the balance of payments, divided by exports of goods and services.<sup>f</sup> Figures to September of each year.<sup>‡</sup> Interest rate on deposits, deflated by the variation in the exchange rate over the fiscal year.

posits. Local-currency money supply (M2), on the other hand, went up by just 8.5%, essentially keeping in step with inflation, while M1 money supply grew by slightly over 3%.

### (c) Structural reforms

Structural reforms were suspended in 1997, following the resignation of the Prime Minister, and only specific aspects relating to public administration were carried out. Larger enterprises that have a greater impact on the economy—such as the telephone company, the power company, the seaports and the airport—are waiting for the privatization process to be resumed. As the situation remained at a standstill, the Government began to make arrangements to issue new calls to tender; these are now scheduled for late 1998 and the first half of 1999.

In contrast to this, other reforms went ahead, including those relating to taxes and exemptions and the public-sector staffing cuts mentioned above. Another important reform carried out within the context of the modernization process involved the revamping of budgetary and accounting procedures, under a protocol signed by the Ministry of Finance and Economic Affairs and the Central Bank. Far-reaching changes have been made in the area of statistics, stemming from the modernization of the Haitian Institute of Statistics and Information Sciences. This institution was provided with new computer infrastructure and assigned important projects aimed at updating national accounts and sectoral surveys, as well as the database for the population and housing census to be carried out in 1999.



### 3. The main variables

#### (a) Economic activity

Global demand, which had grown only moderately in the preceding biennium, gathered pace in fiscal 1998 and expanded by nearly 7%. Factors driving domestic demand included upturns in investment (7.4%) and in total consumption, which grew at a higher rate than the population. Exports of maquila textiles and tropical crops also made a substantial contribution. Meeting this increase in demand led to a 14% growth of imports.

The recovery of investment, at a time when external cooperation disbursements had dropped steeply, was largely made possible by the active participation of the State in the renovation of agricultural infrastructure and the setting up of new maquila firms, which continued coming to the country.

Although consumption grew at a higher rate (4.4%) than the population, it appears that, apart from some improvement among the poorer sectors—thanks to the recovery of agriculture and the creation of new maquila jobs—, a significant proportion of this growth came from demand for imported products among higher-income families. GDP today is barely higher than in 1992—the year the embargo began—and almost 13% lower than it was at the start of the decade. Unrequited transfers from abroad accounted for more than 25% of national income, and external saving represented nearly 40% of gross investment, underscoring the important role of external resources in the incomes of one sector of Haitian society. Moreover, the substantial role of imports in global supply (nearly 37%) is evidence of a certain degree of vulnerability in the economy, particularly considering that net international reserves at the end of the period were equivalent to just three and a half months' imports.

GDP growth, at slightly over 3%, was made possible by recovery in the agricultural sector (2.2%) and a vigorous upturn in construction (9.4%). In the manufacturing sector, the rising trend of the maquila industry did not bring a corresponding growth of industry producing for the local market, which continues to decline despite government efforts to revive it.

The recovery of agriculture was aided by increased rainfall during the year and the greater availability of farm labour resulting from strict maritime controls and prohibitions that made emigration to the United States difficult. Government distribution of subsidized seed

and fertilizer, together with public works on irrigation and road infrastructure, also helped raise yields of basic grain and export crops.

One of the main problems in the livestock sector continues to be the restocking of swine herds, despite ongoing inoculation and sanitation campaigns. The serious shortage of forage or scraps for animal feed has been an important factor behind the decline in the size of livestock herds and poultry flocks. In these circumstances, peasant farmers are increasingly forced to sell their land and fall back on other, non-agricultural means of subsistence.

Construction was the most buoyant sector of the economy, as it was boosted by public works on road and irrigation infrastructure in rural areas, and by residential building in urban zones, which in turn stimulated mining activity (6.1%).

Most manufacturing firms are seriously under-capitalized, which makes it increasingly difficult to produce for the domestic market and compete against imports. The food and beverage industry, along with chemicals, declined in 1998. Among goods produced for local consumption, only beer output exceeded previous levels, while the other product lines posted decreases or at best only grew enough to regain the values of earlier years. This situation stands in contrast to that of the maquila industry, where by mid-year, 14 new establishments had come on stream, raising to nearly 23,000 the number of direct jobs generated by this activity (up by 33% from the 1997 figure). The "various industries" category, which includes maquila firms serving the foreign market, grew by 7.5% in 1998.

Basic, commercial, financial and community services grew more than in the preceding year. Even so, the overall growth rate was under 2%, which, particularly in the case of basic services, was not high enough to revive the economy. Transport and communications, as well as the supply of water and electric power, grew by just 1%. Power generation fell to a level slightly below that of the previous year. On the other hand, metered consumption as a whole rose by more than 8%, reflecting the notable progress made in the delivery of service to the industrial and commercial sectors.

Other services performed better, especially commerce and housing, owing to the steady and continually expanding demand generated by the high population density in the capital city. A more active government involvement in social infrastructure and in vaccination

and sanitation programmes led to an upturn in social services (2%), which had previously been at a standstill.

### **(b) Prices, wages and employment**

Thanks to the fiscal austerity programme and the tight monetary policy followed, one of the year's greatest achievements was an easing of pressure on both the exchange rate and domestic prices, as a result of which the average annual inflation rate dropped from 16.2% in 1997 to 12.7% in 1998. At the end of the period, the slowdown in price increases was even more pronounced, as it reached a year-on-year rate of 8.2% by September, and continued to fall during the final quarter of 1998.

This downward trend was largely made possible by a steady supply of staple agricultural products and a stable exchange rate, on the back of which the availability of imported products rose sharply. A drop in prices of petroleum products further enhanced this positive trend. The financial crisis in the Asian economies and the consequent depreciation of their currencies encouraged automobile imports from those countries, as their prices became more competitive.

In the early part of the period, some central government employees received a significant wage hike. In contrast, the minimum wage again remained flat in nominal terms, while wages in agriculture and in the informal urban sector are assumed to have fallen.

The recovery of maquila and construction activities proved insufficient to alleviate the unemployment and underemployment situation prevailing in the country, for which, however, there are no official estimates. With a slowdown in tourism and fluctuations in construction, the maquila industry was practically the only sector where expansion was sufficient to hire and train labour. Wages paid by maquila firms still tend to vary widely, ranging from one-half to twice the official minimum wage, augmented by allowances that are not adequately specified in the relevant labour legislation.

To broaden the scope of reactivation and reduce the impact of unemployment, the Government has set up job training programmes and an "incubation centre" for small businesses. Both of these endeavours, however, are still in a somewhat precarious position.

### **(c) The external sector**

The buoyancy of trade in goods and services led to one of the largest trade deficits of the 1990s (US\$ 532

million at the end of September 1998). This may be attributed to the marked imbalance in merchandise trade and the traditionally negative balance of services. Although this gap was to a large degree bridged by remittances from abroad (nearly US\$ 467 million), it generated a current account deficit that was higher than in any other recent year (US\$ 77 million). The increase in the surplus on the financial account was sufficient both to cover this deficit and to accumulate international reserves to the tune of US\$ 34.5 million.

Exports grew by over 45%, on the back of maquila textile manufactures, whose strong performance stemmed from the migration of capital from South-East Asia to take up import quotas granted to the Caribbean region for sales in the United States market. Exports of traditional products, such as coffee, cocoa and sisal, were also buoyant, although the price of coffee is estimated to have fallen by 17% in Europe, its main destination.

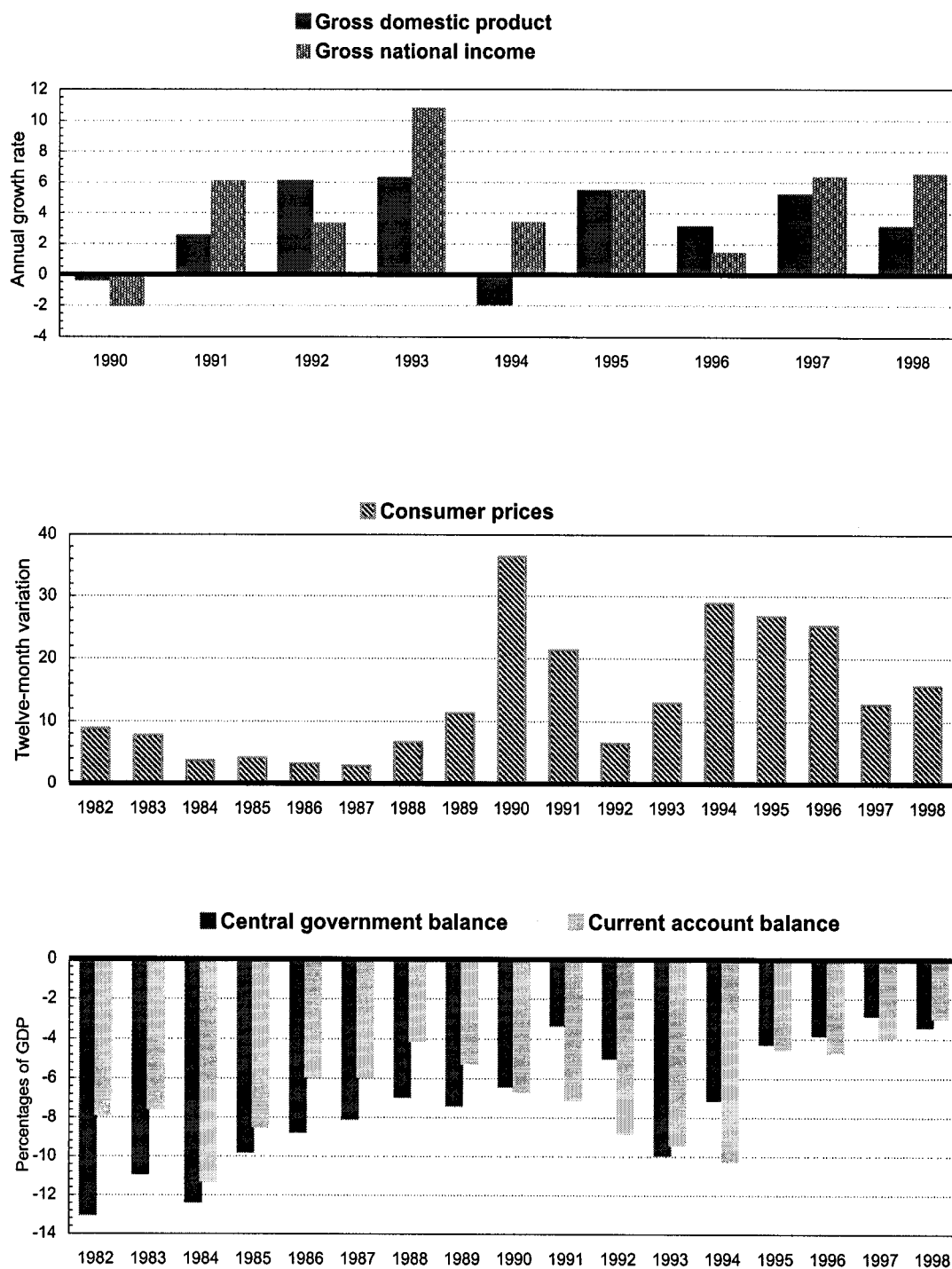
Imports grew more slowly (26% overall), but the high value of purchases abroad made it impossible to cover them by export earnings. Practically all product lines, except oils and some chemicals, increased significantly in value terms (by between 34% and 36%), compared to the preceding year. Thanks to the positive terms of trade, which were more favourable than in 1997, and the exceptional increase in export volumes, purchasing power rose by 55% compared to the previous period.

The balance of trade in real services went into deficit again, to the tune of US\$ 191 million, partly because tourism remained flat. In the case of productive factor services, interest payments on the external debt decreased by nearly US\$ 2 million, thereby easing the burden to 2.5% of export earnings.

External transfers (US\$ 467 million) and investment assets from abroad (US\$ 135 million), which as a whole and in net terms represented slightly over 17% of GDP, were an important source of support for the balance of payments. Inflows in the category of loan disbursements from multilateral financial institutions fell to US\$ 61 million.

Interest payments on the public-sector external debt came to a total of US\$ 12 million, and amortization payments amounted to US\$ 24 million. Total debt service accounted for 7.6% of total export earnings. The balance of public-sector debt continued to climb, reaching US\$ 1.1 billion by the end of September 1998, which is equivalent to 31.5% of GDP.

Figure 1  
HONDURAS: MAIN ECONOMIC INDICATORS



Source: ECLAC, on the basis of official figures.

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## Honduras

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### 1. General trends

The Honduran economy grew by 3% in 1998; this was lower than the 1997 rate and below the 5% forecast by the authorities at the start of the year. During the first ten months, the economy moved ahead under the impetus of tax cuts and incentives to competitiveness and productivity that boosted domestic demand through private investment and consumption. At the same time, wise management of monetary policy brought inflation down to 13.7%.

**I**N LATE October, however, Honduras suffered the worst catastrophe in its history, as Hurricane Mitch devastated vast areas of agriculture and, to a lesser extent, industry. The hurricane left massive destruction of physical capital in its wake and part of the population homeless; this, in turn, created problems relating to loss of income and jobs and caused prices to rise.

Although exchange-rate policy allowed for some real appreciation of the lempira, the crawling-peg system linking prices in Honduras with those of its main trading partners was maintained. Measures continued to be taken to liberalize trade and encourage foreign and domestic investment.

Structural reforms were introduced to encourage greater participation in the growth process by private-sector investors, while the regulation of public utility

rates and supervision of the financial system were both strengthened.

The main impact of the hurricane on the Honduran economy will be seen in 1999 and beyond. The destruction of capital stock and the resulting reduction in gross output value are expected to cause GDP to decline by 2% to 3% in 1999. The external deficit is expected to widen, as exports drop and imports rise, especially in the case of foodstuffs and construction materials. Public finances will come under pressure as a result of reduced revenue and real investment expenditure on reconstruction work. The emergency made it necessary to redirect public spending towards meeting the immediate needs of the affected population and restoring essential infrastructure.

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### 2. Economic policy and structural reforms

The main goal of economic policy was to consolidate macroeconomic stability and deepen structural reforms, with a view to reactivating the economy and reducing poverty over the medium term. Within this framework, a programme was proposed early in the year that was

aimed at achieving a real GDP growth rate of between 4.5% and 5% and bringing the balance-of-payments current account deficit to 1.2% of GDP, while cutting the central government deficit to 1.5% of GDP and keeping inflation in the 12% to 14% range.



Table 1  
HONDURAS: MAIN ECONOMIC INDICATORS

	1990	1991	1992	1993	1994	1995	1996	1997	1998 <sup>a</sup>
<b>Annual growth rates<sup>b</sup></b>									
Growth and investment									
Gross domestic product	0.1	3.3	5.6	6.2	-1.3	4.1	3.7	5.1	3.0
Per capita gross domestic product	-2.9	0.2	2.5	3.1	-4.1	1.1	0.8	2.2	0.2
Gross domestic product, by sector									
Goods	-0.5	3.9	7.3	4.0	-2.6	6.3	2.0	5.0	-0.1
Basic services	5.9	2.4	3.4	4.4	-3.9	9.2	7.0	5.2	6.5
Other services	-1.9	0.9	5.3	9.7	-0.5	3.4	3.4	5.4	6.0
Consumption	-1.9	2.8	3.5	2.5	-0.2	1.2	5.4	4.0	4.9
General government	-13.5	-10.2	12.9	-9.4	-5.1	-2.8	5.3	-6.6	27.7
Private	0.3	5.0	2.2	4.4	0.5	1.7	5.5	5.3	2.4
Gross domestic investment	3.2	17.9	12.4	29.2	7.3	3.0	-5.9	4.5	2.6
Exports of goods and services	0.5	-2.0	8.0	-1.1	-10.1	13.6	8.1	1.0	1.8
Imports of goods and services	-2.8	6.0	7.5	7.1	1.1	4.0	2.4	-1.9	6.0
<b>Percentages of GDP<sup>c</sup></b>									
Gross national income	89.3	92.2	90.1	93.2	98.2	100.0	97.8	99.1	101.6
Gross domestic investment	19.7	22.6	24.1	29.0	31.8	31.6	28.6	28.5	28.1
National savings	13.0	15.3	14.8	19.2	22.0	27.2	24.5	27.0	27.4
External savings	6.7	7.4	9.3	9.8	9.8	4.3	4.1	1.5	0.7
<b>Percentages</b>									
Employment and wages									
Labour force participation rate <sup>d</sup>	48.6	47.4	48.9	50.2	49.2	49.5	52.2	53.1	52.9
Open unemployment rate <sup>e</sup>	4.6	4.5	3.8	3.8	2.8	3.7	4.5	4.0	3.5
Real minimum wage (index: 1995=100)	111.6	107.8	121.3	123.0	105.8	100.0	96.0	102.0	106.0
<b>Growth rates</b>									
Prices (December-December)									
Consumer prices	36.4	21.4	6.5	13.0	28.9	26.8	25.3	12.7	15.7
Wholesale prices	41.3	20.4	9.6	14.0	35.1	21.1	23.0	14.7	...
External sector									
Terms of trade (index: 1995=100) <sup>c</sup>	80.9	86.9	82.2	90.3	92.1	100.0	92.8	115.4	118.0
Nominal exchange rate (lempiras per dollars)	4.04	5.60	5.51	6.50	8.60	9.54	11.71	13.00	13.39
Real effective exchange rate for imports (index: 1995=100)	89.6	98.1	92.9	103.9	115.4	100.0	101.6	96.2	88.1
<b>Millions of dollars</b>									
Balance of payments									
Current account	-186	-213	-298	-327	-351	-177	-189	-182	-156
Trade balance (goods and services)	-94	-124	-192	-320	-345	-178	-207	-276	-379
Exports	997	1 016	1 041	1 211	1 370	1 735	1 920	2 176	2 396
Imports	1 127	1 139	1 233	1 531	1 715	1 913	2 128	2 452	2 775
Capital and financial account <sup>f</sup>	-124	54	51	135	331	220	294	395	313
Overall balance	-311	-160	-247	-192	-21	43	106	213	156
Variation in reserve assets (- indicates an increase)	-20	-67	-92	106	-17	-136	-174	-297	-234
<b>Percentages</b>									
External debt									
Gross debt (as a percentage of GDP)	127.9	113.9	106.0	110.3	117.9	107.1	101.0	86.1	80.0
Net interest (as a percentage of exports) <sup>g</sup>	17.8	20.2	25.0	14.5	14.2	11.5	9.8	7.3	5.7

Table 1 (concluded)

	1990	1991	1992	1993	1994	1995	1996	1997	1998 <sup>a</sup>
<b>Percentages of GDP</b>									
Central government									
Current revenue	16.4	17.4	17.4	16.9	16.0	18.3	16.5	16.8	18.5
Current expenditure	17.2	16.5	16.6	18.4	16.6	15.6	16.0	16.1	16.9
Saving	-0.8	1.0	0.8	-1.5	-0.6	2.6	0.6	0.8	1.6
Capital expenditure (net)	5.6	4.3	5.7	8.8	7.2	7.7	5.1	4.2	5.3
Financial balance	-6.4	-3.3	-4.9	-9.9	-7.1	-4.2	-3.8	-2.8	-3.4
Domestic financing	-1.2	-3.3	-2.9	0.9	2.5	-0.3	0.7	0.0	0.6
External financing	7.5	6.6	7.8	9.0	4.6	4.5	3.1	2.8	2.7
<b>Growth rates</b>									
Money and credit									
Monetary balances of banking system									
Net international reserves	...	...	109.8	-62.9	79.1	252.4	133.8	82.7	42.5
Net domestic credit	39.7	2.6	18.1	25.8	28.7	9.4	17.9	27.6	13.0
To public sector	-61.0	-12.0	-26.6	16.3	14.5	-93.2	...	...	...
To private sector	12.5	10.3	24.8	14.9	24.7	21.1	34.6	47.5	38.4
Money (M1)	25.2	16.8	14.3	13.0	37.0	18.3	27.2	33.7	12.6
Local currency savings and time deposits	58.0	8.1	28.6	6.1	17.1	21.0	19.5	60.5	30.8
M2	43.1	11.6	22.6	8.8	25.1	19.8	22.8	48.4	23.4
<b>Annual rates</b>									
Real interest rates (annualized, %)									
Deposit rate	-20.0	-7.6	5.5	-1.1	-13.2	-11.4	-7.0	0.9	4.5
Lending rate	-13.9	1.1	14.3	8.1	-3.1	0.4	3.5	9.9	15.0
Equivalent interest rate in foreign currency <sup>h</sup>	-50.1	8.6	4.9	-9.6	-12.8	2.7	6.1	...	...

Source: ECLAC, on the basis of official figures.

<sup>a</sup> Preliminary figures. <sup>b</sup> Based on lempiras at constant 1978 prices. <sup>c</sup> Based on constant 1995 dollars. <sup>d</sup> Percentages of the working-age population, nationwide. <sup>e</sup> Open unemployment rate, nationwide. <sup>f</sup> Includes errors and omissions. <sup>g</sup> Refers to net interest as shown on the balance of payments, divided by exports of goods and services. <sup>h</sup> Interest rate on deposits deflated by the variation in the average bank exchange rate (selling rate) for banknotes.

In May 1998, a fiscal reform programme went into effect; the exchange rate floatation band, adopted in March, was widened; trade policy was liberalized through tariff cuts, and the bank reserve requirement was lowered, so as to facilitate the control of liquidity through open-market operations.

At the end of October, just as the goals of the economic programme were being achieved and an enhanced structural adjustment facility with the International Monetary Fund (IMF) was about to be signed, Honduras was devastated by Hurricane Mitch. This disaster affected the final outcome of the economic programme and substantially altered the bases of economic planning.

#### (a) Fiscal policy and public finance

The new Administration, which took office in January 1998, passed legislation in May that was designed to encourage production and competitiveness and support human development. This involved lowering certain taxes to encourage foreign and national investment. Income tax was cut from 42% to 25%, taxes on exports of a number of agricultural products were eliminated, and a programme was set in motion to gradually reduce taxes on banana sales. To make up for the loss of revenue resulting from these cuts, the value-added tax (VAT) was raised from 7% to 12% as from June.

Table 2  
HONDURAS: MAIN QUARTERLY INDICATORS

	1996				1997				1998 <sup>a</sup>				1999 <sup>a</sup>
	I	II	III	IV	I	II	III	IV	I	II	III	IV	I
Consumer prices (12-month variation, %)	21.5	23.2	25.7	25.5	26.0	21.7	17.1	12.7	12.3	14.2	13.5	15.7	13.3
Real effective exchange rate <sup>b</sup> (index: 1995=100)	100.4	100.8	103.3	102.0	98.4	97.4	94.9	94.1	91.6	88.3	86.0	86.5	85.8
Real interest rates (annualized, %)													
Deposit rate	-3.4	-11.2	-11.6	-1.7	0.9	0.3	2.7	3.9	6.8	3.9	3.3	3.8	4.7
Lending rate	6.5	-0.3	-0.3	8.2	2.9	8.1	12.2	16.5	17.8	14.5	14.2	13.6	13.8

Source: ECLAC, on the basis of official figures.

<sup>a</sup> Preliminary figures. <sup>b</sup> Refers to exchange rate for imports.

Thanks to the implementation of the law providing incentives to production and competitiveness, and to a decree relating to the containment of public expenditure, the central government budgetary outturn to November showed a general surplus that was equivalent to 2.9% of GDP. In December, however, fiscal revenues fell, and at the same time, outlays had to be made to deal with the emergency. Consequently, the fiscal deficit for the year as a whole came in at 3.4% of GDP.

The central government's current revenue rose by 27.5%, and annual inflation averaged 13.7%. Tax revenues grew as a result of the aforementioned increase in the general sales tax (VAT), and revenue from income tax grew despite the lower rate applied. Tax receipts from foreign trade dropped as a result of the tariff reductions implemented in conjunction with trade liberalization and the tax cuts applied to a number of export products.

The emergency situation caused by the hurricane led to a 27.4% increase in central government spending. Despite this, however, its current saving rose from 487.5 million to 1,109,800,000 lempiras.

#### (b) Monetary policy

Monetary policy, which continued to focus on structural change in the system used to control liquidity, placed special emphasis on bringing down inflation. The change consisted of replacing reserve requirements by open-market operations. The issuance

of monetary absorption certificates had been authorized in 1995; these certificates have been increasingly instrumental in controlling liquidity, as the bank reserve requirement, which stood at 40% in early 1995, was lowered to 31%, and was then cut further to 25% in 1998. Apart from this, in view of the additional resource needs arising from the hurricane, it was decided in December that three percentage points of the reserve requirement would be covered by bonds issued by the National Housing and Production Fund.

Liquidity in the economy grew by 23.7%, as measured by the broad monetary aggregate (M3). Narrow money (M1) rose by 12.6%, while time deposits in local currency grew by 35.5%, and those in foreign currency, by 25%. Monetary absorption certificates declined from 306.8 million lempiras to 7.7 million, owing to a repo operation by the Central Bank relating to capital outflows abroad in the second half of the year.

Domestic credit from the banking system increased by 13%, as loans to the private sector expanded by 38.4%, and lending to the public sector contracted. International reserves held by the banking system grew by 42.5%, and liquidity, measured as the ratio of M1 to GDP, held steady at 11%. Central Bank credit extended to the Government declined, while net international reserves grew from US\$ 490 million in December 1997 to US\$ 673 million a year later. Money creation by the Central Bank expanded by 14.2%, about half the previous year's rate.



### (c) Foreign exchange and trade policy

Foreign exchange policy was aimed at achieving a balance between exchange-rate stability (so as to reduce inflation), on the one hand, and export competitiveness, on the other. The Public Foreign Currency Allocation System was useful in this regard. Under this system, the base exchange rate is altered every five auctions, in line with the differential between domestic inflation and that of the country's main trading partners, and bearing in mind the trend in the exchange rates of those same countries in respect of the United States dollar. In March 1998, in order to make the system more flexible, the band within which the dollar price was allowed to vary was widened from 10% to 14%. Within this framework, the lempira was devalued by 3% in nominal terms, as the exchange rate rose from 13.14 to 13.54 lempiras per dollar. The real exchange rate, meanwhile, appreciated by 11.5%.

As regards trade policy, the Administration continued to implement a tariff reduction programme, in line with a timetable approved in the context of the Central American Common Market (CACM), according to which average tariffs on consumer goods would be reduced from 18% in 1998 to 15% by the end of 2000. In addition, the fiscal benefits of tax-free zones were extended to the whole country. The Government signed a free trade agreement with the Dominican Republic and, together with El Salvador and Guatemala, pressed ahead with negotiations on a treaty with Mexico, with a view to possibly being included in the North American Free Trade Agreement (NAFTA).

### (d) Public debt policy

The external debt grew by 5.8%, to US\$ 4,264,400,000. Of the total debt, 80% is owed by the public sector, and 20%, by the private sector. Public debt grew by 2.9%, and private debt, by 20.4%. Medium- or long-term debt accounted for 97% of the total external debt, and the debt-service arrears rate stands at 2%.

Borrowing policy was set in the framework of the enhanced structural adjustment facility agreed with the International Monetary Fund; this will be helpful should the country wish to apply to the Paris

Club to alleviate its external debt. In December, at the initiative of IMF, a trust fund was set up with donated monies to help service the multilateral debts of Honduras and Nicaragua. The Administration is also working closely with the World Bank, IMF and the Inter-American Development Bank (IDB) to determine whether the country might be eligible for assistance under the IMF Heavily Indebted Poor Countries Debt Initiative.

### (e) Structural reforms

In the course of 1998, Congress passed a set of laws that represent a significant step forward in the structural reform process. A new mining act was passed to replace the 1906 law, with the aim of attracting foreign investment and encouraging job creation in different parts of the country. A law designed to encourage production and competitiveness and support human development was also passed, as mentioned above. The Tourism Secretariat was created to promote national tourist activity, and legislation was enacted to facilitate the execution of public works and national infrastructure projects. The latter is also known as the "concessions act", and is particularly important for reconstruction work relating to Hurricane Mitch, as the State does not have the capacity to undertake large-scale infrastructure investments, and this legislation clears the way for national and foreign investors to take on such projects. The law governing the capitalization and privatization of Empresa Hondureña de Telecomunicaciones provides for the modernization and development of the country's telecommunications services.

The aforementioned agreement with IMF envisages the restructuring of public administration, backed by a sectoral loan from the World Bank. The goal is to eliminate the duplication of posts and reclassify them, with a view to cutting back on excess staffing. The auctioning of shares in the Empresa Hondureña de Telecomunicaciones is also expected to begin, and steps are being taken towards privatization of electric power distribution; an auction of shares in the new companies that will be created is planned for December. Finally, 1999 should see the conclusion of the bidding process prior to the awarding of concessions to run the country's four international airports.

### 3. The main variables

#### (a) Economic activity

Before Hurricane Mitch, the economy was growing at an annual rate of 5%, but this figure plummeted as gross output for 1998 as a whole fell by over 5 billion lempiras. GDP growth, calculated on a factor-cost basis, dropped to 2.8%. The hardest hit sector was agriculture, where gross output shrank by 2 billion lempiras, and agricultural value added fell by 5.5%. This was followed by manufacturing industry, which lost 1.1 billion lempiras in gross output, while the growth of value added dropped to 3.4%.

Within the agricultural sector, crop growing contracted by 9.8%, and livestock breeding, by 6.2%. Production of maize, beans, bananas, coffee, plantains, African oil palm and cotton crops dropped, as did output of milk, eggs and shrimp (by 1.3%, 1% and 11.5%, in that order).

In the manufacturing sector, production of cement, cement boards, iron rods and beer all declined, while that of fabrics, vegetable shortening and wheat flour increased.

Mining output expanded by 6.5%, with the entry into force of new legislation that is expected to attract direct investment into the sector. Construction activity grew by 16.3%, on the back of an expansion in industrial and residential construction, whereas commercial building declined.

The transport, storage and communications sector was the next worst affected by the hurricane after agriculture and industry; although gross output losses are estimated at 577 million lempiras, sectoral value added still increased by 4.8% for the year as a whole. Commerce, restaurants and hotels saw gross output decline by 528 million lempiras, but value added grew by 4.1%. There were similar patterns in the community, social and personal services sector, where lost output amounted to 495 million lempiras, but value added grew by 4.1%, and in the financial institutions and insurance sector, which grew by 6% in value-added terms, but shed 186 million lempiras in lost production.

Electric power supply grew by 5.3%, as domestic production increased by 3.3%, and energy imports rose by 9%. The sector suffered gross output losses amounting to 155 million lempiras, yet value added was up by 6.5% for the year.

From the standpoint of expenditure, the growth of GDP was the result of a 7.7% expansion in consump-

tion. Government made a significant contribution (24.2%) to this growth, and there was a considerable increase in gross fixed investment (24.8%), both public—indicating a recovery from three straight years of decline—and private.

#### (b) Prices, wages and employment

Average inflation dropped from 20.2% to 13.7%, despite the fact that the monthly year-on-year rate rose from 12.7% in December 1997 to 15.7% twelve months later. This indicator trended moderately upwards—from 11.4% in January to 14.8% in July—and then eased back to 13.6% in August and September, following the harvest of staple grains. It started to rise again in October, and in December, after the hurricane, it stood at 15.7%. The behaviour of the general price index was basically governed by the rate of increase of food prices, which slowed on average from 19.8% to 11.7%. The annualized monthly inflation index for foodstuffs rose from 9.4% in December 1997 to 15.4% a year later.

The average rise in the wholesale price index eased from 14.7% to 9%; increases were lower among imported products, agricultural goods and construction materials. Nevertheless, the annualized monthly index of wholesale prices rose from 6.6% to 11.3%.

The real minimum wage index rose by 2.3%. During the year, the average minimum wage for a normal work day rose by 16.3%, from 33.69 to 39.19 lempiras, staying ahead of inflation in all activity sectors.

According to the eleventh household survey carried out in March 1998, the national open unemployment rate edged down from 4% to 3.9%; however, hidden underemployment reached 22.3% nationwide—28.2% in urban zones and 16% in rural areas. Maquila activity has been the most dynamic sector in terms of employment; with the creation of 9,200 jobs in 1998, the total number of jobs in the sector rose to 96,500.

#### (c) The external sector

The balance-of-payments current account deficit declined from US\$ 182 million to US\$ 156 million; however, the goods and services trade deficit, excluding

international transfers, widened to 11% of GDP. International transfers and the current account deficit were equivalent to 8% and 3% of GDP, in that order.

The value of exports of goods and services rose by 5.9%, from US\$ 1,447,000,000 to US\$ 1,532,900,000. This was driven mainly by coffee exports, which expanded by 31.7%, thanks to an increase in the volume exported, as the price fell from US\$ 145.31 to 141.44 per 46-kg sack. Exports of bananas, timber, refrigerated meat and sugar all declined, and the only other exports to grow were silver and tobacco.

As regards non-traditional exports, sales of lobster and pineapple rose, while melon exports slipped back. Value added in exports from the maquila industry rose from US\$ 304.6 million to US\$ 397.6 million. Of total exports, 14.8% were sent to other Central American countries, and 85.2% went to the rest of the world, with the United States accounting for 42.4% of the latter figure. Import values grew by 16.3%.

The terms of trade rose by 1.4%, as import prices fell more than those of exports. The purchasing power of exports grew by 13.3%.

As regards the balance of payments, the negative impact of Hurricane Mitch on the current account could amount to US\$ 311.5 million, based on an estimated reduction in exports of US\$ 164 million and a rise in imports of US\$ 147.5 million. This was partially offset by an US\$ 83 million increase in international transfers received to cope with the hurricane damage, so the net negative effect was US\$ 228.5 million. When the US\$ 72.1 million surplus that had been expected in the absence of the hurricane is deducted from this amount, the current account deficit stands at US\$ 156.4 million, which represents the balance-of-payments current account deficit for 1998. As far as the capital account is concerned, the natural disaster gave rise to additional capital inflows amounting to US\$ 64 million, of which US\$ 51.5 million went to the banking sector, mostly to cover reinsurance payments on assets destroyed by the hurricane.

## Mexico

### 1. General trends

Despite adverse world economic conditions, the Mexican economy performed well in 1998, with gross domestic product (GDP) growing by 4.8%. This, however, was two percentage points below the preceding year's figure and reflects a slowdown in productive activity in the final quarter of the year. The fall in oil prices and the turbulence on the international financial scene led to adjustments in monetary and fiscal policy and caused instability on foreign exchange and financial markets, especially in the final four months of the year.

**THE SLUMP** in the international price of Mexican crude oil was felt in both fiscal and external accounts. Given that the oil sector contributes one third of total public-sector revenue, the Government made spending cuts equivalent to 0.8% of GDP, particularly in the category of physical investment, to make it easier to meet the target for the public-sector deficit of 1.25% of GDP. In addition, the worsening terms of trade contributed to a doubling of the balance-of-payments current account deficit, which grew to 3.8% of GDP and was covered by a surplus on the financial account.

Monetary policy was designed to cushion the impact of the external shocks, and thus, a more restrictive stance was adopted, with the authorities taking steps to soak up liquidity in the economy. As the international financial crisis worsened, speculation against the peso intensified. With the economic-policy restrictions kicking in, the financial turbulence was met by sharp interest-rate hikes, which prevented the exchange rate from being further undermined and at the same time helped to contain inflationary pressures.

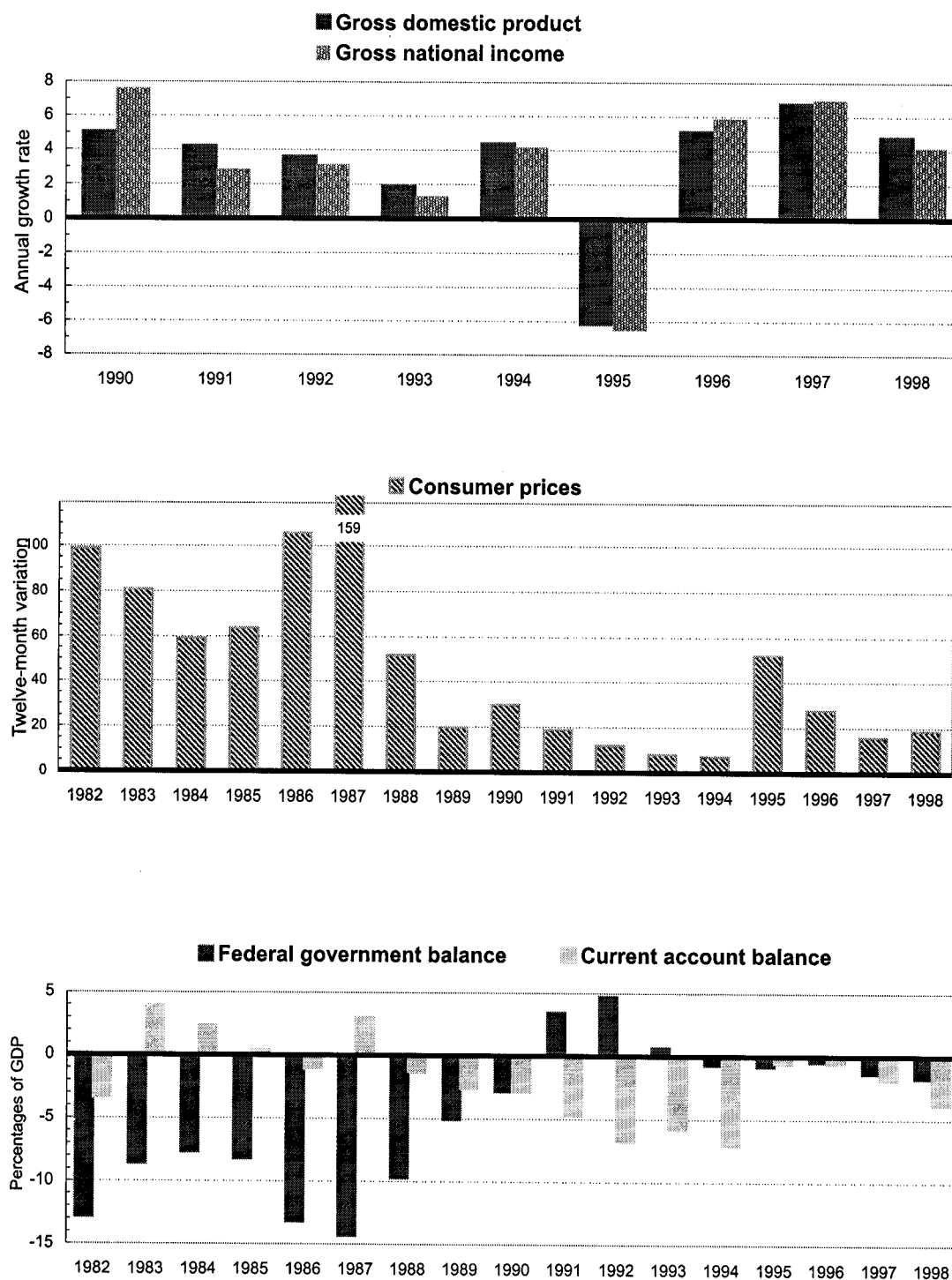
An upturn in wages and a buoyant employment situation underpinned a 6.4% rise in private-sector consumption, which in turn sustained output growth and led to a significant drop in the savings ratio. Investment

lost momentum in the wake of the sharp rise in interest rates and cuts in public spending on infrastructure, while public-sector consumption also fell as a result of budget cuts. Manufacturing and basic services led growth at the sectoral level, although less vigorously than in 1997, while agriculture suffered from an unusual drought which impaired the production of basic grains and livestock.

Fiscal and monetary discipline helped to moderate price rises until mid-year, but the devaluation of the peso pushed inflation up above its 12% official target to nearly 19% by the end of 1998. Real minimum wages increased for the first time in 15 years, and manufacturing wages rose after three years of steep decline, all of which helped to boost private consumption.

Problems persisted in the commercial banking system, owing to its sizeable non-performing loan portfolio, which, together with the rise in interest rates and less vigorous economic activity, contributed to a decline in credit granted to the private sector for the fourth straight year. In contrast to this, foreign borrowing continued to expand, especially by large firms that generate income in foreign currency; other units used non-bank methods to obtain finance.

Figure 1  
MEXICO: MAIN ECONOMIC INDICATORS



Source: ECLAC, on the basis of official figures.

The inflow of funds from abroad declined, with foreign direct investment falling from nearly US\$ 13 billion to US\$ 10.238 billion, while foreign merchandise trade slackened, leading to the first deficit since 1994 (US\$ 7.74 billion). Exports of manufactured goods expanded by 11%, but the fall in oil exports (38%) and the high elasticity of imports with respect to GDP contributed to a considerable widening of the trade gap. The country's external debt grew by more than US\$ 12 billion, topping US\$ 161 billion by the end of 1998; most of the borrowing originated in the non-bank private sector, whose debt rose from US\$ 35 billion to almost US\$ 44 billion. The public-sector external debt stood at slightly over US\$ 100 billion.

The Mexican economy grew at a moderate pace in the early months of 1999, with inflation weakening and interest rates trending downwards. International conditions, which appeared unfavourable at the beginning of the year, gradually changed for the better: the price of oil recovered, the United States economy maintained its buoyancy, and financial flows into the country were restored, thereby strengthening the peso. Nonetheless, fiscal and monetary policy were both tightened further in early 1999, in order to head off the possible consequences of unfavourable changes in external conditions, which could be especially critical in a pre-election year.

In 1999, output is expected to grow by about 3% and inflation to fall to 15%, a level that is two points above the official target but still below the 1998 figure. The public-sector deficit is expected to come very close

to the official target of 1.25% of GDP, and slower output growth will lead to smaller trade and current account deficits. Foreign direct investment inflows are expected to amount to US\$ 10 billion (US\$ 2.6 billion were taken in during the first quarter). Slower economic growth should cause the trade gap to narrow to somewhat over US\$ 6 billion, a level that would be compatible with a current account deficit of around US\$ 14 billion. At approximately 3% of GDP, this would be slightly down from the 1998 figure.

All things considered, the economy today seems to be steering a course that is aimed at reducing the chances of a new bout of speculation, while at the same time ensuring political calm in the midst of an election campaign. In the first place, public finances are virtually in balance. Secondly, the exchange rate floatation scheme should, in principle, be able to absorb any future speculative attacks against the peso. Thirdly, the moderate pace of growth being forecast should help to ease pressures on the trade deficit and hence, on the exchange rate. In the fourth place, the country's international reserves stand at record levels, and, finally, the preponderance of foreign direct investment over portfolio flows reduces current account vulnerability.

There are some underlying structural obstacles, however, that could show through in the medium term, including the weakness of the banking system, the uneven modernization of the industrial apparatus, the fragility of public finance and the high elasticity of imports with respect to GDP. In addition, significant social imbalances remain to be addressed, as reflected in high levels of unemployment and poverty.

## 2. Economic policy

Economic policy pursued the goals of promoting growth in output and employment and reducing inflation. An austere fiscal policy continued to be applied, which entailed reining in expenditure to offset the loss of oil revenues. Monetary policy was also kept tight, but the indirect mechanism used was insufficient to force up interest rates, and the Banco de México had to exert its influence by setting high rates at the start of each weekly auction of government securities.

### (a) Fiscal policy and public finance

Oil revenues declined abruptly in 1998 (by 1% of GDP), as the price dropped by 38%, and volumes exported also fell. The fiscal authorities cut non-discretionary spending by nearly 30 billion pesos (0.8% of GDP), thereby reducing total expenditure by 5.4%. Investment, mainly in communications and transport, was the component most affected, while expenditure relating to reforms in the social security system actually increased.

Table 1  
MEXICO: MAIN ECONOMIC INDICATORS

	1990	1991	1992	1993	1994	1995	1996	1997	1998 <sup>a</sup>
<b>Annual growth rates<sup>b</sup></b>									
Growth and investment									
Gross domestic product	5.1	4.2	3.6	2.0	4.4	-6.2	5.1	6.8	4.8
Per capita gross domestic product	3.1	2.3	1.7	0.1	2.6	-7.8	3.3	5.0	3.1
Gross domestic product, by sector									
Goods	6.7	3.3	3.4	0.7	3.9	-6.5	9.0	7.7	5.6
Basic services	3.4	3.0	5.0	3.8	8.1	-3.9	7.5	9.2	9.4
Other services	4.6	5.1	3.7	2.7	4.3	-6.7	2.1	5.9	3.5
Consumption	6.0	4.8	4.3	1.6	4.4	-8.4	1.8	5.9	5.3
General government	3.3	5.4	1.9	2.4	2.9	-1.3	-0.7	2.9	-1.3
Private	6.4	4.7	4.7	1.5	4.6	-9.5	2.2	6.4	6.4
Gross domestic investment	11.6	9.9	13.3	-0.8	10.3	-34.8	25.5	25.0	8.4
Exports of goods and services	5.3	5.1	5.0	8.1	17.8	30.2	18.2	10.8	9.7
Imports of goods and services	19.7	15.2	19.6	1.9	21.3	-15.0	22.9	22.8	14.2
<b>Percentages of GDP<sup>c</sup></b>									
Gross national income	100.6	99.3	98.8	98.4	98.0	97.6	98.2	98.4	97.7
Gross domestic investment	24.1	25.6	28.1	27.2	28.7	19.8	23.8	27.6	28.7
National savings	21.5	20.6	20.6	20.1	20.4	19.4	23.3	25.7	24.8
External savings	2.6	5.0	7.5	7.1	8.4	0.4	0.5	1.9	3.9
<b>Percentages</b>									
Employment and wages									
Labour force participation rate <sup>d</sup>	51.8	53.3	53.8	55.2	54.7	55.4	55.4	56.2	56.5
Open unemployment rate <sup>e</sup>	2.7	2.7	2.8	3.4	3.7	6.2	5.5	3.7	3.2
Real average wage (index: 1995=100) <sup>f</sup>	88.1	93.8	100.7	109.7	114.9	100.0	90.1	89.1	91.5
<b>Growth rates</b>									
Prices (December-December)									
Consumer prices (nationwide)	29.9	18.9	11.9	8.0	7.1	52.1	27.7	15.7	18.6
Wholesale prices (Mexico City)	27.4	15.7	10.7	7.4	7.8	58.1	27.0	13.6	17.4
External sector									
Terms of trade (index: 1995=100) <sup>g</sup>	113.5	107.0	104.1	104.9	102.9	100.0	102.8	102.0	99.5
Nominal exchange rate (new pesos per dollar)	2.81	3.02	3.10	3.12	3.38	6.42	7.60	7.92	9.14
Real effective exchange rate for imports (index: 1995=100)	82.3	74.8	69.1	65.8	67.6	100.0	89.0	77.2	77.3
<b>Millions of dollars</b>									
Balance of payments									
Current account	-7 451	-14 888	-24 442	-23 400	-29 662	-1 576	-1 923	-7 448	-15 786
Trade balance (goods and services)	-3 110	-9 369	-18 618	-16 010	-21 185	7 153	6 613	-588	-8 882
Exports	48 805	51 556	55 471	61 402	71 203	89 322	106 901	121 835	129 427
Imports	51 915	60 925	74 089	77 412	92 389	82 168	100 288	122 424	138 309
Capital and financial account <sup>h</sup>	9 669	22 861	26 187	30 632	12 464	-14 735	4 517	21 445	17 924
Overall balance	2 218	7 973	1 745	7 232	-17 199	-16 312	2 593	13 998	2 138
Variation in reserve assets (- indicates an increase)	-3 261	-8 154	-1 173	-6 057	18 398	-9 648	-1 805	-10 513	-2 138
<b>Percentages</b>									
External debt									
Gross debt (as a percentage of GDP)	40.6	37.2	32.0	32.4	33.2	57.9	47.7	37.1	38.9
Net interest (as a percentage of exports) <sup>h</sup>	13.6	12.4	13.6	14.9	5.1	5.5	4.3	7.1	6.4

Table 1 (concluded)

	1990	1991	1992	1993	1994	1995	1996	1997	1998 <sup>a</sup>
<b>Percentages of GDP</b>									
Federal government									
Current revenue	17.1	17.0	17.7	15.5	15.1	15.2	15.7	15.8	14.3
Current expenditure	17.3	15.0	13.7	13.4	13.3	14.1	14.2	15.1	14.2
Saving	-0.2	2.0	4.0	2.1	1.9	1.1	1.5	0.7	0.1
Capital expenditure (net)	2.7	2.7	2.7	2.7	2.7	2.7	2.7	2.7	2.7
Financial balance	-2.8	3.4	4.8	0.7	-0.7	-0.8	-0.5	-1.4	-1.7
<b>Growth rates</b>									
Money and credit									
Monetary balances									
Banco de México international reserves	71.3	79.9	7.3	31.8	-57.0	267.5	14.5	64.0	32.0
Net domestic credit	41.7	35.6	21.4	11.5	29.2	31.1	-6.8	-0.1	29.6
To central government (net)	17.7	-2.5	-51.9	...	...	...	...	...	...
To private sector	73.5	61.5	47.7	24.3	40.3	-4.8	-29.7	-0.5	8.7
Money (M1)	64.7	124.8	14.7	17.9	1.1	2.4	39.6	29.4	15.6
Local currency savings and time deposits	111.2	224.6	13.6	19.8	-7.0	-5.5	51.5	30.6	11.5
M2 <sup>i</sup>	46.2	47.2	20.4	11.8	22.7	38.7	30.1	19.1	23.3
Dollar deposits	...	...	...	...	...	85.7	51.4	24.1	36.3
<b>Annual rates</b>									
Real interest rates (annualized, %)									
Deposit rate (30 days)	1.0	-1.3	3.4	6.9	5.8	-7.7	-2.0	-5.1	-0.8
Equivalent interest rate in foreign currency (30 days) <sup>j</sup>	17.2	12.2	14.0	15.9	-8.5	1.4	22.4	11.3	...

Source: ECLAC, on the basis of official figures.

<sup>a</sup> Preliminary figures. <sup>b</sup> Based on pesos at constant 1993 prices. <sup>c</sup> Base on constant 1995 dollars. <sup>d</sup> Percentages of the working-age population; urban areas. <sup>e</sup> Percentages of the economically active population (EAP); urban areas. <sup>f</sup> Manufacturing industry. <sup>g</sup> Includes errors and omissions. <sup>h</sup> Refers to net interest as shown in the balance of payments, divided by exports of goods and services. <sup>i</sup> Includes dollar deposits. <sup>j</sup> Interest rate on deposits, deflated by the variation in the exchange rate.

Economic growth allowed for an increase in tax revenue, but the steps taken to strengthen tax collection and reduce the financial cost of the public-sector debt were insufficient to make up for the 18% drop in oil earnings; as a result, total revenues declined by 8.1%. Even so, the target for the public-sector deficit as a percentage of GDP was virtually met (1.24% as against the projected 1.25%).

Tax revenues grew by 10% in real terms, but non-tax revenues declined by 36%, largely because of a reduction in duties and other taxes on hydrocarbons paid by Petróleos Mexicanos (PEMEX). Revenues of agencies and firms also decreased (9.5%) in the wake of lower PEMEX sales and reduced receipts from Ferrocarriles Nacionales (which was privatized into several railway lines) and from contributions to the Mexican Social Security Institute (as a result of the new social security law).

On the expenditure side, federal government consumption fell by 12%, investment in public works plunged 56%, and asset purchases (both real estate and non-real estate) fell by 18% in real terms. From the sectoral point of view, expenditure grew in education, health, employment and urban development, and in energy and industry. Against this, budget cuts were applied in the areas of communications and transport (64%), administration (29%), rural development (12%), commerce and storage (11%), and in the fight against poverty (8%).

The net domestic debt of the federal government grew by 12% in real terms, to reach 8.1% of GDP by the end of the year, which was 0.8% higher than in 1997. This was mainly due to an increase in government securities in circulation, which came to represent 85% of total domestic debt.<sup>1</sup> Outlays in respect of interest payments and support programmes for borrowers and

<sup>1</sup> The remainder corresponds to the savings fund in the Retirement Savings System.



Table 2  
MEXICO: MAIN QUARTERLY INDICATORS

	1996				1997				1998 <sup>a</sup>				1999 <sup>a</sup>
	I	II	III	IV	I	II	III	IV	I	II	III	IV	I
Gross domestic product <sup>b</sup> (change from same quarter of preceding year) <sup>b</sup>	0.1	6.5	7.1	7.1	4.6	8.4	7.5	6.6	7.5	4.4	5.0	2.6	1.9
Consumer prices (12-month variation, %)	43.8	31.8	30.0	27.7	24.6	20.4	18.7	15.7	15.3	15.3	15.9	18.6	18.2
Real effective exchange rate <sup>c</sup> (index: 1995=100)	95.2	89.0	86.4	85.6	80.1	78.3	75.2	75.3	74.6	74.6	79.1	81.1	76.1
Exports (millions of dollars)	21 870	23 607	24 247	26 275	25 099	27 440	28 176	29 716	28 226	29 886	28 559	30 829	30 054
Imports (Millions of dollars)	19 935	21 409	22 835	25 288	23 529	26 800	28 485	30 994	29 972	31 031	30 849	33 391	31 207
Real interest rate (annualized, %)													
Deposit rate <sup>d</sup>	-3.8	-3.2	2.5	-3.6	-5.1	-5.1	-5.0	-3.9	-2.4	-2.5	0.3	1.4	9.6
Money (M1) (change from same quarter of preceding year)	...	...	...	...	41.6	39.3	34.4	29.4	22.1	19.5	15.1	15.6	14.3

Source: ECLAC, on the basis of official figures.

<sup>a</sup> Preliminary figures. <sup>b</sup> Based on series that have not been seasonally adjusted, at constant domestic prices.

<sup>c</sup> Refers to exchange rate for imports.

<sup>d</sup> 30-day deposits.

savers in the banking system amounted to 65.5 billion pesos (US\$ 7.2 billion).

Fiscal accounts are under considerable strain as a result of the country's low rate of taxation, the fiscal cost of reforming social security, and support programmes for debtors and banks. A positive sign for public finance has been the rise in crude oil prices during the initial months of 1999. Revenues have still not recovered, however, because the appreciation of the peso has reduced oil billings, and because 325,000 fewer barrels are being exported per day than in mid-1998, in keeping with agreements signed by Mexico and other oil-producing countries.

#### (b) External public debt

In late 1998, the net balance of public-sector external debt stood at US\$ 82.222 billion, which was US\$ 3 billion higher than in December 1997; gross debt, be-

fore deducting public-sector assets held abroad, amounted to US\$ 92.294 billion. External debt policy has been aimed at refinancing short-term maturities by making international debt placements on more favourable terms than those prevailing after the peso devaluation in 1994-1995. Due to the extreme turbulence and uncertainty on capital markets, however, external borrowing by the public sector in 1998 was limited to US\$ 1.708 billion, just one third of the 1997 figure.

Consequently, in October 1998, the federal government decided to draw on funds from a contingency credit line for US\$ 2.661 billion that it had taken out with 33 international financial institutions in 1997. This credit line is likely to prove useful in dealing with eventualities on foreign capital and oil markets.<sup>1</sup>

The balance of the country's total external debt grew by 8.3% to US\$ 161.316 billion at the end of 1998 (39% of GDP). The debt owed by the Banco de México to the International Monetary Fund (IMF)

1 Other operations included a loan for US\$ 1 billion obtained by PEMEX from the Japanese Export Import Bank (EXIMBANK) to expand capacity and modernize the Cantarell oil field, and two loans taken out by the federal government with the World Bank for a total of US\$ 415 million, to be used for programmes aimed at promoting know-how, innovation and education.

fell to US\$ 8.38 billion. The private-sector debt rose to US\$ 60.649 billion (up by 17% from the 1997 figure), with the non-bank private sector accounting for US\$ 43.689 billion of this total. This sizeable amount reflects the financing requirements involved in upgrading the productive apparatus, and also highlights how limited access to domestic credit is.

In 1999, the country will have to amortize or refinance more than US\$ 33 billion of external debt. The private sector is facing market-related maturities of US\$ 3.435 billion and will have to renegotiate slightly over one third of its borrowing, which has grown by more than 75% over the last four years. Amortization of public-sector debt amounts to US\$ 12 billion, with market-based maturities (international bonds) totalling US\$ 1.625 billion. In the first four months of 1999, the public sector issued bonds for nearly US\$ 4 billion.

### (c) Monetary and financial policy

The Banco de México reaffirmed its commitment to keep monetary policy neutral but flexible enough to respond to the volatility of international markets. This neutral stance soon turned restrictive, however, given the need to deal with external financial turbulence. Even so, the expansion of the monetary base was essentially in line with the level projected by the bank. Although inflation, which was higher than anticipated, tended to encourage an expansion of the monetary base, this was offset by unexpected economic sluggishness and a rise in the interest rate.

In view of the decline in capital inflows and the peso depreciation that began in early 1998, the monetary authorities activated the "shorts" mechanism, which consists of maintaining a negative operating balance in the current accounts held by the banking system at the Banco de México, thereby exerting upward pressure on interest rates. In March, a "short" of 20 million pesos per day was set, and this made rates rise temporarily; from June onwards, the adverse international conditions worsened (speculation against the Hong Kong and Chinese currencies, crisis in Russia, problems in Japan), causing the Banco de México to raise the "short" to 30 million pesos in June, and then to 50 and 70 million pesos during the month of August. Nevertheless, the interest-rate response was not significant enough to prevent currency depreciation.

As a result, the Banco de México took new measures to restrict liquidity, and announced that as from

September, banks would have to deposit 1.25 billion pesos per working day with the central bank, for a fixed term and at a pre-defined interest rate, until they had accumulated a total of 25 billion pesos. This was tantamount to imposing a form of legal reserve requirement, and from then on interest rates rose sharply. The equilibrium interbank rate bordered on 40% (20% in real terms), but contagion from the international crisis spread more forcefully to Latin American countries, putting renewed pressure on the peso. In a climate of tight liquidity, the Banco de México raised the "short" to 100 million pesos and intervened in the foreign exchange market to prevent an excessive nominal depreciation of the peso, which had already shed 25% of its value by early September. It was only then that depreciation was halted and interest rates gradually came down.

Financial uncertainty and the behaviour of interest rates constrained the course of credit flows in 1998. Bank financing to the private sector shrank by 2.7% in real terms. This led to the proliferation of alternative mechanisms such as credit from suppliers or from firms within the same corporation, and reinvestment of profits. Large companies made use of foreign loans<sup>3</sup> and issued commercial paper and medium-term promissory notes. Apart from this, non-payment of loans continued to be used as a means of financing, even though this practice is unsustainable in the medium term.

The commercial bank arrears index (gross non-performing loans as a percentage of the total loan portfolio) edged up slightly, from 11.34% in December 1997 to 11.41% a year later. In contrast, efforts by the banks to put their finances in order were reflected in improved capitalization ratios.

Outstanding liabilities at the Bank Savings Protection Fund (FOBAPROA) amounted to 651 billion pesos (US\$ 68.5 billion) in December 1998, and they are expected to reach 686 billion pesos in March 1999, when accumulated interest is factored in. Meanwhile, although three quarters of total assets were handed over for administration by third parties, asset values (330 billion pesos) continued to shrink, because the rate of recovery has been very low. In late 1998, Congress agreed to dissolve FOBAPROA and set up the Bank Savings Protection Institute (IPAB) in its place.

As a reflection of the turmoil on international financial markets, the Index of Prices and Quotations (IPYC) on the Mexican Stock Exchange moved downwards—more sharply as from the third quarter—lead-

3 Foreign credit to the private sector rose by 26.5%.

ing to a 24% fall for the year as a whole, or 38% in dollar terms. The main factor underlying this reversal was a reduction in the quantity of Mexican securities held by foreign institutional investors, which contributed to a collapse in the value of shares in circulation—from US\$ 155 billion at the end of 1997 to just US\$ 87 billion by the end of 1998.

In keeping with the monetary policy goal of containing inflation, the Banco de México tightened liquidity further in January 1999 (by raising the “short” to 160 million pesos), in response to the devaluation of the Brazilian *real*, which had put pressure on the peso and led to a sharp rise in interest rates in the two following weeks. Rates came down again in later months, in response to an inflow of foreign funds, which also boosted prices on the Mexican Stock Exchange, with the IPYC posting gains of over 50%.

#### (d) Foreign exchange policy and markets

In contrast with its behaviour in the preceding biennium, the peso depreciated sharply in 1998. This was mainly attributable to the unfavourable course of international financial markets, together with a perception of greater country risk that affected all Latin American countries alike. The exchange rate (pesos per dollar) rose by an average of 15%, while the real exchange rate remained essentially unchanged.

The currency floatation mechanism responded adequately, given the situation of international financial volatility, but interest rates were raised substantially to prevent further disruptions in the exchange rate. In practice, interest rates tend to fluctuate widely in exchange-rate floatation schemes when pressure on the currency is unrelenting. The easing of the international financial crisis and the decline in interest rates, firstly in the United States and then in Europe, strengthened

the peso, as evidenced by its recovery as from October.

The monetary and foreign-exchange policies adopted were effective in defending the level of international reserves, which continued to grow throughout the year, except between September and November, when they contracted very slightly. The balance at the end of December 1998 exceeded US\$ 30 billion (up by US\$ 2 billion since the end of 1997), a level that had not been achieved since early 1994.

As 1999 has proceeded, the earlier pressures on the peso have eased. Abundant capital inflows led to an appreciation of the local currency in the first five months, but in June it fell back to levels close to those of the beginning of the year.

#### (e) Structural reform

Pressing ahead with its financial-system reforms, the Administration sent several bills to Congress, some of which were adopted, with amendments, in late 1998. It was decided to disband FOBAPROA and transfer its assets and liabilities to the newly created IPAB. In May 1999, the board of directors of IPAB was appointed; they will now have the task of halting the decline in the value of assets formerly held by FOBAPROA and speeding up the recovery of ailing banks.

As regards privatizations, a call to tender was put out to award a fifty-year concession for the operation of nine airports in the south-east of the country. The winning consortium—comprising firms from Denmark, Spain, France and Mexico—bid US\$ 127 million for 15% of the shares and undertook to invest a similar amount in maintenance, infrastructure, equipment and capacity expansion over the next five years.

In early 1999, the Administration sent a bill to Congress providing for the partial divestiture of the electricity industry. According to the proposal, there would be no actual privatization until December 2000.

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### 3. The main variables

#### (a) Economic activity

Although it remained below the 5.2% forecast at the beginning of the year, economic growth in 1998 came in at a satisfactory 4.8%, with a slowing trend

showing through in the fourth quarter. Domestic demand continued to revive, and nearly all activity sectors expanded. Agriculture, however, remained at a virtual standstill for the second successive year, mainly because of adverse weather conditions.

Final supply and demand for goods and services increased by 6.8%. Consumption and private investment remained buoyant, in contrast to public investment, which contracted, mainly as a result of restrictions on infrastructure works in transport and communications. Uncertainty about the growth of the world economy contributed to the slowdown in fixed capital formation.

Agriculture suffered because of the drought in the first half of the year, which was followed by heavy rains that buffeted some of the country's most important agriculture and livestock zones. Basic grain production (maize, beans, sorghum and wheat) dropped from 31 million tons in 1997 to 28 million in 1998, and exceptional imports had to be made. Rural migration to the northern border and to the big cities continued to put pressure on urban labour markets.

Industry expanded by 6.6%, led by manufacturing, especially maquila firms. A loss of momentum among manufactured products was evident in the second half of the year (5.6%, as against 9.3% in the first six months). Exports were decisive in the buoyancy of industry, although, as mentioned above, the recovery of domestic demand also played a part. In late 1998, 37 of the 49 manufacturing subsectors had surpassed average output for the period 1993-1994, thanks to improvements in the use of available resources; these subsectors represented 87% of manufacturing output. The installed capacity utilization rate rose, and labour productivity in manufacturing increased by 4.3%, at a faster rate than real wages, thus boosting the sector's international competitiveness. Automobile output expanded by 6.6%, to 1.428 billion units in 1998, although exports declined as a result of buoyant domestic demand, which increased by 27%. Sales abroad accounted for over two thirds of total production.

After experiencing an average growth of nearly 10% over the preceding biennium, construction slowed down from the second quarter onwards, to expand by just 4.6% in the year as a whole, as a result of the contraction of public spending. In the formal sector, building expanded by 3%, and oil and petrochemicals grew by 15%, while irrigation and sanitation, electricity and communications, and transport, posted declines of 25%, 35% and 11%, in that order.

In the services sector, the most buoyant activities were transport and communications (10%) and commerce, restaurants and hotels (4%). The first of these benefited from an increase in cargoes, the buoyancy of passenger transport and growing telephone and satellite communications traffic. Retail sales volumes in commercial establishments increased by 7.6%, led by durable goods. Hotel occupancy was erratic, owing to

weather disturbances that kept tourists from going to the beaches.

The slowdown that began in the final quarter of 1998 lasted into the early months of 1999, with GDP growing by just 1.9% in the first quarter and domestic demand moving along at a slow pace. Government strategy seems to be aimed at maintaining moderate growth, especially in consumption, so as to prevent pressures on the external sector. Nevertheless, the improvement in world economic conditions, already perceptible by mid-year, will probably provide greater impetus from the second half of 1999 onwards (exports today represent 30% of GDP).

### (b) Prices, wages and employment

After an essentially downward trend, inflation moved upward again in the third quarter of 1998, to turn in a cumulative rise for the year of 18.6%; this was above both the official target of 12% and the previous year's level of 15.7%. The basic cause was the acceleration of the devaluation of the peso against the dollar. The index of producer prices rose by over 17% because of pressure from the peso devaluation and significant hikes in the price of agricultural goods (29%).

The peso depreciation fed through directly into domestic prices via its effect on the prices of internationally tradable goods. This, in turn, generated rising inflationary expectations, which were reflected in higher wage increases than had been anticipated at the beginning of the year and in price hikes among non-tradable goods and services. Other factors driving the inflationary process were unexpected increases in officially controlled prices (tortillas, tortilla dough and gasoline) and an unusual rise (45%) in the price of fruits and vegetables that was caused by weather conditions.

The average pay award in collective bargaining contracts was around 18%, while workers' total remuneration (wage increase, productivity bonus, allowances and a rise in the general retabulation) increased by slightly over 20%. As a result, the real wage rose slightly, although for 1998 as a whole, the increase was smaller than had been anticipated at the beginning of the year, owing to higher-than-expected inflation. Based on an inflationary expectation of 13% for 1999, minimum wages were raised by 14% in December 1998.

In the manufacturing sector, real wages rose by 2.4%, while the minimum wage rose by just 0.7%, having declined steadily since 1983. Labour productivity in the manufacturing industry increased by 3.8% in 1998 as a whole, and by a cumulative 36% over the last five years; this was one of the highest levels in the

world, although it was still far below the levels of more advantaged competitors.

The trend of employment during the year was commendable; judging by the number of workers affiliated to the Mexican Social Security Institute (IMSS), a total of 897,000 new jobs were created in the formal economy. The number of permanently insured IMSS affiliates rose to 13.611 billion (up by 7% from 1997), and the number of workers employed in the maquila export industry rose by 12% in 1998, surpassing the one-million mark. The maquila sector accounts for over one third of all manufacturing jobs. Open unemployment held to its downward course and fell to 3.2%, which is a significant improvement on the 3.8% of the preceding year. The partial employment ratio, which measures the number of openly unemployed plus those employed for less than 35 hours per week as a percentage of the economically active population, edged down to 22% (23% in 1997).

As a result of better economic expectations and the real appreciation of the peso, inflation began to fall as from February 1999, thanks to which it is likely to come in at around 15% for the year as a whole.

### (c) The external sector

The main feature of the external sector has been a reduction in capital flows, especially from the second quarter onwards. The trade and current account deficits both grew substantially.

The balance of payments on current account posted a deficit of nearly US\$ 16 billion in 1998, which was twice the previous year's level. This resulted from a shortfall of nearly US\$ 9 billion in goods and services trade and one of almost US\$ 13 billion on the income account, due mainly to interest payments, and a US\$ 6 billion surplus in transfers.

External merchandise trade slowed down as the world economy lost momentum, and the international prices of oil, coffee, copper, honey and syrups, and natural gas all fell. This led to a 5% deterioration in the terms of trade, brought export values down and contributed to a trade deficit for the first time since 1994.<sup>4</sup> Merchandise exports grew by 6.4% (compared to 15% in 1997), and oil exports declined by 38%, but manufacturing exports (91% of the total) grew by 11%. Merchandise sales abroad, excluding the maquila sector, remained at a virtual standstill, whereas those of the maquila industry expanded by 17% and accounted for 45% of total export value.

Exports to the United States continued to grow apace (9.3%). Mexico, which accounted for 10% of imports to the United States, remained that country's third most important supplier after Japan and Canada. Mexico's trade with its partners in the North American Free Trade Agreement (NAFTA) exceeded US\$ 200 billion and accounted for 82% of its total merchandise trade.

Imports lost momentum, but nonetheless grew twice as much as exports; as a result, the merchandise trade balance went from a surplus of US\$ 624 million in 1997 to a deficit of over US\$ 7.7 billion in 1998. Imports of capital goods grew by 15%, in line with the pace of investment. Intermediate goods increased by 13%, with those destined for use in goods produced for the domestic market growing faster than those related to future exports, thereby reflecting the buoyancy of domestic demand. External purchases of intermediate inputs accounted for over three quarters of total imports, which revealed the buoyancy of the maquila industry and the sluggishness of domestic production.

The capital account posted a surplus of US\$ 16.23 billion, as a result of positive trends in foreign direct investment and significant levels of public- and private-sector foreign borrowing, while portfolio investment slackened for the second year running.

Total inflows from foreign investment decreased in 1998, especially from the second quarter onwards. Direct investment amounted to US\$ 10 billion — US\$ 2.6 billion less than in the preceding year, but considerable nonetheless, in view of the international financial volatility. Up to August 1998, 43% of total foreign direct investment consisted of new investment, 54% represented reinvestment of profits, and 2.8%, inter-company transactions. Slightly over half of all new investments were imports of capital goods by maquila enterprises, and the rest related to new projects. The industrial sector contributed nearly two thirds of all new investment and was followed by commerce (18%) and services (15%), with 72% of new investment coming from the United States, 13% from the Netherlands and 5% from France.

In the five-year period 1994-1998, foreign direct investment received by Mexico averaged over US\$ 10.5 billion per year, the highest value in Latin America after Brazil (US\$ 11 billion per year). Portfolio investment yielded a net outflow of nearly US\$ 800 million, a level similar to that of 1997. This trend was due to an outflow of funds from money and security markets, as net international placements of public- and private-sector bonds turned in positive performances.

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4 The terms of trade in 1998 were at their lowest level since 1970, when this index was first constructed.

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## Nicaragua

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### 1. General trends

The steady economic recovery of previous years weakened in 1998, as GDP grew by only 4%, less than expected by the authorities early in the year (6%). Hurricane Mitch<sup>1</sup>, considered the worst natural disaster in the country's history, contributed to these difficulties. The overall impact of the hurricane entailed a total cost of US\$ 988 million, of which US\$ 562 million represented direct storm damage.

**AGAINST THIS BACKGROUND**, there was a surge in inflation (18%) that was due not only to the aftermath of the hurricane in the last two months of 1998, but also to bad weather conditions in the first two quarters of the year. The economic policy applied brought a number of positive results, however, including the strengthening of fiscal discipline, control over the monetary base, growth in credit to productive sectors, a downward trend in interest rates and a reduction of open unemployment. The exchange-rate system of planned devaluations was continued, and thus inflationary expectations were contained. Furthermore,

sustained foreign investment inflows contributed to the process of remonetization and the growth of monetary aggregates, particularly foreign-currency deposits.

The impact of the natural disaster on the export sector was reflected in a reduction in certain traditional exports and a sharp drop in non-traditional exports owing to the expiry of export incentives; this caused the trade deficit to rise considerably. Nevertheless, the consistently high current account deficit was financed to a considerable extent by international grants and unrequited transfers from abroad.

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### 2. Economic policy and structural reform

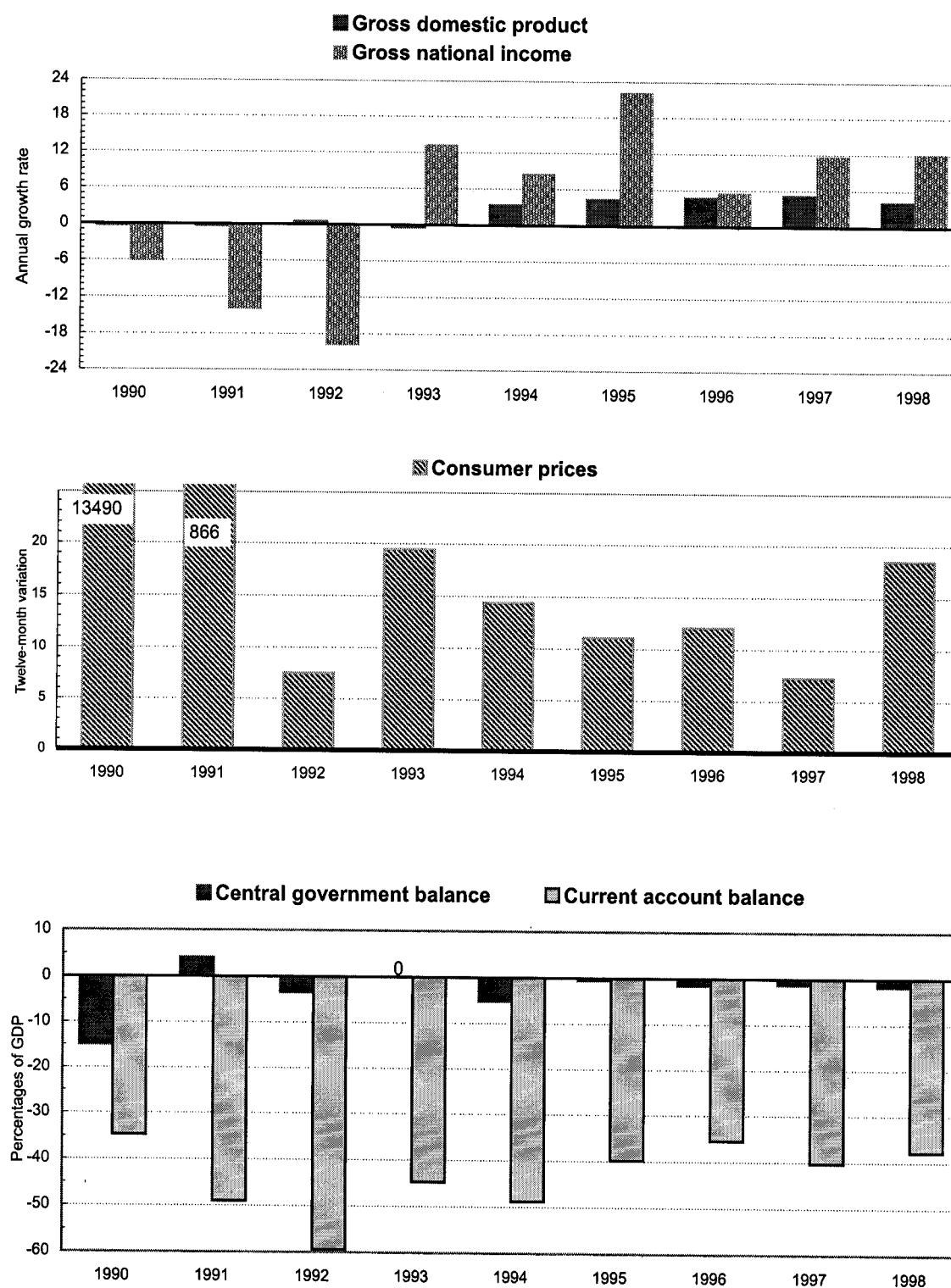
In March 1998, the Government of Nicaragua signed a new enhanced structural adjustment facility (ESAF) agreement with the International Monetary Fund (IMF) for the period from 1998 to 2000, with a view to achieving sustainability in public finance and

the external sector, continuing structural reforms and maintaining economic growth. In April 1998, the Consultative Group announced a commitment by donor countries to provide financial aid amounting to US\$ 1.8 billion during the 1998-2000 period for a programme

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1 Hurricane Mitch hit Nicaragua between 22 October and 1 November 1998, bringing rainfall of exceptional intensity.

Figure 1  
NICARAGUA: MAIN ECONOMIC INDICATORS



Source: ECLAC, on the basis of official figures.

Table 1  
NICARAGUA: MAIN ECONOMIC INDICATORS

	1990	1991	1992	1993	1994	1995	1996	1997	1998 <sup>a</sup>
<b>Growth rates<sup>b</sup></b>									
Growth and investment									
Gross domestic product	-0.1	-0.2	0.4	-0.4	3.3	4.3	4.7	5.1	4.0
Per capita gross domestic product	-3.0	-2.9	-2.5	-3.3	0.3	1.3	1.8	2.3	1.3
Gross domestic product, by sector									
Goods	-1.3	0.4	-0.3	1.0	6.6	5.2	6.2	7.0	4.6
Basic services	2.9	3.1	2.0	-2.0	0.9	5.4	5.1	5.6	3.2
Other services	0.8	-1.5	0.9	-1.8	-0.3	2.9	2.5	2.3	3.4
Consumption	-4.1	8.9	-2.6	-3.6	0.3	4.6	-4.8	6.7	11.2
General government	34.0	-34.1	-10.9	-3.3	-2.7	-0.4	-0.6	-0.7	-0.4
Private	-19.3	37.6	0.0	-3.6	1.1	5.9	-5.9	8.8	14.1
Gross domestic investment	-14.2	15.7	-1.0	-14.9	28.2	21.2	10.2	22.2	6.8
Exports of goods and services	19.3	-15.2	20.2	4.4	16.4	8.8	37.3	4.0	-6.4
Imports of goods and services	-4.6	19.8	4.3	-10.5	15.3	15.6	13.1	14.1	7.9
<b>Percentages of GDP<sup>c</sup></b>									
Gross national income	89.3	77.0	61.3	69.7	72.7	85.0	85.4	90.4	97.3
Gross domestic investment	19.0	21.7	21.8	18.6	22.9	26.2	29.8	31.7	32.6
National savings	-9.0	-31.8	-44.8	-32.5	-29.0	-13.6	-5.5	-3.8	-2.8
External savings	28.0	53.4	66.5	51.1	52.0	39.8	35.3	35.6	35.5
<b>Percentages</b>									
Employment and wages									
Open unemployment rate	7.6	11.5	14.4	17.8	17.1	16.9	16.0	14.3	12.2
Real average wage (index: 1995=100)	81.8	84.5	100.5	93.3	98.2	100.0	97.9	97.7	105.0
<b>Growth rates</b>									
Prices (December-December)									
Consumer prices	13 490	866	3.5	19.5	14.4	11.1	12.1	7.3	18.5
<b>External sector</b>									
Terms of trade (index: 1995=100) <sup>c</sup>	119.1	98.3	71.9	81.3	95.5	100.0	91.9	96.9	101.5
Nominal exchange rate <sup>d</sup>	689.96	4.27	5.00	6.12	6.72	7.53	8.44	9.45	10.59
Real effective exchange rate for imports (index: 1995=100) <sup>e</sup>	80.7	84.7	85.6	89.7	95.4	100.0	102.2	108.0	107.6
<b>Millions of dollars</b>									
Balance of payments									
Current account	-385	-852	-1 095	-879	-893	-751	-700	-814	-804
Trade balance (goods and services)	-290	-492	-610	-475	-477	-468	-494	-742	-845
Exports	392	350	309	356	476	647	805	866	802
Imports	682	843	919	831	953	1 114	1 299	1 609	1 647
Capital and financial accounts <sup>f</sup>	-310	360	-13	-95	-269	74	240	821	627
Overall balance	-696	-492	-1 108	-975	-1 162	-677	-460	6	-178
Variation in reserve assets									
(- indicates an increase)	7	-38	-11	91	-85	12	-53	-173	-31
<b>Percentages</b>									
External debt									
Gross debt (as a percentage of GDP)	965.0	593.1	585.4	609.5	638.4	543.1	308.9	296.7	295.2
Net interest (as a percentage of exports) <sup>g</sup>	55.3	103.6	156.1	117.8	95.7	53.1	34.7	23.0	16.9



Table 1 (concluded)

	1990	1991	1992	1993	1994	1995	1996	1997	1998 <sup>a</sup>
<b>Percentages of GDP</b>									
Central government									
Current revenue	14.9	19.3	20.3	19.6	20.1	21.5	21.7	24.2	26.2
Current expenditure	30.7	23.5	22.1	20.6	21.3	19.3	19.7	19.9	20.9
Current saving	-15.8	-4.2	-1.8	-1.0	-1.2	2.3	2.0	4.4	5.3
Capital expenditure (net)	1.3	3.3	5.9	6.3	8.7	11.1	10.4	9.9	9.8
Financial balance	-15.0	4.1	-3.4	0.0	-5.1	-0.5	-1.5	-1.3	-1.7
Domestic financing	-5.1	-4.6	-6.1	0.0	-1.2	0.7	-3.6	-0.1	-5.8
External financing	20.1	0.5	9.4	0.0	6.4	-0.2	5.1	1.4	7.5
<b>Growth rates</b>									
Money and credit									
Monetary balance									
Net international reserves	...	449.2	4.1	-51.6	132.7	-10.1	185.6	137.0	-4.5
Net domestic credit	-96.9	2 518.7	56.5	80.3	54.7	51.4	24.9	25.4	50.5
To public sector	191.9	295.5	794.4	7.9	5.0	-6.1	-17.9	18.2	7.4
To private sector	150.0	1 659.4	21.8	49.8	33.7	26.6	-8.2	39.8	45.3
Money (M1)	-2.6	850.8	16.4	-4.4	36.9	16.3	26.8	30.7	18.1
Local-currency savings and time deposits	67.5	808.0	39.9	48.7	99.4	24.7	29.9	75.7	17.8
M2	6.8	841.8	21.1	7.9	56.9	19.7	28.1	50.1	18.0
Dollar deposits	41.4	770.5	55.3	70.8	77.6	59.8	61.3	57.2	35.3
<b>Annual rates</b>									
Real interest rates (annualized, %) <sup>h,i</sup>									
Deposit rate (savings accounts)	...	...	8.5	8.9	8.8	...	-1.2	-1.3	-1.9
Lending rate (short-term)	...	...	19.7	20.1	20.3	...	6.1	9.7	7.7
Equivalent interest rate in foreign currency <sup>j</sup>	...	...	8.5	8.9	8.8	...	0.3	-2.8	0.8

Source: ECLAC, on the basis of official figures.

<sup>a</sup> Preliminary figures. <sup>b</sup> Based on new córdobas at constant 1980 prices.

<sup>c</sup> Based on constant 1995 dollars.

<sup>d</sup> 1990: thousands of

córdobas per dollar; 1991 on: gold córdobas per dollar, official exchange rate.

<sup>e</sup> Official exchange rate.

<sup>f</sup> Includes errors and omissions.

<sup>g</sup> Refers to net interest as shown on the balance of payments, divided by exports of goods and services.

<sup>h</sup> Interest rates are subject to a provision

requiring the maintenance of dollar values; therefore, once the nominal interest rate has been adjusted by the index for the real effective exchange rate, it equals the real interest rate. For these purposes, the December-December variation in this index should be used.

<sup>i</sup> These figures represent a simple

average of the floor and ceiling rates in the State and private banking systems. <sup>j</sup> Interest rate on deposits, deflated by the variation in the exchange rate.

the main objectives of which are to strengthen the sustainability of public finances, complete the transition to a market economy and improve governance, particularly through the development of a professional civil service.

Half the country's total population and three-quarters of its rural inhabitants live in extreme poverty. Combating poverty has become a key element in maintaining political and social stability and is the main focus of the Administration's strategy, in which high priority has been assigned to modernizing the rural sector, planning investments in rural infrastructure, creating credit funds for small-scale farmers and expanding and improving social services.

### (a) Fiscal policy

Fiscal policy was central to the financial programme implemented in 1998. The economic objectives of the programme entailed devising an income and expenditure policy that would increase current saving, cut the fiscal deficit and improve the financial position of the Central Bank.

Despite budgetary adjustments in November and December, the original objectives of the programme for 1998 in terms of consolidated public-sector saving and deficit were met, thanks to the cumulative balances remaining as targets were surpassed during the first 10 months of the year. Primary saving by the non-financial

Table 2  
NICARAGUA: MAIN QUARTERLY INDICATORS

	1996				1997				1998 <sup>a</sup>				1999 <sup>a</sup>
	I	II	III	IV	I	II	III	IV	I	II	III	IV	I
Consumer prices (12-month variation, %)	11.7	12.1	11.9	12.1	9.2	9.5	9.3	7.3	10.9	14.1	12.5	18.5	12.0
Real effective exchange rate <sup>b</sup> (index: 1995=100)	100.1	100.9	104.3	103.6	106.0	108.1	108.6	109.3	108.9	106.6	108.7	106.3	106.9

Source: ECLAC, on the basis of official figures.

<sup>a</sup> Preliminary figures. <sup>b</sup> Refers to the exchange rate for imports.

public sector (NFPS) was 15.4% of GDP, an increase of 2.2 percentage points over 1997. Current saving rose to 10.4% of GDP, up from 7.5% the previous year. At the same time, the deficit (excluding donations) decreased significantly, from 7.1% of GDP in 1997 to 2.2% in 1998. The reduction of the overall deficit enabled the Administration to carry out its investment programme, meet external debt obligations and increase its Central Bank deposits.

Thanks to accelerating economic activity, the corrections introduced by fiscal reform and the strengthening of tax administration, including customs procedures, the tax burden rose to 30.1% of nominal GDP, which represents an increase of 27.3% over the previous year.

Current spending as a percentage of GDP rose slightly (from 26.1% to 26.8%), while NFPS capital spending was 12.7% of GDP, 2.1 points lower than in 1997. This fall in investment was caused by a decrease in capital transfers to the private sector and delays in the implementation of projects by Empresa Nicaragüense de Acueductos y Alcantarillados Sanitarios (ENACAL) and Empresa Nicaragüense de Telecomunicaciones (ENITEL).

During 1998, the Administration continued with its endeavours to strengthen the financial position of a number of State-owned enterprises. In the cases of the electric power, sewerage and water companies, pricing adjustments were introduced in order to cover their long-term marginal costs and eliminate cross subsidization.

#### (b) Monetary policy

Monetary policy, backed by strict fiscal discipline, continued to give priority to regulating internal factors that cause the expansion of primary liquidity. The purpose is to maintain the domestic and external stability of the currency and ensure that goals for international reserves and external payments are met.

Exchange-rate policy remained unchanged, with daily devaluations resulting in a nominal devaluation for the year of 12%. The Administration had announced that the slide would be reduced to 8% per year, but this was not achieved because of rising inflation and the fall in exports, with the resulting loss of foreign exchange.

Owing to internal and external factors, nominal growth of the monetary base for 1998 was 12.7%, as against the 1997 level of 35%. Domestic factors leading to monetary expansion included net reimbursements of negotiable investment certificates known as CENIs (dollar-indexed government securities having terms of up to one year) and operating losses in córdobas by the central bank resulting from the financial cost of those instruments. Net domestic credit to central government was the main factor controlling the monetary base, as the increase in central government deposits softened the expansionary impact of other variables.

The growth of total liquidity in the economy (28.6%) was smaller than in 1997; this indicator did increase in every regard, however, particularly as a result of the rise in foreign-currency deposits, which

represent almost 65% of the total money supply. Bank loans to the private sector grew by 11.2%, with private banks accounting for a substantial share of this lending (81.7%). The sectors that benefited most were commerce, industry and agriculture.

Interest rates on savings accounts were lowered in 1998 for both local- and foreign-currency deposits, in response to the drop in international interest rates. This was not the case with time deposits: in local currency, rates for shorter-term transactions were reduced, whereas those for nine-month and one-year deposits were raised. The trend was generally upward for most forms of term deposits in foreign currency, except for periods of more than one year. Lending rates in córdobas also rose, particularly for long-term transactions, while dollar rates were lower than in 1997.

### (c) Trade policy

The tariff reduction process moved ahead according to the schedule set out in 1997. In January 1998, reductions of five percentage points were made in import duties and the temporary protection tariff (ATP), and the latter was further reduced by five points in July. There is currently a ceiling tariff of 15% and a floor rate of 0%.

In the context of export promotion, a list of inputs exempted from tariffs was adopted in May. This measure will remain in force for two years and will benefit raw materials and intermediate and capital goods.

In April 1998, Nicaragua and the other Central American countries signed a free trade agreement with the Dominican Republic that will come into force in 1999, once the parties have completed their ratification formalities. The agreement was negotiated on the basis of lists of products that are to be excluded from free trade arrangements, including coffee, sugar, rum, oils and soap, as well as products made in export processing zones.

### (d) External debt policy

At the end of 1998, public external debt totalled US\$ 6.273 billion, which represented an increase of US\$ 272 million over 1997. Of this amount, bilateral creditors account for 65.5%; multilateral creditors, 30.1%, and commercial banks 3.9%. The remaining 0.5% was owed to suppliers. Although Nicaragua has made notable progress in managing its external debt, it is still the most highly indebted country in Central America, and its debt service represents an unsustainable burden for the country's fiscal accounts and balance of payments.

Before Hurricane Mitch, Nicaragua was planning to meet the requirements for access to the Heavily Indebted Poor Countries (HIPC) Debt Initiative of the IMF and the World Bank. Despite the heavy losses caused by the natural disaster, the Government is committed to maintaining sound economic policies (to preserve the country's financial stability) and to moving forward with structural reforms, to which a few minor adjustments are envisaged. Hence, it expects to reduce its indebtedness by the end of 1999. Meanwhile, as an emergency measure, the Paris Club agreed to a postponement of the country's debt service during the period 1999-2001. In addition, debt forgiveness was obtained from the Governments of Cuba (US\$ 50.1 million), Austria (US\$ 39.9 million) and Canada (US\$ 9.5 million).

### (e) Structural reforms

The banking system was strengthened through the closure or privatization of State banks that were in financial difficulties. The Banco Nacional de Desarrollo (BANADES) was liquidated in June. To fill the resulting financial gap, the Administration created the Rural Credit Fund, which is to be administered by Financiera Nicaragüense de Inversiones (FNI). The main objectives of the Fund, which began operations in September, are to promote socio-economic progress in the rural sector by funding financially sound projects through financial institutions, public corporations, business associations and other qualified non-conventional intermediary lending organizations; to guide and organize State intervention in rural financial markets, and to implement credit programmes.

The National Assembly passed legislation privatizing the Banco Nicaragüense de Industria y Comercio (BANIC), and the Administration submitted to the Assembly a bill providing for partial privatization of the last remaining State-owned bank, the Banco de Crédito Popular (BCP).

The National Assembly also passed legislation authorizing the sale of the State telephone company ENITEL; the restructuring of Empresa Nicaragüense de Electricidad (ENEL), along with the leasing of its generation and distribution divisions; private administration of the water supply system and the opening up of the petroleum sector to private investment.

Lastly, the Assembly enacted legislation providing for the restructuring of the executive branch, with a view to reducing the number of ministries and downsizing the State.

### 3. The main variables

#### (a) Level of activity

The various sectors of the economy were performing well until the end of October. Although this progress was halted in almost every case by the destructive impact of Hurricane Mitch, results for the year as a whole remained positive.

Real GDP growth, initially estimated at 6%, fell to 4%. This increase was due to higher domestic demand, which was up 10.3% on the previous year owing to increased private consumer spending (14.1%) and higher gross fixed capital investment (5.7%). Investment efforts by the private sector were mainly focused on construction and agriculture. The share of private gross fixed capital investment rose to more than 60% of total investment. In contrast with the behaviour of private investment and consumption, public-sector consumption and investment continued to fall. Unlike the previous year, exports of goods and services fell significantly (-6.4%), while imports continued to surge upwards (7.9%).

Early in the year, the expectations for agriculture were for an excellent production cycle. However, Hurricane Mitch inflicted serious damage on crops, especially those that are sown late in the season, bringing the rate of output growth down to 4.2%. Agricultural value added (7.2%) was 2.5 percentage points lower than the previous year. Apart from coffee, bananas, sugar cane and tobacco, output of other export goods fell. As for agricultural crops for domestic consumption, production of soybeans and rice increased, but sorghum, maize and beans dropped sharply. Value added in the livestock sector declined by 1.8%, influenced by a decline in cattle slaughtering in both local and export slaughterhouses. The decline is in relation to 1997, when exports of live cattle, as well as slaughtering, had increased in anticipation of potential supply difficulties resulting from the drought caused by El Niño. Poultry farming prospered in 1998, however, producing a greater volume of dressed meat; milk and egg production also increased.

Value added increased by 1.5% in the fishery sector, sustained by improved fish and lobster catches. Despite growth in the artisanal fishing fleet, fishing output fell by 4.5 percentage points in relation to the previous year because of shrimp-farming losses caused by Hurricane Mitch.

Industrial output rose by 2.1%, but this growth rate was 1.7 percentage points down on the previous year, basically because of a slowdown in the meat-packing industry and a fall in output of vegetable oil, rum, burlap and polypropylene sacks, leather goods, cardboard boxes and laundry soap. In addition, some factories—mostly located outside the capital—experienced production and distribution difficulties during the fourth quarter following the destruction caused by Hurricane Mitch. The subsectors that experienced the greatest growth were clothing, non-metallic minerals, transport equipment, metal products, household machinery and appliances, tobacco, beverages and plastics.

The construction sector grew by 8.6%, as a result of the growth in private investment up to September, as well as of the initial reconstruction work in the last two months of the year.

The value of mining output in real terms was 44.6% higher than the previous year, thanks to investments made with a view to boosting production and introducing technological change at mining sites. As a result, despite its being such a small sector, mining contributed 0.5 percentage points to overall GDP growth in 1998.

Service activities as a whole grew by almost 3.4%, and accounted for almost 45% of the increase in GDP; commerce alone, with a 4.7% expansion, contributed 20% of the overall growth of the economy. Apart from community, social and personal services, other components of the sector, especially basic services, posted slightly lower growth rates than in 1997, mostly owing to the damage caused by Hurricane Mitch.

#### (b) Prices, wages and employment

The increase in inflation in 1998 was mainly due to the shortage of food supplies caused by natural phenomena such as El Niño and Hurricane Mitch, which especially affected agricultural production. Increases in rates for basic services also contributed to the problem. Cumulative inflation over the year amounted to 18.5%, and the average rate of increase in price levels for the year (13%) was 3.8 percentage points higher than in 1997.

Foodstuffs and beverages were prominent in inflationary behaviour and were mainly responsible for the extreme values recorded in April, July and November. As much as 58.8% of the cumulative inflation in 1998

was attributable to foodstuffs. Inflation in the housing sector was also very high (24%), and contributed 3.9 percentage points, or 21%, to the cumulative inflation figure. The items that accounted for the greatest share of this sector's inflation were water supply, where rates were increased; housing repairs, where the cost of construction materials rose, and electric power, where rates were also increased.

As for fuel prices, liquid petroleum gas and regular gasoline posted negative variations of 3.6% and 3.2%, in that order; in contrast, diesel fuel prices showed a positive variation of 5.6%, which was less than in 1997 (21.5%).

Average real wages rose significantly in 1998 (7.4%), mostly owing to central government wage increases (36.4%), while pay hikes in the private sector were moderate. The increases in central government were mostly accounted for by adjustments granted to teachers, national police and doctors in the health sector. At the sectoral level, the highest increases were in community and social services, construction, and financial services.

The improvements in the national economy in recent years have led to a steady reduction in unemployment; the rate in 1998 was 13.2%, compared with 17.8% in 1993. There was also a slight decline in the rate of underemployment, measured in equivalent units of open unemployment. Agriculture, commerce, community and social services, industry and construction made appreciable contributions to generating new jobs.

### (c) The external sector

The high current account deficit remained virtually unchanged in respect of 1997, although it did fall

slightly, as interest payments were lower and unrequited transfers from abroad increased. As a proportion of GDP, it fell from 40.2% to 37.9%. The trade gap was responsible for 96.7% of the current account deficit. Although external grants and foreign investment continued to rise, the current account deficit was financed by drawing from international reserves and not meeting current payments.

The merchandise trade deficit (f.o.b.) grew by US\$ 110 million (16.5% more than in 1997) owing to a 13% drop in exports and a slight increase in imports (1.4%).

Exports of goods totalled US\$ 613 million, compared with US\$ 704 million in 1997, reflecting a sharp drop (34.2%) in non-traditional exports, which had accounted for more than 50% of overall exports in 1997. Traditional exports rose (12.2%), thanks to an increase in coffee, banana and seafood exports; however, other traditional exports fell considerably. This outcome was influenced by the expiry of legislation providing incentives for non-traditional exports, the suspension of subsidies previously provided by means of tax benefit certificates, the negative impact of natural phenomena such as El Niño and Hurricane Mitch, and the international crisis, which caused a fall in the prices of the country's main export products.

Imports (c.i.f.) totalled US\$ 1.479 billion, 1.7% more than the previous year. Increases in imports included consumer goods (14.3%), especially non-durables (16.5%). Imports of capital goods rose by 3.1%, especially those used in agriculture. On the other hand, imports of intermediate goods fell by almost 5% owing to decreased outlays on oil, fuels and lubricants (-26%), while purchases of raw materials for industry and construction increased.

## Panama

### 1. General trends

The Panamanian economy grew by 3.9% in 1998, less than the 4.7% recorded in 1997. Despite this, per capita GDP increased by 2.3%. The slowdown was essentially due to external factors, including those that affected activities in the Colón Free Zone and the bad weather caused by El Niño. These negative developments were counteracted by the good performance of the domestic market, which was buoyed up by higher levels of spending on consumption and investment, and increases in employment and real wages. Despite the worldwide financial turbulence of 1998, the country's international banking centre remained very stable, and liquidity remained abundant, leading to a slight downward trend in interest rates.

**PUBLIC SPENDING** on both consumption and investment rose considerably, significantly boosting economic activity. As a result, the public-sector deficit exceeded 4% of GDP. However, the general macroeconomic situation remained stable; inflation was low, and interest rates fell, although the current account deficit was one of the highest of the decade.

The authorities maintained their policy of modernizing the public sector and privatizing State-owned enterprises, and continued with activities relating to the withdrawal of United States troops and the handing over to the national Government of

land and infrastructure connected with the Panama Canal. This process will culminate on 31 December 1999, when all Canal facilities come under Panamanian control.

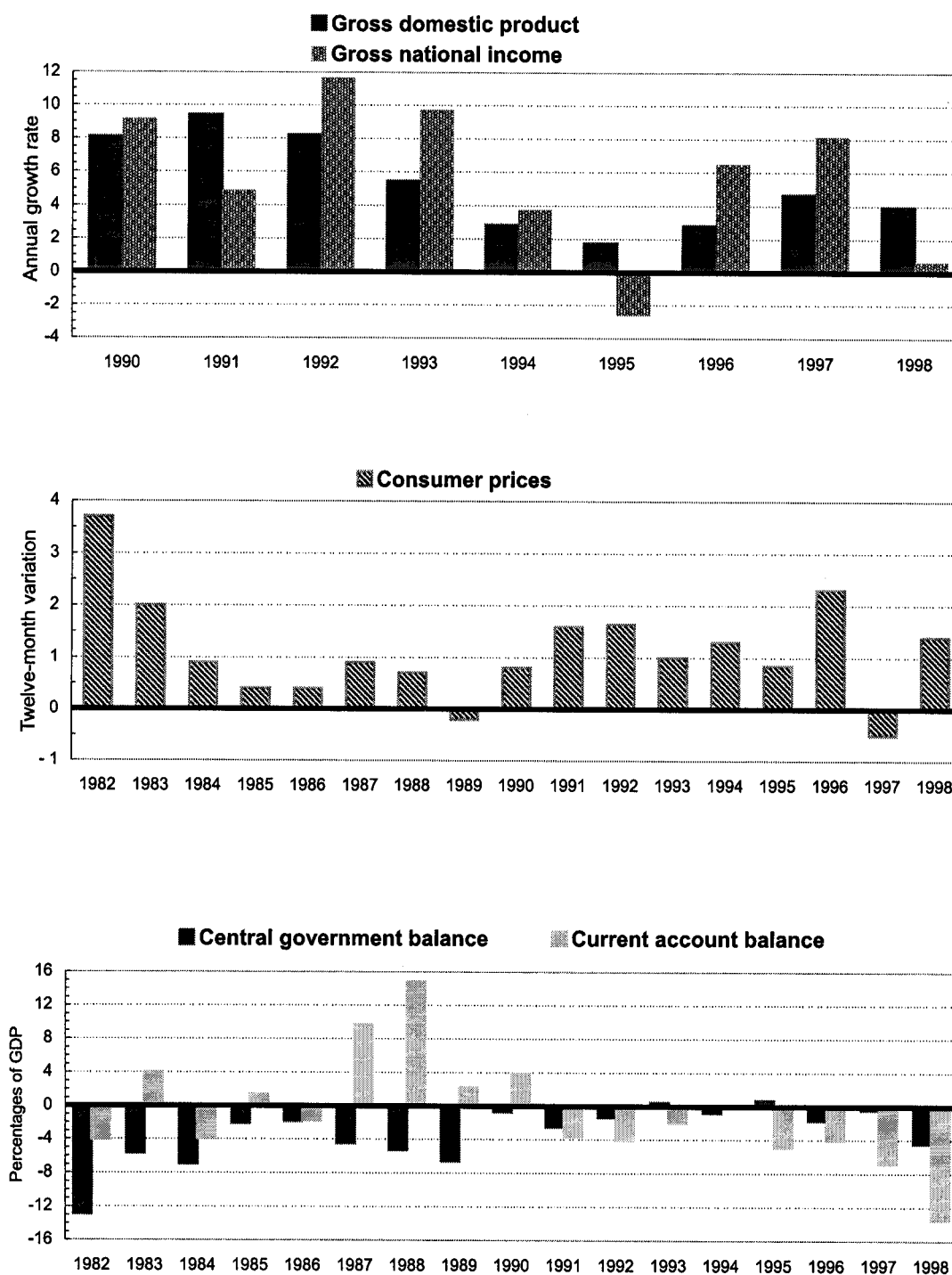
Economic growth of more than 4% is expected for 1999, based in part on investment projects that are already under way. The level of activity in the Colón Free Zone is expected to remain depressed, however, owing to the low levels of economic growth in Latin America. Although it is anticipated that strong growth in public investment will continue, no increase in the fiscal deficit is forecast, and inflation should remain very low.

### 2. Economic policy and tax reform

The economic policies adopted in recent years were continued in 1998: priority was given to macroeconomic stability, trade liberalization, promotion of market-

oriented mechanisms and institutions and modernization of the public sector. Special emphasis was placed on the privatization of State-owned enterprises.

Figure 1  
PANAMA: MAIN ECONOMIC INDICATORS



Source: ECLAC, on the basis of official figures.

**(a) Fiscal policy**

The basic goal of fiscal policy was to keep government finances under control at a time when major changes were being made in the structure of public-sector income and expenditure. With the prospect of elections and a change of administration during the year, spending on current infrastructure projects was accelerated. As a result of these outgoings, along with an increase in current expenditure, the non-financial public-sector (NFPS) deficit rose from 0.03% of GDP in 1997 to 2.1% in 1998.

The central-government deficit grew considerably, from 0.4% to 4.5%. There was a surge in overall central government spending in 1998, with both current and capital expenditure rising. The higher level of current spending (19.5%) was caused by a significant upswing in operating costs, partly because of one-time severance payments to employees of State-owned enterprises.

Capital expenditure rose quickly (3.8%), owing to increased physical investment in economic and social infrastructure. Spending increased substantially in the areas of road building, health and housing infrastructure and crop irrigation.

The central government's current revenue rose by 18.9%, boosted by growth in non-tax revenues (9.5%), mostly as a result of increases in contributions to public funds by State-owned enterprises and in other miscellaneous income.

Tax revenues were up only 1.9%, compared with 11.4% in 1997, owing to the fact that direct taxation fell (-10.9%), although indirect taxation rose (13.2%). The loss of direct tax revenue was mostly due to a significant fall (-12.6%) in income tax revenue, following the payment of large sums by privatized telecommunications firms in 1997 and the subsequent normalization of tax payments in 1998. Contributions by enterprises located in the Colón Free Zone also dropped sharply (-74.2%), as taxes formerly levied on them were eliminated.

Other taxable items, however, posted considerable increases. This was the case with payrolls, which yielded 7% more because of rising employment and incomes, and with retirement and severance payments, which rose as a result of the privatization of several State-owned firms. In addition, dividend income from shareholdings in privatized companies increased by 56%, although the sums involved are still modest.

Indirect tax revenue was 13.2% higher than the previous year, owing to a 15.3% increase in receipts from the transfer tax on movables. Import and sales tax

revenue showed sizeable increases (18% and 11.5% respectively).

Public-sector external debt stood at US\$ 5.179 billion, 2.6% higher than the 1997 figure. This was influenced by the placement of US\$ 300 million in bonds on the United States market. A further issue of "global bonds" on the United States market followed in March 1999, this time for US\$ 500 million; of this amount, US\$ 300 million was used to support the budget and the remainder, to repurchase Brady bonds.

The country's foreign debt stood at 1,835,000,000 balboas at the close of 1998, 2.3% down on the previous year. The Development Trust Fund held by the Government in the National Bank of Panama rose to 1,038,900,000 balboas, as the proceeds of the privatizations carried out in 1998 came in. Thus, the public sector now holds a net credit with the National Bank of 2,113,000,000 balboas.

**(b) Credit policy and the international banking centre**

Despite the difficult conditions faced by the international financial markets in 1998, the Panamanian banking system was somewhat sheltered from the disturbances. Although foreign transactions fluctuated considerably, domestic operations showed remarkable growth and stability.

The total assets of the international banking centre rose to US\$ 36.578 billion, 1% more than in 1997. Local-currency deposits in the banking system were up 12.3% as a result of increased time deposits, but with foreign-currency deposits down 24.2%, liquid assets ended 13.3% lower than the previous year. The credit portfolio grew by 7.1%, mostly owing to domestic market operations; foreign credit stagnated and equity investment fell by 3%.

Domestic deposits increased by 9.2%, while foreign deposits fell by 12.6%; as a result, total deposits were down by 2.7%. Bank capital rose by 20.2%, causing total liabilities and capital to increase by 1% in respect of 1997. The performance of the domestic banking system, which accounts for 78% of total assets, was the main factor contributing to the overall results of the international banking centre.

Generally speaking, the trend in interest rates was slightly downwards. Lending rates for commercial activities averaged 9.95% for the year, compared to 10.1% in 1997. The rate for industry was 8.95%, and consumer loans stood at 12.9%. The cost of medium- and long-term credit also decreased, ending slightly lower than that of short-term loans. The trend in deposit



Table 1  
PANAMA: MAIN ECONOMIC INDICATORS

	1990	1991	1992	1993	1994	1995	1996	1997	1998 <sup>a</sup>
<b>Growth rates <sup>b</sup></b>									
Growth and investment									
Gross domestic product	8.1	9.4	8.2	5.5	2.9	1.8	2.8	4.7	3.9
Per capita gross domestic product	6.0	7.3	6.2	3.5	1.0	0.0	1.1	2.9	2.3
Gross domestic product, by sector									
Goods	8.0	13.0	10.5	8.8	3.3	2.0	-1.0	4.4	3.7
Basic services	2.3	0.3	1.2	1.6	4.9	7.4	6.3	3.9	3.6
Other services	8.9	7.6	10.7	4.3	4.4	0.1	3.6	5.4	3.8
Consumption	-10.0	17.1	3.3	3.8	-1.8	-2.8	4.6	3.7	5.6
General government	0.9	8.7	-8.0	2.8	-0.4	4.6	3.4	7.0	6.6
Private	-12.9	19.7	6.4	4.1	-2.2	-4.7	4.9	2.9	5.4
Gross domestic investment	260.2	10.5	38.6	13.8	14.3	10.8	6.1	21.0	12.8
Exports of goods and services	17.1	39.4	-8.4	-10.4	-3.4	9.8	-6.3	10.3	-4.1
Imports of goods and services	16.7	47.2	-6.5	-9.1	-3.4	9.0	-3.5	15.8	1.7
<b>Percentages of GDP <sup>c</sup></b>									
Gross national income	97.9	94.2	97.2	101.2	101.8	97.3	100.9	104.1	100.7
Gross domestic investment	17.8	18.1	23.2	25.1	27.8	30.3	31.3	35.9	38.9
National savings	26.9	19.6	24.3	28.3	31.4	30.2	31.9	34.9	29.2
External savings	-9.0	-1.5	-1.0	-3.1	-3.6	0.1	-0.7	1.1	9.7
<b>Percentages</b>									
Employment and wages									
Labour force participation rate <sup>d</sup>	58.9	57.5	60.2	60.4	60.7	61.7	60.6	61.5	62.2
Open unemployment rate <sup>e</sup>	16.8	16.0	14.7	13.3	14.0	14.0	14.3	13.1	12.6
Real minimum wage (index: 1995=100)	93.8	92.7	91.3	102.0	100.6	100.0	104.3	103.1	105.9
<b>Growth rates</b>									
Prices (December-December)									
Consumer prices	0.8	1.6	1.6	1.0	1.3	0.8	2.3	-0.5	1.4
External sector									
Terms of trade (index: 1995=100) <sup>c</sup>	69.1	82.2	104.0	106.8	110.0	100.0	100.1	108.6	108.6
<b>Millions of dollars</b>									
Balance of payments									
Current account	208	-212	-273	-143	9	-389	-326	-592	-1 240
Trade balance (goods and services)	252	-51	-81	-36	89	-168	-152	-334	-850
Exports	4 438	5 388	6 318	6 692	7 449	7 597	7 358	8 316	8 051
Imports	4 187	5 439	6 399	6 728	7 359	7 763	7 509	8 649	8 901
Capital and financial account <sup>f</sup>	-361	-116	86	-165	-371	52	590	934	778
Overall balance	-152	-328	-187	-308	-362	-337	264	341	-462
Variation in reserve assets (- indicates an increase)	-356	-148	116	-93	-106	-75	-297	-610	102
<b>Percentages</b>									
External debt									
Gross debt (as a percentage of GDP) <sup>g</sup>	71.4	63.3	53.4	48.2	47.4	49.8	62.2	58.1	58.0
Net interest (as a percentage of exports) <sup>h</sup>	5.6	6.0	3.7	4.4	2.2	3.6	0.4	-1.4	-1.9

Table 1 (concluded)

	1990	1991	1992	1993	1994	1995	1996	1997	1998 <sup>a</sup>
<b>Percentages to GDP</b>									
Central government									
Current revenue	17.4	18.5	18.3	18.7	17.7	18.6	18.4	19.2	18.9
Current expenditure	18.0	21.0	19.6	18.2	18.4	17.9	20.1	19.6	23.3
Saving	-0.7	-2.5	-1.3	0.5	-0.7	0.7	-1.7	-0.4	-4.5
Capital expenditure	3.0	3.4	4.6	4.3	4.2	4.1	3.8	5.1	7.5
Financial balance	-0.2	2.5	0.4	2.5	1.4	2.5	0.7	1.3	-1.3
Domestic financing	-0.7	-2.5	-1.3	0.5	-0.7	0.7	-1.7	-0.4	-4.5
External financing	-2.1	1.6	2.8	1.1	2.2	0.7	0.2	...	...
<b>Annual rates</b>									
Real interest rates (annualized, %)									
Deposit rate	9.1	7.1	4.4	5.5	6.2	7.8	...	...	...
Lending rate	12.1	11.5	9.1	10.5	9.6	10.0	...	...	...

Source: ECLAC, on the basis of official figures.

<sup>a</sup> Preliminary figures. <sup>b</sup> Based on balboas at constant 1982 prices. <sup>c</sup> Based on constant 1995 dollars. <sup>d</sup> Percentages of the working-age population. <sup>e</sup> Percentages of the economically active population (EAP). <sup>f</sup> Includes errors and omissions. <sup>g</sup> Refers to the external debt contracted by the public sector; no adjustment has been made for currency fluctuations. <sup>h</sup> Refers to net interest as shown on the balance of payments, divided by exports of goods and services.

rates was also slightly downwards: in December, the rate for six-month deposits was 6.76%, which compared favourably with the London interbank offered rate (LIBOR) of 5.16% for six-month deposits.

The balance on loans granted locally by the domestic banking system was 18.5% higher than in 1997. Lending to commerce accounted for 35% of the total, having increased by 18.3%, mostly as a result of growth in domestic commercial activity. Mortgage lending was up 15.2%, strengthened by government programmes aimed at providing housing at preferential interest rates for medium- and low-income groups.

Consumer lending was up 40%, reflecting increased liquidity and employment, higher wages and lower interest rates. Credit-card lending and lending for motor-vehicle purchases grew appreciably (25% and 45%, in that order). Lastly, credit to industry rose by 11.6%, while lending to the agricultural sector remained stagnant.

### (c) Trade policy

In early 1998, Panama stepped up implementation of the trade liberalization policy it had adopted in mid-1997 in the context of the agreements relating to its admission to the World Trade Organization (WTO). Tariffs were cut across the board, as the ceiling was set at 15% and the floor rate at 0%; this entailed a consider-

able reduction of effective protection. Exceptions to this measure included tariffs on motor vehicle parts, which remained between 15% and 20%; rice, on which the levy was 49%, and milk, which had a 50% tariff. The number of steps in the tariff scale was cut from 198 to five, reducing the dispersion of tariffs.

Negotiations for free trade agreements with various countries also continued in 1998. Talks with Chile practically ended in August 1998 without having produced an agreement acceptable to both countries; in the talks with Mexico, the negotiating teams held several meetings.

### (d) Structural reform

In the second half of the year, electric power firms were partially privatized; 49% of shares in hydroelectric power companies and 51% of shares in thermal power companies were sold. In addition, 51% of shares in the three electric power distribution companies were sold. These sales produced total receipts for central government of US\$ 603 million. Following competitive bidding, concessions in two national gambling casino groups were granted to international operators; operation of the public registry system was awarded, and the Evergreen Group company Colon Port Terminal was granted concessions on quays 3 and 4 of Coco Solo port.

As part of the public-sector modernization process, the Ministry of Economic Affairs and Finance was created in 1998, bringing together into a single entity the Ministry of Finance and the Treasury and the Ministry of Planning and Economic Policy.

A major change took place in Panama's financial system with the entry into force of legislation providing

for reforms in the institutional framework of the banking sector and the creation of a Superintendency of Banks. A new prudential regulation regime was introduced to strengthen the authority of the Superintendency, ensure improved levels of liquidity and monitor the quality of assets and the risks in the system, in accordance with the Basle Capital Accord.

### 3. The main variables

The growth of Panama's economy in 1998 rested mainly on the domestic market. Consumption increased by 5.6%, with rises in both the public and private components (6.6% and 5.4%, in that order). Private consumption was influenced by factors such as rising employment, higher real wages and expanding consumer credit.

There was also a considerable increase in investment. Public investment rose substantially (51%), particularly for road works and for social infrastructure in the health sector. Private investment rose by 8%, with activity increasing in ports, road works and hotel infrastructure.

#### (a) Economic activity

Generally speaking, the rate of growth in production of goods and services slowed down. Performance was highly uneven at the sectoral level, with some sectors showing considerable vitality and others declining. Service activities slowed down, for example, in the Colón Free Zone, one of the largest components of the country's economy.

The number of ships passing through the Panama Canal in the 1997-1998 fiscal period was up 2.6%, and the average size of vessels and volume of cargo increased substantially. The income of the canal company rose even more (11.7%), as rates were raised and charges were instituted for deck cargo. Transport, storage and communications expanded by 6.6%, mostly because of a significant increase in port activity (24%). There was a rapid upswing in container cargo traffic in the ports of Colón and Manzanillo.

Telecommunications showed considerable growth, thanks to the introduction of new telephone and related services. The output of financial sector ac-

tivities rose by 8%, as banking services for the domestic market increased, as did also, to a lesser degree, those for the external market. Other financial-sector services showed significant growth as well, including insurance companies and other financial institutions.

Agricultural activity grew by 3.6%, although the output of the crop-growing sector contracted by 1.6%, owing to a number of adverse factors. Banana production, which usually contributes more than a quarter of the sectoral value added, fell by about 24%; this was partly due to a prolonged strike and partly to a cut in the export quota allotted to Panama by the European Union.

Other crops performed very well, however, despite having suffered from unfavourable weather conditions during the year. Production of basic grains, mostly rice and maize, was affected by a severe drought in the first half of 1998, but recovered later in the year, ending 1998 with growth figures of 35.3%, in the case of maize, and 40%, of rice. Although sugar-cane production was affected by the same problems, an expansion of 9.9% was achieved.

Livestock activities prospered in 1998, posting a growth rate of 6.9%. This was mainly due to expansion in poultry production (35.7%). Pig stocks were up 5%, but cattle breeding barely achieved 1.5% growth, following two years of contraction. Fisheries continued to expand strongly (13.6%), especially shrimp farming, the volume of which has multiplied in recent years thanks to the adoption of integrated production methods.

Manufacturing output increased by 3.1%, reflecting the positive and negative developments in various branches of industry that resulted from the substantial tariff cuts of early 1998. Food and beverage production was up (9.1%), thanks to significant increases in the slaughtering of beef cattle, pigs and poultry and in output of evaporated and condensed milk, carbonated

drinks, rum and beer. Production fell, however, in the following categories: textiles (-3.4%), clothing (-6.3%) and footwear (-9.8%), electrical machinery and equipment (-16.6%) and chemicals (-0.6%).

Electric power generation contracted by 9.4% as a result of the severe drought that affected the country in the first half of the year and reduced the level of water in the reservoirs. Consequently, electric power had to be rationed, inconveniencing large numbers of consumers. The situation began to return to normal towards the end of the year.

Construction grew by 5% in 1998, thanks to two factors: the building of medium- and high-income housing, boosted, in part, by government support programmes; and growth in public-sector investment, especially in sanitation, housing and roads.

#### **(b) Prices, wages and employment**

Consumer prices in Panama City rose at an average annual rate of only 0.6%, which was half the previous year's increase and was the lowest rate recorded in 10 years. This outcome was largely due to the tariff cuts of early 1998, the almost total lack of movement in food prices and the drop in international oil prices.

Food prices rose by only 0.4%, and in the transport and communications sector, prices fell by 1.6%. Prices were also below average for furniture, accessories, and home appliances and maintenance (0.3%). The only items showing above-average increases were medical services and health care (2.8%); recreation, entertainment and educational cultural services (2.5%), and rentals, fuel and electric power. Wholesale prices (-3.9%) reflected a downward trend in a number of categories on the international market.

Employment increased significantly, thanks to the vigorous growth of production and the investments made in productive infrastructure. Employment grew, on average, by 4.4%, and the average open unemployment rate fell to 12.6%, compared with 13.2% in 1997.

Wages rose significantly. Minimum wages had remained unchanged since November 1995; in July 1998, an across-the-board increase of eight centavos per hour was implemented. Real wages also rose in a number of sectors: in industry, by 5.2%; in miscellaneous services, by 5%, and in the public sector, by 3%. Increases were more moderate in other areas, such as the hotel industry (2%) and commerce (1.7%).

#### **(c) The external sector**

The balance-of-payments current account deficit rose steeply, from US\$ 592 million in 1997 to US\$ 1.24 billion in 1998. This was due to an increase in the merchandise trade deficit and a fall in the surplus generated by the Colón Free Zone. The 35% increase in the traditional surplus from trade in services did not compensate for the imbalance in goods and services. The capital and financial account yielded an income of US\$ 780 million; since this income was lower than the current account deficit, a fall in reserves resulted.

Overall exports were down by 4.8%. Re-exports from the Colón Free Zone fell by 4.9% (compared with a 14.3% rise in 1997), while domestic exports rose considerably (8.9%). This increase occurred despite a 22.9% fall in sales of bananas, the country's largest export product, owing to a prolonged strike. Most noteworthy among Panama's other exports was a remarkable surge in marine products. Cultivated shrimp exports were 41.7% higher than in 1997, moving up into second place among export sales. Fish oil and fish meal exports increased (by 41% and 46.7%, in that order), thanks to the opening up of new markets in Latin America and Asia; fresh fish exports grew by 53.8%. Other major exports were those of unroasted coffee, which rose by 6.7%, and of tropical fruits, which also grew substantially.

The overall value of imports was 4.4% higher than the previous year. Purchases for the domestic market rose sharply, while imports for the Colón Free Zone fell by 1.3%. The 11.7% increase in imports for the domestic market was largely brought about by an increase in economic activity and the tariff cuts implemented at the beginning of the year. Imports of food and beverages rose by 23.2%; vegetable oils and fats, by 54.5%, and miscellaneous vegetables, 34.8%. Among investment goods, imports of electrical machinery and equipment increased by 34.3% and those of transport equipment by 27.8%. The value of crude oil purchases was 29.6% down, as a result of a drop in international oil prices.

The surplus on the financial account was US\$ 800 million. Direct investment remained high (US\$ 1.2 billion) for the second consecutive year, mostly as a result of privatizations. Portfolio investments showed a net inflow of about US\$ 400 million, which contrasted with the net outflow of 1997, when large transactions were made with bank debt instruments. The "other investment" account posted a net outflow of US\$ 800 million.



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## Paraguay

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### 1. General trends

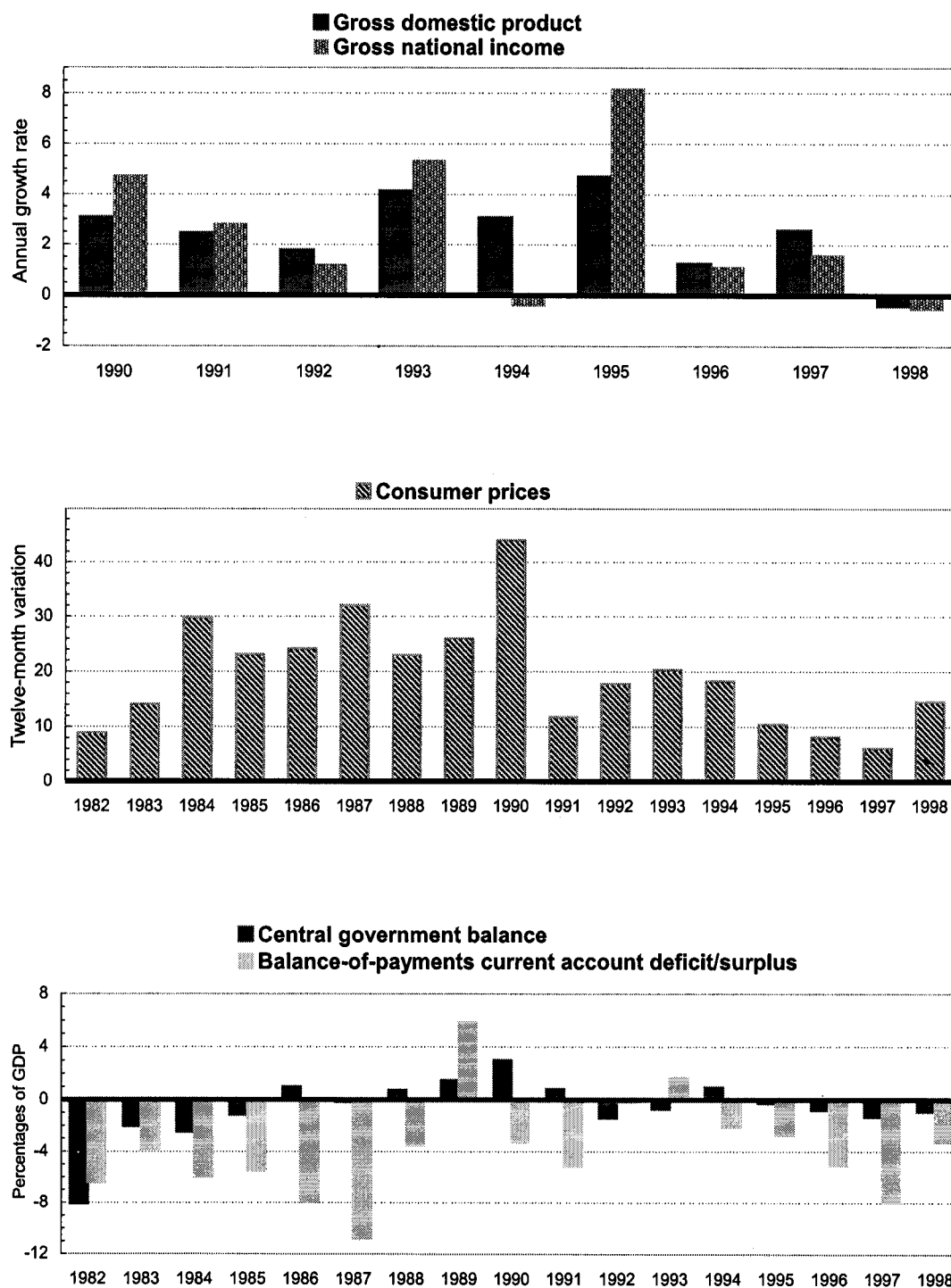
Per capita output declined in 1998 for the third year running, as the economy as a whole shrank (for the first time in 12 years) by 0.5 percentage points in the wake of weaker external demand and the ongoing financial crisis. The downturn in demand from Brazil (Paraguay's main trading partner) led to a decrease in both formal and informal trade, while the liquidation of several banks that were in difficulties as a result of the banking crisis had an adverse effect on commercial and financial activities. The same factors dampened the demand for money and drove up the demand for hard currency, which caused the guaraní to depreciate and thus fueled inflationary pressures.

**AS A RESULT**, the downward path of inflation over the past five years was reversed, and the rate shot back up to 15% —compared to 6% in 1997— due to higher prices for agricultural products and for imported goods, which became more expensive as a consequence of the 25% depreciation of the local currency. The guaraní depreciated despite intervention by the Central Bank, which, aided by a balanced fiscal sector, defended the currency mainly through a tight monetary policy that drove up nominal interest rates, albeit by less than inflation.

A combination of domestic and external factors have made growth prospects for 1999 less than encouraging. The situation in the Brazilian economy and tighter controls on border trade have already led to a

reduction in Paraguay's exports. International soybean and cotton prices are following the downward trend that was anticipated in view of the increase in world production, and national agricultural output is also expected to sag. The depreciation of the guaraní was moderated during the first quarter of 1999 by a larger volume of foreign currency sales by the Central Bank and, as a result, inflationary pressures eased; as of June 1999, prices had risen by just 0.8% since the beginning of the year (nearly 10 points less than in the same period in 1998), or by 4.4% over the previous 12 months. Price rises in 1999 are expected to be smaller than in 1998, since no increases are planned in either utility rates or the minimum wage.

Figure 1  
PARAGUAY: MAIN ECONOMIC INDICATORS



Source: ECLAC, on the basis of official figures.

## 2. Economic policy

Given the unfavourable domestic and external conditions that prevailed, the aim of economic policy in 1998 was to moderate the rise in the exchange rate so as to limit its inflationary impact and, in view of the scant availability of financing, to keep public accounts in balance.

Fulfilment of this goal ran up against several obstacles. The slowdown in both economic activity and external demand led to lower public revenues, which made fiscal consolidation difficult for the central government and resulted in a smaller public-sector surplus. Apart from this, the low level of Paraguay's international reserves limited the monetary authority's ability to intervene in the foreign exchange market. As a result, monetary policy had to be used to attenuate the demand for foreign exchange and contain the depreciation of the guaraní, an approach which the public viewed with suspicion because of the financial crisis and the pressures on the Brazilian real.

### (a) Fiscal policy

The central government's deficit narrowed slightly to just under 1% of GDP, mainly as a result of the spending cuts made in response to the decline in revenues. Equal proportions of domestic and external funds were used to cover the deficit.

Tax revenues were hurt by the slower pace of economic activity, which squeezed revenues not only from indirect taxation (which accounts for three quarters of all tax revenues) —especially value added tax and import duties— but also from direct taxes. A 10% increase in non-tax income, including revenues (amounting to 3% of GDP) from energy sales by the binational hydroelectric dam projects in which Paraguay participates and compensation for land flooded during their construction, was not enough to offset the drop in tax revenues. In late August, revenue-enhancing measures were taken that included selective tax hikes and the discontinuation of certain allowances.

The bulk of the adjustment burden fell on investment, while the Government strengthened its control over expenditures on goods and services via administrative improvements. In fact, investments were cut by 25%, while payroll expenses held steady.

The non-financial public sector ended the year with a small surplus thanks to savings made by State firms, local governments and decentralized agencies;

this compensated for increased capital expenditure by State firms facing higher prices for imported inputs.

Given the likelihood of continued sluggish economic activity, the budget for 1999 is based on expectations of an outturn similar to that of 1998. However, unlike last year, it is anticipated that the deficit will be financed by external funds in order to avoid the high cost of domestic borrowing.

### (b) Monetary and foreign exchange policy

Since 1995, in its struggle to bring inflation under control, the monetary authority had been grappling with expansionary pressures arising from bailout operations undertaken in response to the financial crisis and lending to the public sector, all of which had resulted in an expansion of domestic credit. These pressures eased in 1998, but in their place came other kinds of shocks deriving from reduced foreign-exchange inflows in the wake of the worsening external situation and the stronger demand for hard currencies generated not only by the pressures on the real (Brazil is Paraguay's main trading partner), but also by uncertainty in the domestic economy.

In August 1998, the Central Bank cut off practically all assistance to ailing banks. Seven banks and a variety of other financial institutions were liquidated during the year, bringing the total number of banks in which the Government has intervened since the onset of the crisis in 1995 to 13 (one third of the entire banking system). This halting of assistance was reflected in a smaller balance of Central Bank lending to the banking system. Currently there is only bank still being considered for intervention.

Net lending to the public sector was also contractionary, since this sector's deposits with the Central Bank increased as a result of accounting surpluses.

During the first and third quarters the monetary authority sold hard currency through money-desk operations in an attempt to stem the slide in the value of the guaraní. However, the Central Bank's ability to intervene was more limited than in the two previous years owing to the low level of international reserves held during the year, equivalent to about three months' worth of imports. As a result, the monetary authority had to rely on open-market operations, which it did by issuing larger amounts of treasury bills (known as "monetary regulation notes", or LRMs), —especially



Table 1  
PARAGUAY: MAIN ECONOMIC INDICATORS

	1990	1991	1992	1993	1994	1995	1996	1997	1998 <sup>a</sup>
<b>Growth rates <sup>b</sup></b>									
Growth and investment									
Gross domestic product	3.1	2.5	1.8	4.1	3.1	4.7	1.3	2.6	-0.4
Per capita gross domestic product	0.1	-0.4	-0.9	1.4	0.4	2.0	-1.4	-0.1	-3.0
Gross domestic product, by sector									
Goods	2.0	0.4	0.8	4.0	0.6	5.9	0.4	3.1	0.6
Basic services	7.6	6.8	6.0	8.1	11.7	9.1	4.4	3.7	2.2
Other services	3.6	4.1	2.2	3.5	4.1	2.5	1.5	1.8	-2.1
Consumption	12.5	3.7	7.2	5.3	8.5	8.1	2.4	3.1	-4.2
Government	3.2	20.0	7.8	5.3	3.9	12.1	10.0	2.0	0.7
Private	13.5	2.1	7.2	5.3	9.1	7.6	1.6	3.2	-4.9
Gross domestic investment	9.2	8.6	-6.5	2.3	4.5	7.1	-0.1	-2.0	-4.7
Exports of goods and services	19.6	7.4	-4.1	39.6	14.5	8.7	-11.6	-5.9	-7.0
Imports of goods and services	66.7	14.5	4.1	31.6	23.4	14.4	-6.1	-4.0	-13.8
<b>Percentages of GDP <sup>c</sup></b>									
Gross domestic investment	23.7	25.1	23.2	23.1	23.4	23.9	23.7	22.7	21.7
National savings	19.7	19.2	14.6	15.2	7.4	8.0	7.1	5.9	9.4
External savings	4.0	5.9	8.6	7.9	16.0	15.9	16.6	16.8	12.3
<b>Percentages</b>									
Employment and wages									
Labour force participation rate <sup>d</sup>	61.0	59.4	...	...	59.1	64.8	63.0	61.9	60.6
Unemployment rate <sup>e</sup>	6.6	5.1	5.3	5.1	4.4	5.3	8.2	6.9	7.2
Real average wage (index: 1995=100)	87.7	91.8	90.9	91.7	93.0	100.0	103.1	102.6	100.7
<b>Growth rates</b>									
Prices (December-December)									
Consumer prices	44.1	11.8	17.8	20.3	18.3	10.5	8.2	6.2	14.6
Wholesale prices	67.2	12.4	...	14.8	15.1	13.9	7.1	1.1	18.1
External sector									
Terms of trade (index: 1995=100) <sup>c</sup>	86.6	86.7	79.4	87.2	105.1	100.0	110.5	118.1	112.6
Nominal exchange rate (guaraníes per dollars)	1 230	1 325	1 500	1 744	1 912	1 971	2 063	2 191	2 756
Real effective exchange rate for imports (index: 1995 = 100)	106.2	96.5	102.0	106.4	100.5	100.0	95.7	94.0	104.7
<b>Millions of dollars</b>									
Balance of payments									
Current account	-172	-324	-11	118	-166	-246	-487	-761	-276
Trade balance (goods and services)	-214	-390	-43	-16	-305	-395	-644	-856	-379
Exports	1 880	2 024	2 411	3 321	3 807	4 756	4 340	3 911	3 559
Imports	2 093	2 415	2 455	3 337	4 112	5 151	4 984	4 767	3 938
Capital and financial account <sup>f</sup>	287	687	-30	-34	510	328	423	566	324
Overall balance	114	363	-41	84	344	82	-64	-195	48
Variation in reserve assets (- indicates an increase)	-219	-299	364	-87	-346	-62	44	216	-29
<b>Percentages</b>									
External debt									
Gross debt (as a percentage of GDP)	32.2	26.7	19.8	18.2	16.2	16.0	14.9	15.4	19.3
Net interest (as a percentage of exports) <sup>g</sup>	1.4	1.4	3.0	-0.1	-0.1	0.0	-0.3	0.4	0.7

Table 1 (conclude)

	1990	1991	1992	1993	1994	1995	1996	1997	1998 <sup>a</sup>
<b>Percentages of GDP</b>									
Central government									
Current revenue	7.9	11.4	12.4	11.8	12.6	12.3	14.5	15.3	14.8
Current expenditure	5.9	8.9	7.8	8.5	11.5	11.1	11.4	11.7	12.4
Saving	2.0	2.5	4.6	3.3	1.1	1.1	3.1	3.7	2.5
Net capital expenditure	1.3	1.0	1.6	2.5	2.4	1.8	2.1	4.0	3.3
Financial balance	0.7	1.5	3.0	0.8	-1.4	-0.7	1.0	-0.3	-0.8
<b>Growth rates</b>									
Money and credit									
Monetary balances of banking system									
Net international reserves	...	46.3	-11.4	28.3	41.3	-0.4	12.6	-19.8	39.7
Net domestic credit	...	107.5	532.4	19.6	8.2	58.1	37.5	50.5	-8.3
To public sector	...	...	...	-2.2	-82.9	...	...	...	-82.0
To private sector	...	59.6	39.2	35.7	36.7	18.3	22.8	12.3	-2.8
Money (M1)	27.7	27.5	30.5	17.7	32.4	21.1	2.0	13.9	7.4
Local currency savings and time deposits	-9.4	99.1	-3.9	4.1	59.3	22.2	39.4	1.1	-13.6
M2	20.0	48.1	23.4	9.7	38.4	28.3	15.4	7.2	-2.8
Dollar deposits	63.1	56.0	66.5	53.0	15.3	3.0	39.5	25.8	26.1
<b>Annual rates</b>									
Real interest rates (annualized, %) <sup>h</sup>									
Deposits rate	13.4	23.9	16.7	3.2	5.3	11.5	9.8	6.8	6.4
Lending rate	30.0	35.6	28.2	11.9	15.2	21.1	22.2	19.4	17.1
Equivalent interest rate in foreign currency <sup>i</sup>	-18.3	-9.1	5.0	9.1	17.9	19.8	11.0	4.0	...

Source: ECLAC, on the basis of official figures.

<sup>a</sup> Preliminary figures.

<sup>b</sup> Based on constant 1990 dollars.

<sup>c</sup> These entries measure the impact of the variation in each aggregate on GDP growth. The coefficients were obtained by multiplying each aggregate's annual growth rate by the level of the same aggregate as a percentage of GDP.

<sup>d</sup> Percentages of the working-age population in Asunción. From 1994, rate for urban areas nationwide.

<sup>e</sup> Percentages of the economically active population (EAP). Up to 1993, this figure refers to the Asunción metropolitan area, and from 1994 it refers to the rate for urban areas nationwide.

<sup>f</sup> Includes errors and omissions.

<sup>g</sup> Refers to net interest as shown on the balance of payments, divided by exports of goods and services.

<sup>h</sup> Figures for 1990-1992 are December-December rates; figures for 1993-1994 are annual averages.

<sup>i</sup> Interest rate on deposits, deflated by the variation in the exchange rate.

during the second half of the year—at an average yield of more than double the 1997 rate. The outcome of these measures was: (i) a rise in interest rates, with average nominal annual lending rates rising from 28% in 1997 to 30% in 1998, and rates on deposits moving up from 14% to 18%; (ii) a depreciation of the local currency amounting to 25% in nominal terms and 9% in real terms to December 1998; and (iii) an international reserve balance equal to US\$ 890 million at year's end, which was only slightly higher than 12 months earlier.

As a result of all this, the growth rate of the stock of currency in circulation dipped to 12%, after having stood at 17% the year before. This, in combination with

the sluggishness of sight deposits, slowed the growth of M1 to 7% in 1998, down from 14% the year before. The reduced demand for local currency was reflected in a decrease in term deposits, which investors shunned because they lacked confidence in the guaraní, since real local-currency yields had slipped from 8% to 3% due to inflation and the banking crisis. As a result, local-currency liquidity (M2) contracted, while dollar deposits grew substantially. These deposits amounted to more than 3 billion guaraníes and thus came close to matching the 3.3 billion guaraníes in local-currency liquidity, thereby accentuating the dollarization of the economy.

Table 2  
PARAGUAY: MAIN QUARTERLY INDICATORS

	1996				1997				1998 <sup>a</sup>				1999 <sup>a</sup>
	I	II	III	IV	I	II	III	IV	I	II	III	IV	I
Consumer prices (12-month variation, %)	11.1	9.6	9.8	8.1	8.6	7.9	5.9	6.2	6.6	10.8	14.9	14.6	9.4
Registered exports (millions of dollars)	214	346	278	206	207	430	359	146	208	430	359	146	158
Registered imports (millions of dollars)	607	590	728	926	726	702	895	802	611	622	587	558	399
Real effective exchange rate <sup>b</sup> (index: 1995=100)	95.4	94.9	95.9	96.4	93.6	92.5	93.6	96.3	103.4	106.1	104.7	104.6	96.8
Real interest rates (annualized, %)													
Deposit rate	-0.9	14.1	12.1	14.0	7.3	7.2	5.2	7.6	7.9	8.1	5.1	4.5	10.1
Lending rate	9.5	25.8	26.1	27.4	19.3	18.8	20.5	19.1	17.1	18.6	15.4	13.8	17.8

Source: ECLAC, on the basis of official figures.

<sup>a</sup> Preliminary figures. <sup>b</sup> Refers to the exchange rate for imports.

### 3. The main variables

#### (a) Economic activity

For the first time in this decade output declined slightly as a result of the downturn in external and, to a lesser extent, domestic demand. This setback was somewhat less severe than it would otherwise have been thanks to the lower level of imports. The main reason for the fall in demand for nationally made products was a decrease, for the third year running, in purchases by Brazil. Private consumption fell, and government consumption was cut back in line with spending targets. Private investors cancelled many of their projects in view of the fragile economic prospects engendered by the external situation and because of difficulties in obtaining credit from the weakened banking system. The burden of the adjustment in the public sector was also mainly absorbed by capital expenditure and, as a result, total investment was cut back by about 5%. Imports fell sharply (14%) in the wake of lower investment and the rising exchange rate. Per capita output slipped by three percentage points, and national income was 0.5% lower as a result of worsening terms of trade and the fall in output.

The agricultural sector managed to maintain output at the levels reached in 1997, which had been a bumper year. This was achieved by expanding the areas with the main crops (cotton and soybeans), since yields were actually lower as a result of excess rainfall during the planting season followed by periods of drought. All of this was compounded by pest outbreaks. Weather conditions also hurt the livestock industry, where output fell for the first time in the 1990s. The agro-based industrial sector grew by only slightly more than agricultural products themselves (1%), and the remainder of goods production grew equally slowly; as a result, the sector as a whole also expanded by just 1%.

Total services production slipped by more than 1% owing to a sharp decline (4%) in the commerce and financial sector, which accounts for one quarter of GDP. This sector suffered from the impact of the banking crisis and the shrinkage of re-export trade—an item of considerable importance in the structure of Paraguay's economy. Basic services also ended the year on a mediocre note, with growth falling back once again, partly as a consequence of a smaller increase in electricity generation and a reduction in the supply of drinking water and sanitation services.

### (b) Prices and wages

In 1998 the downward trend of inflation observed over the last three years was reversed (1997 had seen the lowest rate in the last two decades). The consumer price index (CPI) rose by 14.6% during the year owing to a combination of external and domestic factors. The 25% depreciation of the guaraní raised the prices of imported products, which account for a considerable part of the consumer shopping basket. In addition, adverse weather conditions pushed up the prices of certain foodstuffs, especially meat and dairy products, while other domestic factors leading to higher prices included increases in charges for public services such as electricity, drinking water, education and transport, and higher taxes on luxury goods.

As a result, the prices of food products in general, which have a strong influence on the CPI, rose in line with the global index (14.6%), compared to an increase of 4% in 1997. The prices of non-tradables (housing, health care, transport and education) went up by between 12% and 21% with respect to the previous year owing to the rate hikes mentioned above. Producer prices rose by even more than the CPI, mainly as a result of the price increases for domestic and imported food products, which were steeper at this stage of the process than at the retail stage. This underscores the importance of supply-side factors in the resurgence of inflation.

The average wage went up by 10% in nominal terms, which implied a loss of purchasing power of nearly 2%. Average wages for workers employed in basic services rose the most, although by less than inflation, followed by wages in construction, manufacturing and commerce. Wages in the services and transport sector posted the smallest nominal increases, of just 8% and 5%, respectively. Open urban unemployment edged up slightly, from 6.9% in 1997 to 7.2% in 1998, with the services sector (which accounts for the bulk of the labour force) being the worst hit because of the effects of the banking crisis on this segment since 1995. The degree of informality in the labour market has increased in recent years, as reflected in lower activity rates and a rise in hidden unemployment—that is, people who have stopped looking for work because of the scant prospect of finding it. If this last group of persons were included, the equivalent rate of unemployment would stand at 15%, according to official estimates.

### (c) The external sector

The current account deficit narrowed from its quite high 1997 level of over 7% of GDP to 3% in 1998. This

deficit was financed with capital flows entering the country, for the most part as foreign direct investment, and in fact the overall balance of payments achieved a small surplus. This, in turn, translated into a slight rise in international reserves.

The narrowing of the current account deficit was attributable to the reduction of the trade deficit by more than half. During the two-year period 1996-1997, the trade deficit had widened to US\$ 760 million; this was the net result of a slight reduction in total imports, whose effect was partly offset by an increase in registered imports, and a more substantial fall in exports due to a reduction in border trade. In 1998, the decline in imports intensified and was reflected in the level of registered imports as well, while exports were also lower but by a smaller amount. The outcome of all this was that Paraguay's total merchandise trade fell to its lowest level of the last five years, thereby strengthening the trend displayed by both exports and imports since 1996.

The total value of exports fell by 9.5% as a result of a 12% decrease in the value of registered exports, which accounted for one third of the total, and an 8% drop in re-exports and other unregistered exports (two thirds of total value exported). In the registered segment of export trade, soybean sales (the leading export since 1996) were down by 11% in value terms due to sagging prices on the international market. The value of cotton exports was also lower as a consequence of weaker external prices. The countries of the Southern Common Market (Mercosur) continued to absorb the bulk of Paraguay's exports (52% of the registered total). However, registered exports to Brazil (which accounts for two thirds of total demand generated by Mercosur) fell by 25%, and the 50% upswing in purchases by Argentina was not enough to compensate for this. Sales to the rest of the world also fell back (14%). The remaining export items, mostly re-exports, have been trending downward over the past three years due to slack demand from Brazil.

Total imports declined by one fifth owing to a 23% fall in the registered imports category, which accounts for 70% of the total. The lower level of economic activity, including border trade, and the depreciation of the currency translated into a generalized retrenchment in merchandise imports, especially in the cases of capital goods and consumer durables. Unregistered imports have also followed the downward path of re-exports.

The services account showed a slight deficit as the transport sector was hurt by the downturn in re-exports. Capital inflows fell sharply in 1998; in fact, foreign direct investment, destined mostly for the agricultural

and financial sectors, has declined during each of the last two years owing to the country's fragile financial situation.

The total external debt grew by 11% in 1998 to the equivalent of 18% of GDP, after having been quite stable over the three previous years. Nearly all of the debt corresponds to the public sector, with 70% held by cen-

tral government and 27% by State firms. The main creditors were international agencies, particularly the Inter-American Development Bank (IDB); the rest were bilateral creditors belonging to the Paris Club. Most debt disbursements in 1998 (85%) were for terms of over 15 years and at fixed interest rates, mainly below 3%.

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## Peru

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### 1. Recent trends

After having grown by 7.2% in 1997, the Peruvian economy expanded by just 0.7% in 1998. This poor result was due to the havoc wreaked on fishing and agriculture by El Niño and a fall in metal prices resulting from the Asian crisis. Although factors were more or less expected at the beginning of the year, their effect was compounded by the unilateral debt moratorium declared by Russia, which led to reduced capital flows to emerging countries, and the Brazilian crisis, which pushed up the perceived risk level of the region as a whole. On the external front, the Government faced this situation by combining devaluation and the shedding of international reserves; even so, the current account deficit on the balance of payments widened to 6% of GDP.

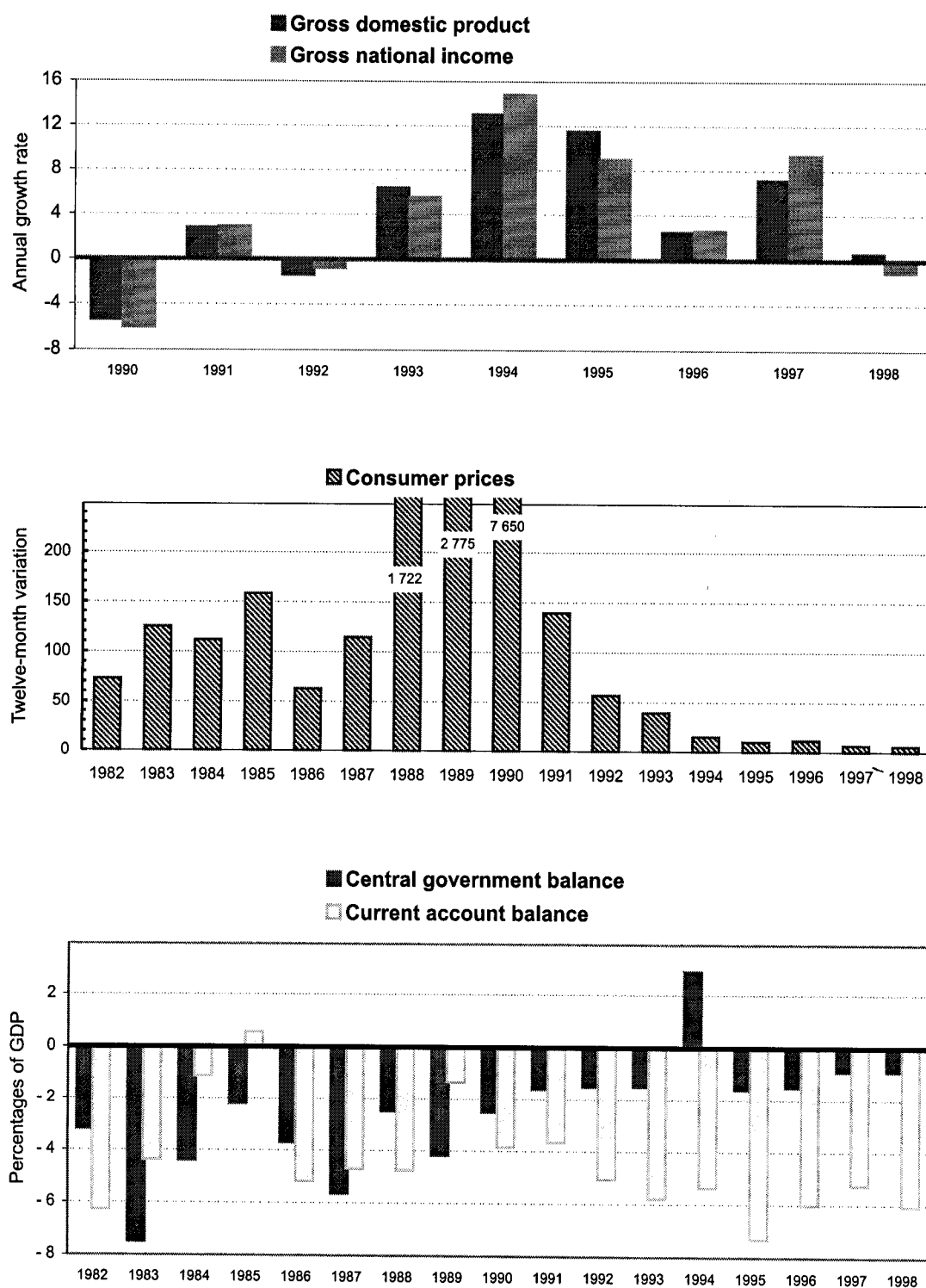
**A** RESTRICTIVE macroeconomic policy was maintained during 1998. In response to the reduction in fiscal revenues caused by the phenomena described above, central government made spending cuts, especially in reconstruction work on infrastructure destroyed by the ravages of the weather, so as to avoid a further widening of the fiscal deficit. Monetary policy was also kept tight, and the reduced flow of short-term capital from abroad that resulted from the international financial crisis caused serious liquidity problems towards the end of the year.

On the whole, 1998 was an important year for investment projects. Although negotiations between Shell and the Peruvian Government concerning exploitation of the Camisea gasfield broke down, the Atamina

mining project—involving an estimated investment of US\$ 2.2 billion and operated by a Canadian consortium—went on stream. Other mega-projects in the mining sector, especially those related to copper, seem to be awaiting an upswing in international prices.

Growth prospects for 1999 remain pessimistic. Although the fiscal budget is predicated upon a growth of 5.5% for the year, most analysts estimate that it will be between 2.5% and 3%. The fisheries and agricultural sectors are expected to improve once the weather returns to normal, and the mining sector should continue to expand despite depressed international prices. Thus, production should pick up slowly from the second half of the year onward.

Figure 1  
PERU: MAIN ECONOMIC INDICATORS



Source: ECLAC, on the basis of official figures.

## 2. Economic policy

### (a) Fiscal policy

In 1998, the primary balance of the non-financial public sector (NFPS) posted a surplus equivalent to 1.2% of GDP, compared to 1.7% the year before. When interest payments on the public debt are factored in, the result is a deficit of 0.6% of GDP, as against the equilibrium achieved in 1997. This slight deterioration in fiscal accounts during a year of deep productive retrenchment was the outcome of a fall in revenues that was partly offset by expenditure cuts. Central government's current revenues fell from 14.1% to 13.8% of GDP, while the primary surplus among public-sector enterprises dropped back from 0.7% of GDP to 0.1%. This slippage was caused by two factors: firstly, the economic slowdown that showed through in smaller revenues from income tax and the selective consumption tax, and secondly, and linked to this, the persistent pressure from business associations for relief from the tax burden that was hampering their competitiveness in the productive sector. Consequently, the Administration lowered the national housing fund tax (FONAVI) from 7% to 5%, and later replaced it with the Special Solidarity Tax at a 5% rate.

In response to the revenue shortfall, the Administration trimmed its total spending from 13.4% to 13.2% of GDP. Whereas current expenditure rose by 0.2% of GDP, owing to an increase in outlays for wages and for the purchase of goods and services, investment expenditure was reduced by 0.3 point. As from the second half of the year, expenditures on infrastructure and disaster prevention were cut back, as were FONAVI-related expenses, once the corresponding tax had been reduced.

### (b) Monetary and foreign exchange policy

Total liquidity in the financial system (in both local and foreign currency) was 12.6% higher in 1998 than in 1997. The aggregate figure conceals the uneven performance of the different monetary aggregates throughout the year and between currencies. The liquidity of the financial system in soles tightened considerably in August (-4.1%) and September (-4.3%) and recovered in the third quarter to post a growth rate of 7.2% for 1998 as a whole. Liquidity in foreign currency, measured in dollars, was virtually unchanged, although it too became tighter in August and Septem-

ber. As the rate of devaluation was greater than the increase in liquidity in soles, the economy's dollarization coefficient (percentage of total liquidity held in foreign currency) edged up from 60% in December 1997 to 62% a year later.

The trend of liquidity in local currency was partly a reflection of primary money creation, which fluctuated considerably during the course of the year. This indicator fell back in August and September by 6.4% and 3.8%, in that order, just when the Russian moratorium was affecting external short-term borrowing by medium-sized banks. These factors played a part in triggering a liquidity crisis in the banking system and consequent interest rate hikes at the end of the year. To correct these problems, primary money creation was boosted by 12.8% in December.

The sources of primary money creation were significantly different from those of the previous year: in 1997, the main source had been foreign, and the Central Reserve Bank of Peru had had to issue securities in order to sterilize the excess money supply. In 1998, on the other hand, money creation from external sources was negative, especially from May on, and the Bank was forced to pump extra liquidity into the economy. This seems to have been insufficient in the new international context, as a liquidity crisis erupted in the fourth quarter.

The other measure used by the Administration in the final quarter to solve the liquidity problem was to lower the reserve requirement on foreign currency deposits, which had been held at 45% since the present Administration took office. However, the reduction was only modest, since it was feared that a deeper cut in the rate might trigger a loss of reserves, given the backdrop of limited external capital flows. Accordingly, the reserve requirement rate was lowered to 38.3% in December 1998.

In 1998, total credit in the financial system expanded by 23% in nominal terms. This was due to the high degree of dollarization in lending (76% of all loans from the financial system were in dollars at the end of 1998) and to the acceleration of devaluation late in the year. Foreign-currency denominated lending grew by 10.7%, and lending in new soles, by 8.5%. Local currency lending by the banking system declined from May to October and picked up in November and December. The outturn for the year as whole was marginally positive (0.4%).



Table 1  
PERU: MAIN ECONOMIC INDICATORS

	1990	1991	1992	1993	1994	1995	1996	1997	1998 <sup>a</sup>
<b>Annual growth rates <sup>b</sup></b>									
Growth and investment									
Gross domestic product	-5.4	2.8	-1.4	6.4	13.1	7.3	2.4	6.9	0.3
Per capita gross domestic product	-7.2	0.9	-3.1	4.6	11.1	5.5	0.7	5.0	-1.5
Gross domestic product by sector									
Goods	-5.6	3.7	-2.7	8.0	16.1	12.8	2.1	7.6	0.5
Basic services	-4.4	2.4	2.1	6.5	7.5	12.5	3.2	6.3	2.1
Other services	-5.2	2.8	-2.2	4.0	11.0	13.2	3.0	6.7	0.6
Consumption	-3.3	1.9	1.9	4.4	9.8	9.7	1.8	3.9	-0.1
Government	-9.5	1.9	2.9	3.1	8.6	9.9	6.7	7.8	1.8
Private	-2.4	1.9	1.8	4.5	9.9	9.6	1.1	3.4	-0.4
Gross domestic investment	14.6	11.3	-1.1	11.0	28.1	17.9	-4.9	12.1	-2.0
Exports of goods and services	-14.9	11.5	0.8	3.6	18.7	6.5	10.7	13.0	3.4
Imports of goods and services	11.9	20.1	13.7	1.3	23.9	24.8	0.6	10.2	0.2
<b>Percentages of GDP <sup>c</sup></b>									
Gross national income	96.0	96.3	96.5	96.3	97.3	97.7	98.0	98.7	97.6
Gross domestic investment	18.8	20.4	20.3	21.4	24.1	26.2	24.3	25.1	24.6
National savings	15.5	16.7	15.3	16.0	18.8	18.9	18.4	19.8	18.4
External savings	3.3	3.7	5.1	5.3	5.3	7.3	5.9	5.3	6.2
<b>Percentages</b>									
Employment and wages									
Labour force participation rate <sup>d</sup>	61.3	57.2	58.8	60.8	59.7	62.4	60.3	63.3	...
Open unemployment rate <sup>e</sup>	8.3	5.9	9.4	9.9	8.8	8.2	8.0	9.2	8.4
Real average wage (index: 1995=100) <sup>f</sup>	85.7	98.7	95.2	94.4	109.2	100.0	95.2	94.5	92.7
<b>Growth rates</b>									
Prices (December-December)									
Consumer prices	7 650	139	56.7	39.5	15.4	10.2	11.8	6.5	6.0
Wholesale prices	6 534	96	50.5	34.1	10.5	8.8	11.4	5.0	6.5
External sector									
Terms of trade (index: 1995=100) <sup>g</sup>	92.5	86.8	95.0	89.1	95.7	100.0	96.5	103.2	89.7
Nominal exchange rate (New soles per dollar)	0.19	0.77	1.25	1.99	2.20	2.25	2.45	2.66	2.93
Real effective exchange rate for imports (index: 1995=100)	114.0	94.8	94.7	106.2	100.2	100.0	98.6	99.1	100.5
<b>Millions of dollars</b>									
Balance of payments									
Current account	-1 384	-1 558	-2 116	-2 327	-2 667	-4 303	-3 626	-3 408	-3 789
Trade balance (goods and services)	33	-602	-916	-1 181	-1 499	-2 943	-2 673	-2 486	-3 000
Exports	4 120	4 232	4 497	4 353	5 662	6 722	7 312	8 354	7 531
Imports	4 086	4 834	5 413	5 535	7 161	9 665	9 985	10 840	10 531
Capital and financial account <sup>g</sup>	-1 071	161	818	895	3 494	2 996	4 122	4 101	1 691
Overall balance	-2 455	-1 397	-1 299	-1 432	827	-1 307	496	693	-2 098
Variation in reserve assets (- indicates an increase)	-212	-899	-554	-667	-3 068	-915	-1 882	-1 628	950
<b>Percentages</b>									
External debt									
Gross debt (as a percentage of GDP)	55.3	48.8	51.1	68.3	61.2	56.9	55.9	44.1	48.0
Net interest (as a percentage of exports) <sup>h</sup>	41.7	31.5	32.7	34.1	28.4	24.4	16.7	10.8	13.4

Table 1 (concluded)

	1990	1991	1992	1993	1994	1995	1996	1997	1998 <sup>a</sup>
<b>Percentages of GDP</b>									
Central government									
Current revenue	7.8	9.1	11.0	10.8	13.0	13.6	14.2	14.1	13.8
Current expenditure	9.1	9.2	10.0	9.8	11.1	13.2	12.7	11.7	12.0
Saving	-1.3	-0.1	1.0	1.0	1.9	0.4	1.5	2.2	1.8
Capital expenditure (net)	1.2	1.5	2.5	2.5	-1.1	2.1	3.0	3.1	2.7
Financial balance	-2.5	-1.6	-1.5	-1.5	2.9	-1.6	-1.5	-0.9	-0.9
Non-financial public sector									
Financial balance	-4.5	-1.5	-1.4	-1.2	3.0	-1.3	-1.0	0.0	-0.6
Domestic financing	2.0	-0.7	0.5	-0.3	-4.2	-1.0	0.3	0.6	0.3
External financing	2.5	2.2	0.9	1.5	1.1	2.3	0.7	-0.5	0.3
<b>Millions of new soles</b>									
Money and credit									
Monetary balances of banking system									
Net international reserves	352	1 856	3 953	6 255	13 109	15 461	23 040	21 710	22 408
Net domestic credit	742	1 976	3 080	5 699	4 532	7 562	8 726	15 713	18 842
To non-financial public sector	171	- 32	- 391	- 844	-5 754	-7 825	-14 709	-16 535	-18 358
To private sector	642	2 471	4 852	8 444	13 934	19 834	29 314	38 639	47 014
Money (M1)	421	945	1 620	2 399	3 792	4 678	5 523	6 590	6 177
Local currency savings and time deposits	160	591	845	1 297	2 545	3 785	4 793	6 365	6 575
M2	581	1 536	2 465	3 696	6 337	8 463	10 316	12 955	12 752
Dollar deposits	514	2 295	4 568	8 258	11 304	14 231	21 060	24 119	28 399
<b>Annual rates</b>									
Real interest rates (annualized, %)									
Deposit rate	-54.3	13.7	-20.9	-16.9	-4.6	-0.5	-1.4	1.6	3.4
Lending rate	-13.0	248.2	58.5	38.7	34.5	23.5	17.8	20.5	23.6
Equivalent interest rate in foreign currency <sup>i</sup>	-33.8	83.0	12.7	-12.8	11.4	0.9	-1.2	5.6	-3.9

Source: ECLAC, on the basis of official figures.

Note: The growth rates given for 1990 under the heading "Money and credit" have been revised since the publication of the *Economic Survey of Latin America and the Caribbean, 1994-1995*.

<sup>a</sup> Preliminary figures.

<sup>b</sup> Based on new soles at constant 1979 prices.

<sup>c</sup> Based on constant 1995 dollars.

<sup>d</sup> Percentages of the working-age population.

<sup>e</sup> Percentage of the economically active population (EAP). Lima Metropolitan Area.

<sup>f</sup> Private-sector manual workers in Lima.

<sup>g</sup> Includes errors and omissions.

<sup>h</sup> Refers to net interest as shown on the balance of payments, divided by exports of goods and services.

<sup>i</sup> Interest rate on deposits, deflated by the variation in the exchange rate.

Interest rates were relatively stable during the first half of the year, and rates on foreign-currency operations actually fell. Late in the year, however, as a result of the liquidity crisis, local-currency lending rates jumped from 30.7% in September to 36.5% in December. Interest rates on foreign-currency loans behaved in a similar way, rising late in the year as a result of a sharp outflow of short-term capital in the fourth quarter (US\$ 1 billion).

The downswing in production, together with slackening domestic demand and the faster pace of devaluation in a highly dollarized market, had a negative

effect on the financial system. The fraction of total credit accounted for by non-performing loans and those subject to legal collection proceedings first rose in May (to 6.4%), as a result of the crisis in fisheries and agriculture caused by El Niño.

About halfway through the year, just when a general recovery was expected as a result of revival in the sectors worst hit by the abnormal weather pattern, the Russian crisis led to a reshuffling of loan portfolios by the main European banks, as well as more stringent constraints on lending to other emerging markets, including the Latin American ones. This made it very

Table 2  
PERU: MAIN QUARTERLY INDICATORS

	1996				1997				1998 <sup>a</sup>				1999 <sup>a</sup>
	I	II	III	IV	I	II	III	IV	I	II	III	IV	I
Gross domestic product (change from same quarter of preceding year) <sup>b</sup>	0.3	2.5	2.1	4.9	5.7	9.0	7.2	6.6	2.7	-2.5	3.1	-0.1	1.0
Consumer prices (12-month variation, %)	11.6	11.0	11.7	11.8	9.3	9.5	8.1	6.5	8.2	8.7	6.6	6.0	3.4
Real effective exchange rate <sup>c</sup> (index: 1995=100)	97.3	97.1	98.4	101.5	100.9	100.5	97.5	97.6	97.2	98.2	100.6	106.1	112.4
Exports (Millions of dollars)	1 427	1 459	1 495	1 518	1 602	1 852	1 770	1 571	1 192	1 336	1 553	1 640	1 395
Imports (Millions of dollars)	1 791	2 008	2 039	2 056	1 930	2 133	2 281	2 217	2 074	2 158	2 042	1 927	1 540
Real interest rates (annualized, %)													
Deposit rate	-6.8	1.4	-0.5	0.1	0.5	1.3	1.9	2.8	2.0	1.9	3.7	6.1	8.4
Lending rate	12.7	20.9	18.0	18.9	20.5	20.4	20.6	21.8	21.4	21.6	22.8	28.6	30.7
Money (M1) (change from same quarter of preceding year)					24.2	19.8	22.0	19.3	15.8	14.4	0.4	-6.3	-7.2
Central government economic result (as a percentage of GDP)	-0.9	0.1	-1.0	-3.5	0.6	1.8	-1.3	-4.4	0.4	0.7	-0.4	-4.2	-1.3
International reserves (millions of dollars)	6 819	7 207	8 482	8 862	8 576	8 605	8 438	7 982	7 836	7 633	7 108	7 114	6 965

Source: ECLAC, on the basis of official figures.

<sup>a</sup> Preliminary figures.

<sup>b</sup> Based on original figures expressed in the local currency at constant prices.

<sup>c</sup> Refers to exchange rate for imports.

difficult for local banks to roll over their foreign credit lines, which had been growing at an average of US\$ 120 million per month during the first half of the year. The credit crunch raised expectations of devaluation and encouraged the banks to take foreign currency positions.

As a result of this situation, the non-performing portfolio of the banking system grew by 53% in 1998. On 24 November, the Superintendency of Banks and Insurance Companies intervened in the Banco República (which was holding 1.3% of total deposits), owing to liquidity problems in meeting the reserve requirement and its excessively concentrated loan portfolio. In December, the Banco Latino (holder of 4% of

total deposits) was placed under a special "surveillance regime". The Development Finance Corporation (COFIDE) became this bank's main shareholder when it capitalized US\$ 60 million in amounts owed.

During the year, the new sol depreciated by about 15%, way above the 5% figure for 1997, and the pace of devaluation quickened from June onwards. The Central Bank continued with its strategy of intervening only to avoid abrupt movements in the exchange rate, thereby making it possible to achieve part of the external sector adjustment through steeper devaluation. Given that the higher rate of devaluation coincided with a downswing in domestic demand and a fall in fuel prices in the second half of the year, the inflationary impact was

limited, and in fact, inflation was negative in September and October.

As regards the financial bourses, the general index of the Lima stock exchange fell by 25% between December 1997 and December 1998. Following the negative impact of the Asian crisis in the second half of 1997, the stock market had begun a slow recovery around March 1998, but the Russian crisis in August and the Brazilian crisis late in the year led to the aforementioned negative outcome.

### (c) Structural reforms

The privatization process has lost momentum in recent years. In 1998, revenues from privatization fell to US\$ 50 million, compared with US\$ 145 million the year before. Privatizations taking place in 1998 included those of the land tracts linked to the Chavimochic irrigation project, some plots in the

Majes project, and a certain quantity of State-held shares in electric power companies.

Although several mega-projects were postponed during the year, others proceeded as planned, including the Antamina mining project, which involves an investment of more than US\$ 2.3 billion over a three-year period. Another large-scale investment in the mining sector is being undertaken by the Doe Run Resources Company, which acquired the operational unit of Empresa Minera Cobriza, for which it bid over US\$ 7 million.

Infrastructure concessions awarded by the State in 1998 included the Mantaro-Socabaya electric power line, which was awarded for a three-year period, and a cellular phone waveband for provinces outside Lima, for a 20-year term. For 1999, the Government has announced further concessions covering a number of ports, airports in different parts of the country and the national road system.

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## 3. The main variables

Due to bad weather conditions and the upheavals on international financial markets, growth in the Peruvian economy was a very meagre 0.3%, while annual inflation amounted to just 6%, the lowest level of the 1990s. Natural disasters held exports back in the first half of the year, and this resulted in a balance-of-payments current account result for the year of US\$ 3.8 billion, equivalent to 6% of GDP.

### (a) Economic activity

Domestic demand shrank by 0.1% in 1998, declining especially in the second half of the year, when it was down by 7% with respect to the same period in 1997. The adjustment of demand was the result of a US\$ 76 million reduction in external financing for the public sector, and a cutback in short-term external financing for the banking system to just US\$ 250 million, compared to the previous year's US\$ 2.3 billion.

Private consumption and investment were the variables that fell the most, while their public-sector counterparts both rose slightly.

External saving grew by 0.9 percentage point, as a result of the large El Niño-related current account deficit of the first half of the year. For 1998 as a whole, the deficit climbed to 6% of GDP, while domestic saving amounted to 18.4% of GDP, i.e., 1.4 percentage points less than in 1997. During the second semester, however, as a result of weakening domestic demand, the external accounts posted a smaller deficit.

The direct impact of El Niño was mainly seen in the fishing catch, which was down by 35.7%, and in the fishmeal and fish oil industry, where production dropped to less than half that of a normal year, especially between January and September. Consequently, the natural resources processing industry saw its output slashed by 11% compared to 1997. Agriculture and commerce also posted negative results from the second quarter on, although agriculture recovered in the final months of the year.

Of all the sectors of the economy, mining showed the strongest growth (4.8%), despite El Niño-related shipping delays in the first few months of the year and falls in the main metal prices (in 1998, the average price

of copper was down by 27.3%, zinc was down by 22.3%, and gold, by 11.2%). The crisis in the Asian economies, which account for 37% of world metal demand, contributed to the fall in international prices. However, a sharp increase in gold mining (22.1%) and a favourable trend in the price of silver boosted growth in the sector.

After leading the growth process in 1997, the construction sector fell steeply in the fourth quarter of 1998 (-11.2%), mainly because of the slowdown in government spending on infrastructure. This also dragged down industries that produce inputs for construction, and the result was a 10.3% decline in non-raw-materials processing industry as a whole. Despite this, the construction sector managed to grow by 2.3% with respect to its 1997 level, whereas expansion in non-raw-materials processing industry was practically non-existent.

#### **(b) Prices, wages and employment**

Inflation in 1998 came in at 6%, the lowest level since 1972. This was achieved in the face of a 15% devaluation of the new sol and despite the fact that El Niño drove up the price of farm and fish products in the first half of the year. It would seem that price increases were neutralized by other factors, such as the downturn in domestic demand and the drop in prices of many imported products, including crude oil. The supply of agricultural and fish products picked up again from the middle of the year, thus eliminating inflationary pressures in these markets. As a result, the prices of agricultural and livestock products, which in the first quarter had posted a 15% rise on an annualized basis, ended the year in December with a 5% year-on-year increase. Prices of tradable goods (foodstuffs and home appliances) went up by more (7.4%), whereas those of non-tradables rose by 5.1%, led by rentals and education.

There was no major change on the employment front in 1998: the jobless rate edged down to 8.4%, while underemployment climbed to 44% of the economically active population (EAP). Fully employed people accounted for 48.3% of the EAP.

#### **(c) The external sector**

Although by late 1997, a deterioration in the balance-of-payments current account was already expected, lower service and factor payments and a slowdown in imports towards the end of the year helped to moderate the increase in the current account deficit.

This deficit widened to US\$ 3.8 billion, which was equivalent to 6% of GDP (US\$ 400 million and 0.8 percentage points above the 1997 level).

Bad weather and the recession in Asia reversed the trend the external sector had been displaying since 1996, when exports had grown vigorously and the growth of imports had slowed down. In 1998, exports declined by 16%, while imports were down by only 4%. As a result, the trade gap widened considerably, to 3.9% of GDP, more than one point above the 1997 figure. Merchandise exports in the first semester were 27% down from their 1997 figure, but the downward trend then began to level out, and the fourth quarter saw an increase with respect to the same period a year earlier.

Traditional exports fell steeply (-21.3%), but the extent of the fall varied between different product lines. Some were seriously affected by changed weather patterns, especially those related to fishing (down by 63.7%) and agriculture (down by 32%), as a sharp fall in domestic production reduced the amounts available for export. The Asian crisis contributed to a plunge in international mineral prices, and in 1998, gold and copper were quoted at their lowest values of the decade. However, higher volumes offset the fall in prices, and mining became the only traditional sector to show export growth in 1998. As a result, mineral products accounted for 48% of traditional exports in 1998, compared to 40% the year before.

Non-traditional exports declined by 4.3%, although this was entirely due to the drop in sales of fish and agricultural products. Other non-traditional exports generally held steady, and some product lines, such as metal manufactures and machine tools, grew by as much as 84% with respect to 1997.

Import performance varied greatly during the course of the year, expanding by 4.4% in the first six months, only to fall back by 11.8% in the second semester, in the wake of the contraction of domestic demand and the rise in the real exchange rate. Imports of consumer goods in the final quarter of the year were 20% down on the same period a year earlier. Imports of capital goods and inputs also fell.

With the devaluation of the new sol far outpacing the rate of domestic price increases, and given that inflation in the United States was a mere 1.6% per year, the real exchange rate in terms of the dollar rose by slightly over 10%. The real exchange rate of the sol against the currencies of Peru's main trading partners remained virtually unchanged, albeit with some fluctuations, from the onset of the Asian crisis until July 1998. After that, it rose sharply, and this coincided with

the worsening of the international financial crisis and the cutback in bank lending from abroad.

The global financial crisis caused an upset in the short-term borrowing that the banks had actively engaged in during 1997 and the first half of 1998. This, together with a withdrawal of portfolio investments on the order of US\$ 700 million, reduced the flow of private capital to the country by 19% in 1998. Portfolio investment was negative to the tune of US\$ 370 million, a level that was US\$ 640 million lower than the previous year. This was largely the result of a buy-back of American Depositary Receipts (ADRs) from foreign holders, made by the Telefónica company, for a total of US\$ 360 million. An increase in direct investment and long-term loans partly offset the decline in revenues from privatization and portfolio investments.

The public-sector financial account posted a deficit of US\$ 76 million, having been in surplus in 1997 by slightly over US\$ 700 million. It should be noted, however, that this account has basically been in deficit ever since the present Administration took office, owing to its policy of curtailing external borrowing. The positive balance in 1997 was exceptional and arose from the guarantees required for signing up to the Brady Plan. In the preceding year, there had been a deficit of US\$ 414 million.

Liquidity tightened in the final quarter of 1998, as US\$ 1 billion left the country, essentially in the form of short-term external liabilities held by the banking sector, which had increased substantially in 1997. This liquidity crisis was triggered by the sudden cancellation of such credit facilities, especially those benefiting medium-sized institutions.

The balance of payments ended 1998 in deficit for the first time since 1990, by nearly US\$ 1 billion. Nevertheless, although this entailed a loss of foreign exchange reserves on the order of 10%, the economy still ended the year with reserves of over US\$ 9 billion.

During the first half of 1999, the Administration expects to finalize an agreement with the International Monetary Fund (IMF), the negotiation of which will probably hinge on fiscal targets. These need to take into account the fall in tax revenues, on the one hand, and, on the other, the Administration's desire, in a pre-election year, to increase capital expenditure for the purpose of rebuilding the infrastructure destroyed by El Niño. Although the country still has a healthy stock of foreign exchange reserves, the Administration considers it important to sign an agreement with IMF, so as to be able to fall back on external financing should that prove necessary.



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## Dominican Republic

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### 1. General trends

Economic activity in the Dominican Republic continued to expand in 1998, thus prolonging the trend of recent years and growing at the fastest rate to be recorded in the entire region (over 7%) despite the destruction caused by the passage of Hurricane Georges in September (losses —mainly property damage— are estimated at over US\$ 2 billion). Production flows were also impaired, although the reconstruction work undertaken in the aftermath of the hurricane had a positive effect on economic activity. On the other hand, the global financial crisis did not affect the Dominican Republic, thanks to its limited impact on growth in the United States (the country's leading trading partner and main source of foreign exchange) and the fact that the scant development of the Dominican Republic's capital market had the effect of sheltering it from the volatile foreign exchange flows observed in larger economies.

**THE ECONOMY** remained buoyant, especially in the area of investment, which was boosted by the reconstruction work referred to above and by the growing demand for inputs for the more dynamic sectors of the economy, such as export processing zones (EPZs), construction, commerce, communications and, to a lesser extent, tourism. Exports, led by products from the EPZs, also contributed to the strength of the economy.

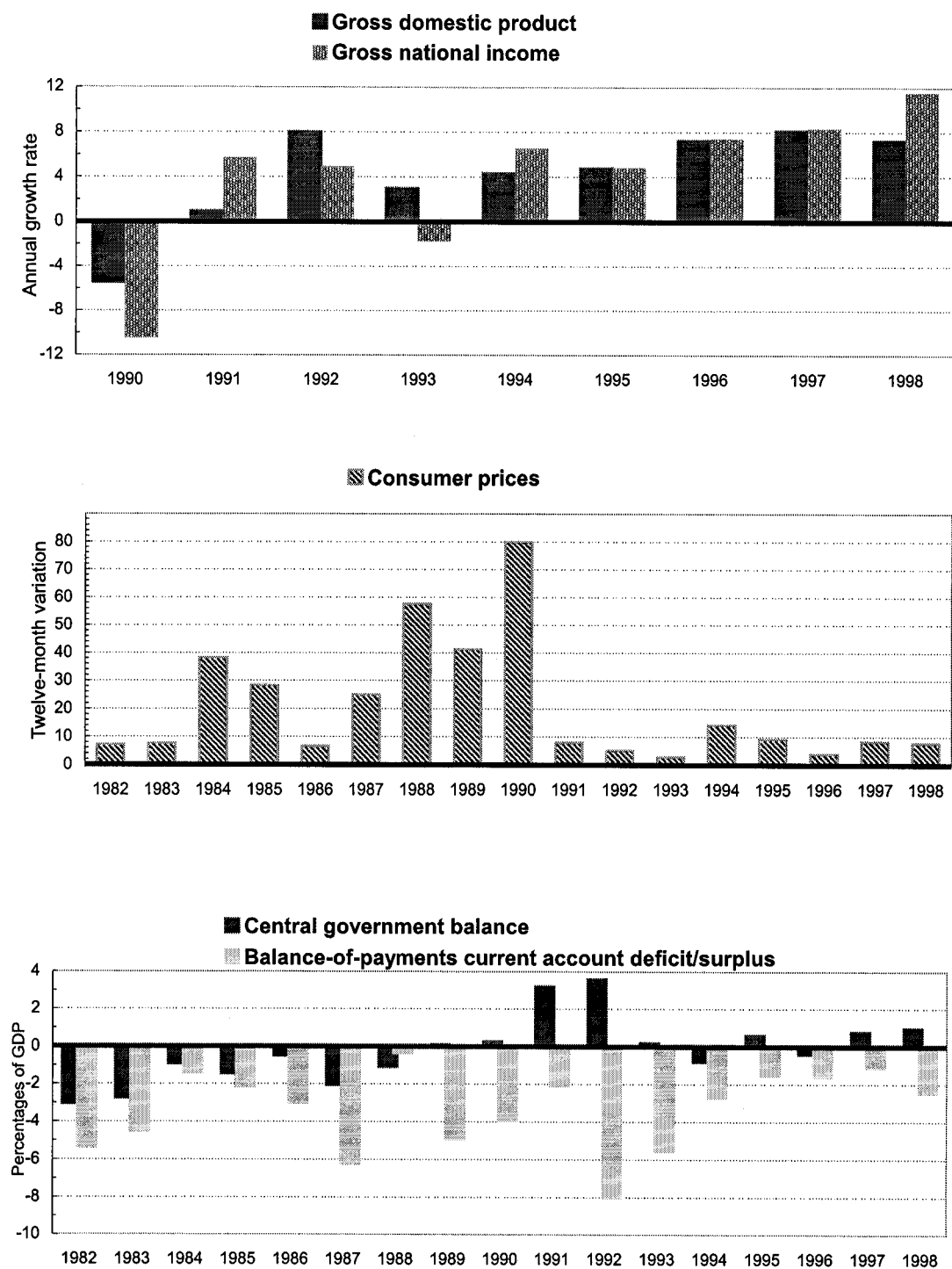
Inflation was below 8%, which was slightly lower than the year before. This improvement was achieved despite the contraction of the supply of basic goods following the hurricane and was mainly attributable to a budgetary cash flow surplus, a small slippage in the exchange rate and a tight monetary policy, which pushed up interest rates.

External transactions again yielded a surplus despite a deterioration in the terms of trade and in the current account balance. These setbacks were more than offset by capital inflows, especially of foreign direct investment (FDI), which far surpassed the previous record for the decade. As usual, revenues from net EPZ sales, tourism and transfers were even higher. The Government continued to carry forward the external liberalization and institutional modernization process initiated at the beginning of the decade.

The expectation was that the trends observed in 1998 would continue in 1999, with GDP growth of 7%, inflation close to 6% thanks to a policy designed to keep a tight rein on domestic credit, a current account deficit close to the 1998 level (2.7% of GDP) and an overall balance-of-payments surplus of US\$ 30 million.



Figure 1  
DOMINICAN REPUBLIC: MAIN ECONOMIC INDICATORS



Source: ECLAC, on the basis of official figures.

## 2. Economic policy

The central aim of economic policy was to control inflation, with monetary policy being the main instrument used for this purpose; the effectiveness of this policy tool was bolstered by the small cash surplus maintained by the Government. The main difficulty in achieving this objective lay in the expansion of the money supply caused by the inflow of external resources, some of which came in the form of disaster aid in the wake of the hurricane.

Economic policy continued to focus on liberalizing the external sector through the adoption of a more flexible exchange-rate regime, the reduction of impediments to foreign trade and the signing of free-trade agreements with the countries of Central America and the Caribbean Community (Caricom). Other noteworthy events were the passage of the Omnibus Telecommunications Act (May 1998) and the commencement of the programme under which State enterprises are to be capitalized through privatization as provided for in the Omnibus State Enterprise Act (of April 1997).

### (a) Fiscal policy

The central government closed out its fiscal year with a slight surplus (1% of GDP) despite the unplanned expenditures made necessary by Hurricane Georges. The year-end figure was similar to that of the previous year since, in terms of GDP, income rose very slightly while expenditure scarcely varied at all. If liabilities incurred but not paid were taken into account, however, then the fiscal year might actually have ended with a deficit.

Total revenues rose by 9%,<sup>1</sup> but this increase was substantially smaller than the preceding year's (22%) owing in part to the limited effects of measures designed to improve the efficiency of the tax system. The hurricane also had a negative influence on tax receipts.

The increase in revenues was attributable to a slight rise in the tax burden (from 14.7% of GDP in 1997 to 15% in 1998). The 10% expansion of tax re-

ceipts was a reflection of the significance of the tax on transfers of industrial goods and services (20% of the total) and especially of taxes on foreign trade (27% of total fiscal revenues). Earnings from oil price differentials were hurt by the decline in international prices in 1998 and by the unification of the exchange rate. By increasing the cost of imported crude in the local currency, unification reduced revenues, while the decline in oil prices had the opposite effect.

Total fiscal expenditure also increased at a slower pace (7% in 1998 compared with 14% in 1997) despite an 11% upswing in current expenditure and the extraordinary expenses occasioned by Hurricane Georges. The latter expenditures were channelled through the Solidarity Fund for Reconstruction, which was financed by national and foreign donations, contributions from central government employees and an advance payment made by the Central Bank to the Banco de la Reserva. The Solidarity Fund also benefited from the deferral of some payments on the external public debt, which freed up resources obtained from the differential in oil prices.

The increase in current spending was mainly accounted for by the 8% rise in operating expenditures (i.e., outlays on wages and salaries, goods and services), with the government payroll climbing by 6% and those of decentralized and autonomous agencies and of the municipalities rising by 1% and 8%, respectively, due to staff increases. On the other hand, current transfers declined by 2%. The 1% upturn in capital outlays required for repairs to property damaged by the hurricane reversed the downward trend of the previous year (-29%). The greater part of real capital expenditure (82%) was used for the construction or repair of roads, schools and other facilities.

For 1999, it is estimated that nominal income will increase by 12.5% (assuming 7% growth in GDP and inflation of close to 6%), which would represent a slowdown in the growth rate for real income as compared with 1998.

<sup>1</sup> All the fiscal statistics mentioned in the text are expressed in real terms. The deflation of the corresponding figures was calculated on the basis of the consumer price index (CPI).

Table 1  
**DOMINICAN REPUBLIC: MAIN ECONOMIC INDICATORS**

	1990	1991	1992	1993	1994	1995	1996	1997	1998 <sup>a</sup>
<b>Annual growth rates <sup>b</sup></b>									
Growth and investment									
Gross domestic product	-5.5	1.0	8.0	3.0	4.3	4.8	7.3	8.2	7.3
Per capita gross domestic product	-7.4	-1.0	5.9	1.1	2.4	2.9	5.4	6.3	5.5
Gross domestic product, by sector									
Goods	-6.8	-0.5	10.2	1.3	5.1	3.4	7.5	8.4	6.3
Basic services	-6.9	6.5	17.1	8.0	4.8	7.6	10.7	11.8	13.5
Other services	-3.9	1.2	4.1	3.5	3.5	5.4	6.1	6.9	6.3
Consumption	-11.2	11.0	8.0	-7.9	6.5	1.7	7.6	6.8	6.6
General government	6.1	1.6	5.7	-1.9	7.2	-0.5	4.2	13.5	11.0
Private	-13.5	12.5	8.3	-8.7	6.4	2.0	8.2	5.9	5.9
Gross domestic investment	-15.9	-8.7	23.9	18.7	0.4	4.4	9.5	18.9	27.1
Exports of goods and services	9.4	-13.8	9.8	134.9	6.6	12.5	7.9	14.2	15.8
Imports of goods and services	-25.6	12.6	26.8	100.4	8.2	7.4	9.8	18.7	26.5
<b>Percentages of GDP <sup>c</sup></b>									
Gross national income	99.8	104.7	103.2	99.5	101.6	101.9	102.4	103.6	109.0
Gross domestic investment	18.9	17.1	19.9	23.1	22.3	22.3	22.8	25.3	30.4
National saving	16.0	15.3	12.4	18.2	19.8	20.7	21.1	24.1	27.4
External saving	2.9	1.8	7.5	5.0	2.5	1.5	1.7	1.2	2.9
Employment and wages									
Real minimum wage (index: 1995=100)	83.4	80.9	98.4	93.5	99.5	100.0	100.6	102.0	106.3
<b>Growth rates</b>									
Prices (December-December)									
Consumer prices	79.9	7.9	5.2	2.8	14.3	9.2	4.0	8.4	7.8
External sector									
Terms of trade (index: 1995=100) <sup>c</sup>	94.0	102.8	96.2	87.6	92.3	100.0	97.7	102.0	104.8
Nominal exchange rate (pesos per dollars)	8.53	12.69	12.77	12.70	13.20	13.60	13.78	14.27	15.27
Real effective exchange rate for imports (index: 1995=100)	96.4	104.5	108.8	106.5	103.0	100.0	93.5	95.7	103.9
<b>Millions of dollars</b>									
Balance of payments									
Current account	-280	-157	-708	-533	-283	-183	-213	-163	-387
Trade balance (goods and services)	-402	-351	-818	-730	-584	-406	-656	-720	-1 419
Exports	1 832	1 857	1 911	4 748	5 240	5 731	6 193	7 060	7 472
Imports	2 233	2 208	2 729	5 478	5 825	6 137	6 848	7 780	8 891
Capital and financial account <sup>d</sup>	-195	414	644	35	-142	251	183	258	426
Overall balance	-474	257	-64	-498	-425	68	-30	95	39
Variation in reserve assets (- indicates an increase)	49	-357	-64	-156	387	-131	15	-40	-98
<b>Percentages</b>									
External debt									
Gross debt (as a percentage of GDP)	63.6	60.8	50.0	47.5	37.8	33.5	28.6	23.3	22.1
Net interest (as a percentage of exports) <sup>e</sup>	8.7	3.9	6.3	4.4	2.9	2.5	3.3	2.5	2.8

Table 1 (concluded)

	1990	1991	1992	1993	1994	1995	1996	1997	1998 <sup>a</sup>
<b>Percentages of GDP</b>									
Central government									
Current revenue	10.3	13.1	15.4	16.1	15.1	15.0	14.1	15.9	15.8
Current expenditure	5.4	5.3	6.0	8.3	7.7	7.9	8.2	11.2	11.3
Saving	4.9	7.9	9.4	7.8	7.4	7.1	5.9	4.7	4.5
Capital expenditure	4.6	5.1	6.5	8.2	8.6	6.6	6.4	4.2	3.9
Financial balance	0.3	3.2	3.6	0.2	-0.8	0.6	-0.4	0.8	1.0
Domestic financing	-0.2	-2.5	-2.2	1.4	2.1	0.5	1.4	0.4	-0.1
External financing	-0.1	-0.7	-1.4	-1.6	-1.3	-1.1	-1.0	-1.1	-0.9
<b>Growth rates</b>									
Money and credit									
Monetary balances of banking system									
Net international reserves	41.1	94.2	53.8	45.3	-91.4	409.7	1.4	37.9	-6.7
Net domestic credit	17.2	34.9	24.4	17.4	41.0	11.5	22.9	21.5	21.1
Money (M1)	21.1	27.6	15.3	25.1	3.1	16.0	26.5	22.2	7.8
Local-currency savings and time deposits	18.0	48.9	38.9	30.3	15.8	19.4	13.5	23.9	31.8
M2	19.6	37.4	27.1	27.9	10.1	18.0	18.8	23.2	21.4
Dollar deposits	...	...	94.7	-71.4	-8.4	101.3	164.0	8.2	-50.6

Source: ECLAC, on the basis of official figures.

<sup>a</sup> Preliminary figures.<sup>b</sup> Based on constant 1970 pesos.<sup>c</sup> Based on constant 1995 dollars.<sup>d</sup> Includes errors and omissions.<sup>e</sup> Refers to net interest as shown on the balance of payments, divided by exports of goods and services. As from 1993, export figures include *maquila* exports.**(b) Monetary policy**

As in previous years, monetary policy-makers sought to avoid excessive price rises, which was consistent with the increase in the narrow money supply (M1) of just 8%. This was achieved despite the fact that the monetary base and the broad money supply (M2) grew at rates similar to those of the year before (19% and 21%, respectively).

The expansion of the monetary base was due to an increase in net international assets (53%) and, to a lesser extent, to the advance that the Central Bank paid out to the Banco de la Reserva to cover reconstruction expenditures, interest paid to holders of monetary regulation bonds and the return of frozen funds to the commercial banking system (US\$ 103 million). These factors were not entirely offset by the Central Bank's efforts to absorb liquidity through the sale of monetary regulation bonds.

The Central Bank's intervention did, however, result in a rise in interest rates, which led to a shift in the general public's holdings of liquid assets towards higher-yielding term deposits. Hence, while the expansion in the money supply was similar to that of the monetary base, narrow money (M1) grew much less, and the money multiplier therefore declined.

With the rise in real lending rates (from 11% in 1997 to 16% in 1998), loans to the private sector increased more slowly; the growth rate for this variable was still 17%, but this was five percentage points lower than the previous year. The loan portfolio for foreign trade-related activities did expand at a faster pace, however (from 20% in 1997 to 26% in 1998).

**(c) Foreign exchange and trade policy**

The widening gap between the official and private-market exchange rates (3% in January and 9% in June) sparked expectations of a devaluation and penalized the export sector to an increasingly serious extent, since exporters were required to hand over all of their foreign exchange earnings to the Central Bank. At the beginning of the second semester, the Central Bank therefore proceeded to adjust the official exchange rate by initiating a gradual slippage in the rate that could be interpreted as a move towards a crawling peg regime. The adjustment translated into a 9% nominal depreciation in the Dominican peso, which meant that the value of the currency remained more or less constant in real terms.

Table 2  
DOMINICAN REPUBLIC: MAIN QUARTERLY INDICATORS

	1996				1997				1998 <sup>a</sup>				1999 <sup>a</sup>
	I	II	III	IV	I	II	III	IV	I	II	III	IV	I
Gross domestic product (change from same quarter of preceding year)	5.4	7.5	7.3	8.6	5.1	9.5	7.5	9.9	5.9	7.1	7.4	8.3	...
Consumer prices (12-month variation, %)	6.5	6.2	3.8	3.9	6.7	7.5	9.9	8.4	5.3	4.6	2.9	7.8	7.7
Real effective exchange rate <sup>b</sup> (index: 1995=100)	93.8	92.7	93.6	93.8	95.3	96.1	94.6	96.8	99.2	104.1	103.6	108.8	112.2

Source: ECLAC, on the basis of official figures.

<sup>a</sup> Preliminary figures. <sup>b</sup> Refers to the exchange rate for imports.

The Government signed free-trade agreements with the countries of Central America and Caricom which were due to enter into force in January 1999. The agreement signed on 16 April with the presidents of Central America immediately removes tariffs on all tariff items other than those included on a list of exceptions (negotiated on 29 November), which will be subject to a more gradual tariff reduction programme. The agreement with Caricom (dated 22 August) also includes a list of exceptions and incorporates a plan of action for permitting the free movement of persons and capital within the subregion.

#### (d) Structural reforms

Important events in this sphere included the passage of the Omnibus Telecommunications Act (May 1998) and the start-up of the programme under which public-sector firms are to be capitalized through privatization operations as provided for in the Omnibus State Enterprise Act of April 1997.

The capitalization of the Corporación Dominicana de Electricidad (CDE) was initiated in December 1998 when electricity distribution and generating companies were put up for bid. In view of the types of services provided by CDE, the capitalization process will be accompanied by a new omnibus law on electrical power utilities, whose passage is still pending.

### 3. The main variables

#### (a) Economic activity

Total demand grew by 14% thanks to strong investment, the performance of exports of goods and services and, to a lesser degree, the expansion of domestic consumption. In response to domestic demand, increases were seen both in GDP (7.3%) and in imports.

Total investment expanded by 27%, with private investment in the lead (34%). Despite the rise in interest rates, the growth of private investment was bolstered by the increase in commercial bank loan portfolios in the first half of the year and by the repercussions of

Hurricane Georges, which indirectly gave a boost to production in some sectors. Contrary to initial forecasts, public investment expanded owing to the need for reconstruction and rehabilitation after the hurricane. Private consumption, undermined by the rise in interest rates, managed to do no more than to maintain its growth rate of the previous year (5.9%).

Exports of goods and services were brisk (16%), with the main components—the EPZs and the services sector—both performing well. Some of the country's exports posted a decline, however, due to weather-related factors (as in the case of sugar) or reac-

tions to weakening international prices (as in the case of the mining industry). The country's export performance paved the way for the exchange-rate adjustment and sliding parity arrangement instituted by the authorities in the second half of the year.

Imports of goods and services expanded substantially (27%) in response to the demand for the capital goods and inputs needed to maintain growth rates similar to those recorded by the economy in the preceding five years. Emergency measures taken in the aftermath of the hurricane and the subsequent reconstruction work also generated an additional demand for producer and consumer goods that was met by the external sector.

The agricultural sector was hurt by the hurricane, which reduced overall output (by 1%) and particularly output for domestic consumption (down by 3%). In fact, agriculture bore the brunt (US\$ 440 million or 54%) of the direct damage sustained by the production sector. Nevertheless, production figures for some crops were up, including leaf tobacco, coffee and cocoa (19%, 7% and 16%, respectively), thanks to an expansion of the land area under cultivation, a rise in productivity and the implementation of health measures.

Manufacturing posted a growth rate of only 5% but would have turned in a better performance had it not been for a 22% downturn in sugar production, the hurricane damage sustained by some production facilities and the suspension of operations made necessary by the reconstruction process. Nevertheless, the sector did benefit from favourable local conditions in a number of areas, including a steady supply of raw materials, the upswing in construction activity and the improvements made in terms of the supply of electrical power, which made it possible to regularize production linkages. In addition, a number of factors on the external front—the dynamism of the EPZs, which were not harmed by either the Asian or the world financial crisis, and increased imports of capital goods and raw materials—helped to maintain the stability of the manufacturing sector's production activities.

The EPZs recorded an 8% increase in value added. Factors contributing to this robust performance included the strength of the United States economy, the use of improved production techniques and the start-up of a vertical integration process in some textile firms.<sup>2</sup> Growth in this sector was reflected in increases of 11% in the number of firms, of 7% in direct job creation

—with a total of 195,000 jobs in 1998— and of 18% in foreign exchange earnings.

Mining activity slumped (-16%), with output of the industry's main products —ferronickel, gold and silver— down by 23%, 39% and 40%, respectively, following a loss of profitability occasioned by declining international prices.

Construction (20%) benefited from the repair and rehabilitation work undertaken following Hurricane Georges within the framework of the National Plan for Reconstruction, which generated a strong demand for materials, machinery and equipment. The energy subsector grew by 17%, mainly as a result of a 102% increase in gas-fired electricity generation and, to a lesser degree, the normalization of power flows. The telecommunications sector boasted its highest growth rate in 25 years (21%), thanks to a forceful performance by the telephone industry following elimination of the 10% tax on long-distance calls, increased competition and the expansion of services. A positive trend in tourism (5% in 1998) could be seen despite an 8.5% decline in hotel occupancy rates that was partly a result of the hurricane.

#### (b) Prices, wages and employment

The cumulative rate of inflation stood at 7.8%. During the first seven months of the year, the trend in this variable reflected such factors as the slowdown in domestic demand caused by the rise in interest rates, exchange-rate unification and sagging fuel prices. Consequently, as of August, the cumulative rate of inflation was only 1.59%. Between October and December, however, hurricane damage to infrastructure and agricultural facilities drove inflation rates up.

The real minimum wage lost purchasing power over the course of the year (-4.8%), but on average was higher (4.3%) in 1998 than in 1997. Unemployment amounted to 14.3% (April-June 1998), which was a decline of over one percentage point from the previous year's level (15.9%). Nonetheless, some analysts contend that the unemployment rate is overestimated and that it should in fact be between 7% and 8%.

#### (c) The external sector

The overall balance of payments yielded a US\$ 39 million surplus thanks to the fact that the current

2 Value added is measured in terms of salaries and wages at 1970 prices. See the Central Bank report: *Informe de la economía dominicana, enero-diciembre*, Santo Domingo, 1998. Measured in current dollars, net exports from the EPZs expanded by approximately 18%.

account deficit (-US\$ 387 million) was more than offset by the surplus posted on the capital and financial account.

Merchandise export earnings climbed by 8%; this improvement was made possible by increased shipments, since average prices were down 1%. The strong performance of the EPZs (with a growth rate of 14%) was a decisive factor in this respect, since they accounted for 82% of the total value of merchandise exports. Textiles, tobacco and tobacco products, and electronics made particularly important contributions to the overall result.

Other exports (referred to as "local" because they do not include goods and services produced in the EPZs) declined by 13% in value terms. This was the result of a contraction in traditional exports (sugar was down by 33%, coffee by 1.7%, tobacco by 27% and ferronickel by 38%), since non-traditional items expanded by 7.2%.

Imports continued to trend upwards (15%). Imports for the local market (that is, those not intended for the EPZs) were driven up 17% by a 38% increase in consumer imports (which accounted for more than 40% of the national total) despite the reduction in the oil bill, while imports destined for the EPZs climbed by 12%. The performance of imports was buttressed by the economy's growth rate, the surge in demand for capital goods following the hurricane and the requirements that arose in connection with the disaster relief work.

Of the other components of the current account balance, the non-factor services account showed a surplus (US\$ 1.189 billion) which, as usual, was mainly attributable to revenues from tourism. The growth rate

for this variable did weaken, however, chiefly as a result of the hurricane. With a negative balance of US\$ 936 million, the income account reflected an increasing level of outflows in the form of repatriated profits and interest payments on the public and private external debts. Unrequited current transfers, at US\$ 1.969 billion, displayed a higher surplus than the previous year.

The positive balance on the capital and financial account (US\$ 668 million) was largely attributable to a 64% increase in gross FDI (over US\$ 690 million, thanks to the reinvestment of profits from production activities connected with the EPZs and tourism) and resulted in a surplus on the balance of payments as a whole, despite the level of capital outflows registered under the heading of errors and omissions. This outturn, together with the use of credit from the International Monetary Fund (IMF) and exceptional financing, enabled the country to build up its international reserves to the equivalent of almost US\$ 100 million.

The external debt balance (public and publicly-guaranteed private liabilities) was kept at the same level as the year before (US\$ 3.507 billion) by postponing payments on external obligations, given the need to maintain foreign-exchange liquidity in order to cope with the necessary rehabilitation and reconstruction work.

The debt stock and net interest were equivalent to 47% and 1.7% of exports of goods and services, respectively. The service on the medium- and long-term public debt amounted to US\$ 342 million, or the equivalent of 7% of the total value of exports of goods and services.

## Uruguay

### 1. General trends

Economic activity continued to grow at a good pace in 1998. The increase in output was close to 4.5%, bringing the cumulative total for the past three years to 15%. Growth during the first half of the year resulted from expansion in all components of total demand. This was followed by a weakening in exports and consumption, which actually fell in the third quarter; however, growth in overall output received a further boost when the sustained expansion of fixed investment was reinforced by a considerable increase in stocks owing to a surge in agricultural supply. The terms of trade were very favourable for Uruguay, as the sharp drop in international oil prices more than made up for the slight fall in export prices, and national income rose by almost 6.5%. Accelerated activity pushed up labour demand by more than the increase in supply, helping to bring down unemployment by 1.5 points, to about 10%.

**CONSIDERABLE SUCCESS** was achieved in controlling inflation, which fell to 8.6%, the lowest level since the mid-1950s; this was helped by a further fall in the public-sector deficit and a reduction in the rate of devaluation of the national currency. Capital inflows continued despite uncertainties on international financial markets, more than making up for the widening external deficit of about 2% of GDP.

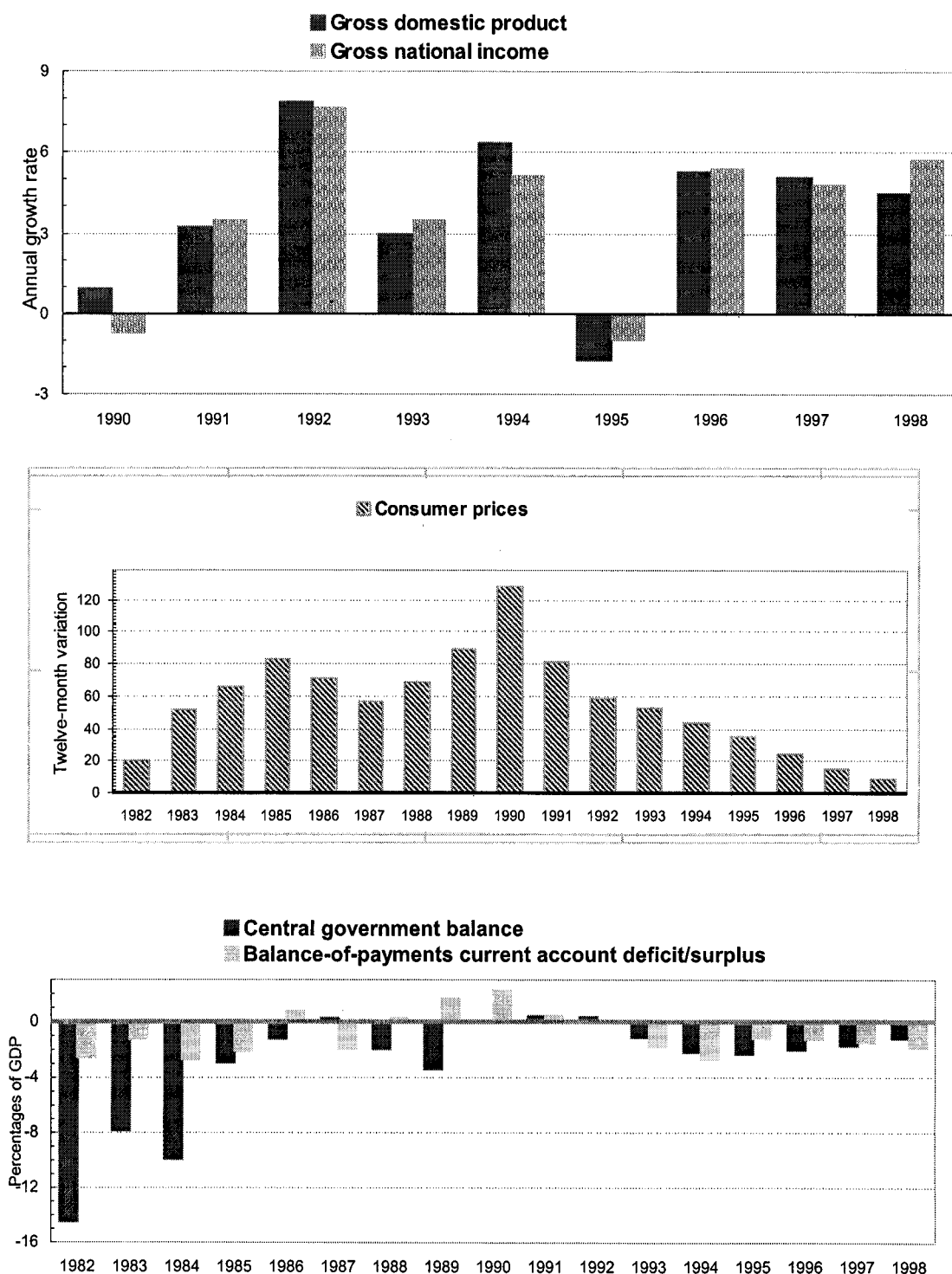
Negative developments on the external scene in mid-1998 were further accentuated in 1999. The fall in demand from neighbouring countries intensified following the Brazilian crisis in early 1999. With domestic demand also contracting, owing to a slowdown in the growth of credit and a deceleration of public spending, the level of activity decreased during the first few months of 1999. This new situation led to increases in consumer prices in the first five months of the year

(slightly over 2%), and unemployment also showed an upward trend.

Taking these developments into account, the financial programme for 1999 allows for a decline in GDP of about 2%. The authorities are maintaining their anti-inflationary goals, and hope to reduce the annual rate of increase in the consumer price index to 5%. Given the falling levels of activity and consumption and their direct impact on tax revenue, the consolidated public-sector deficit is expected to increase to about 2% of GDP, most of which will be financed through external borrowing. The simultaneous contraction of exports owing to lower international demand, and of imports because of falling domestic demand, should mean little change in the balance-of-payments current-account deficit, which will be financed with increased borrowing and the international reserves built up during the previous year.



Figure 1  
URUGUAY: MAIN ECONOMIC INDICATORS



Source: ECLAC, on the basis of official figures.

## 2. Economic policy

Economic policy in 1998 remained focused on bringing about a gradual decline in inflation within a context of productive growth, through a fiscal policy aimed at balancing public-sector accounts together with a slowing of the monthly rate of inflation. Thus, there were no significant changes in economic policy in relation to the previous years. Around the middle of the year, international financial fluctuations, compounded by the Russian crisis and its repercussions in Brazil, caused a considerable change in the external conditions affecting Uruguay.

The authorities reacted to this new situation with great caution: on the one hand, they endeavoured to strengthen the banking system and reduce the growth of credit to the private sector, which had been incurring swiftly in recent years. At the same time, steps were taken to set up a reserve fund of US\$ 450 million with financing from international agencies; this fund began to take shape in late 1998 with the disbursement of an IMF loan under an agreement concluded earlier. Thanks to favourable financial conditions, part of the financing needed for 1999 was brought forward to the last two months of 1998, through the issuance of a US\$ 200 million bond.

The Brazilian crisis of early 1999 worsened the deteriorating external situation and added to economic-management difficulties in a general election year. Faced with a new situation involving a considerable loss in the country's ability to compete with Brazil, one of Uruguay's main trading partners, the authorities announced fiscal spending cuts and decided to postpone and reduce certain domestic taxes. At the same time, discussions with the other Mercosur countries were intensified, because of increased concerns at the interruption in the spontaneous convergence of economic policies that had been occurring in recent years.

### (a) Fiscal policy

Fiscal policy was aimed at holding down real spending at the level of the previous year, and the consolidated public-sector deficit for 1998, including that of the Central Bank, was expected to be no more than 1% of GDP. This goal was achieved (although income and outlays were greater than expected), making it possible to cut the deficit significantly relative to the previous year (1.7% of GDP).

Real central-government revenue rose by 8% in the first seven months of the year, while public-sector enterprises achieved considerable increases in their operating surpluses. Central-government spending increased, but to a lesser extent than revenue; as a result, the consolidated public-sector deficit for the first nine months of 1998 fell to 0.7% of GDP. The decline in private consumption in the third quarter affected indirect tax receipts, which are closely linked to the economic cycle. Spending continued to rise in the fourth quarter, particularly in connection with public-sector investment. Thus, the cumulative deficit for the year remained at the level originally projected.

The non-financial public-sector deficit for 1998 fell to 0.6% of GDP, half the previous year's level. This improvement was due to a revenue increase of more than half a percentage point, to 32.6% of GDP, while expenditure as a percentage of GDP remained steady. Leaving out expenditures for reforms in social security and public administration, given their temporary nature, the non-financial public sector posts a surplus of 0.7% of GDP in fiscal 1998.

Revenue is closely linked to the economic cycle. Thus, rising levels of activity and consumption helped to increase real receipts from both taxes and social security contributions. Rising levels of activity, improvements in the availability of water for power generation, and falling oil prices boosted the operating results of public-sector enterprises. Central-government spending reflected the increase in output, particularly because of the substantial increase in public investment (24%); current expenditure only rose by 3% in real terms.

The consolidated public-sector deficit was financed without difficulty through borrowings equivalent to more than 2% of GDP. Since monetary liabilities also increased (by 0.3% of GDP), the overall deficit was financed with room to spare, and international reserves increased.

### (b) Foreign exchange policy

The economic plan provided for a slowing in the rate of devaluation of the national currency to between 7% and 9% per year. On that basis, the monthly devaluation rate was cut from 0.8% to 0.6% in April 1998, while the width of the flotation band was cut from 7% to 3%.

Table 1  
URUGUAY: MAIN ECONOMIC INDICATORS

	1990	1991	1992	1993	1994	1995	1996	1997	1998 <sup>a</sup>
<b>Annual growth rates <sup>b</sup></b>									
Growth and investment									
Gross domestic product	0.9	3.2	7.9	3.0	6.3	-1.8	5.3	5.1	4.5
Per capita gross domestic product	-0.1	2.5	7.1	2.2	5.6	-2.5	4.5	4.3	3.7
Gross domestic product, by sector									
Goods	-2.0	1.0	5.6	-5.0	5.4	-2.1	5.6	3.1	4.4
Basic services	4.1	9.2	13.2	7.1	9.8	6.6	5.1	5.1	7.6
Other services	1.9	1.2	4.5	4.9	3.3	-2.6	4.3	5.1	3.9
Total consumption	-2.7	5.0	12.5	5.5	7.7	-2.6	7.5	5.6	3.7
Government	2.0	1.1	1.5	0.9	4.5	0.2	5.0	2.8	3.3
Private	-3.6	5.8	14.7	6.3	8.2	-3.0	8.0	6.0	3.8
Gross domestic investment	0.2	28.8	11.7	14.2	7.9	5.1	-1.7	7.1	31.3
Exports of goods and services	12.7	2.6	9.9	8.3	14.6	-0.9	10.1	13.1	1.6
Imports of goods and services	1.1	18.7	25.2	18.8	16.8	-0.4	11.4	13.2	9.0
<b>Percentages of GDP <sup>c</sup></b>									
Gross national income	97.3	97.8	98.1	98.4	98.1	99.1	99.5	99.3	100.4
Gross domestic investment	8.2	10.0	10.4	11.6	11.8	12.4	11.3	11.4	14.5
National savings	9.5	10.3	10.3	10.0	9.3	11.1	10.1	9.9	12.5
External savings	-1.4	-0.3	0.1	1.6	2.6	1.2	1.3	1.5	2.1
<b>Percentages</b>									
Employment and wages									
Labour force participation rate <sup>d</sup>	57.0	57.4	57.4	56.6	58.1	59.1	58.2	57.7	60.5
Open unemployment rate <sup>e</sup>	8.5	8.9	9.0	8.3	9.2	10.3	11.9	11.5	10.1
Real average wage (index: 1995=100)	91.7	95.2	97.3	102.0	102.9	100.0	100.6	100.8	102.7
<b>Growth rates</b>									
Prices (December-December)									
Consumer prices	129.0	81.3	59.0	52.9	44.1	35.4	24.3	15.2	8.7
Wholesale prices	120.7	68.6	46.9	31.1	41.0	27.7	23.5	13.3	3.3
External sector									
Terms of trade (index: 1995=100) <sup>c</sup>	100.2	98.2	96.2	94.6	94.7	100.0	96.7	96.4	103.1
Nominal bank exchange rate (pesos per dollar), annual average	1.17	2.02	3.03	3.95	5.05	6.35	7.97	9.45	10.47
Real effective exchange rate for imports (index: 1995=100)	142.4	130.2	127.2	113.9	104.3	100.0	99.1	97.1	96.2
<b>Millions of dollars</b>									
Balance of payments									
Current account	186	42	-9	-244	-438	-213	-233	-288	-400
Trade balance (goods and services)	499	235	150	-105	-237	-62	-127	-169	-282
Exports	2 159	2 201	2 632	2 760	3 248	3 507	3 847	4 217	4 225
Imports	1 659	1 966	2 482	2 865	3 485	3 568	3 974	4 386	4 507
Capital and financial account <sup>f</sup>	-54	37	147	437	547	440	386	687	760
Overall balance	132	80	138	193	109	228	152	399	360
Variation in reserve assets (- indicates an increase)	-40	-114	-186	-179	-99	-218	-141	-390	-521
<b>Percentages</b>									
External debt									
Gross debt (as a percentage of GDP)	88.4	71.4	64.9	57.2	56.2	57.5	60.6	62.5	65.6
Net debt (as a percentage of GDP)	35.1	24.3	20.5	17.3	19.0	16.4	15.0	14.7	14.4
Net interest (as a percentage of exports)	9.3	5.6	3.2	1.9	3.5	1.3	0.4	0.4	-0.5

Table 1 (concluded)

	1990	1991	1992	1993	1994	1995	1996	1997	1998 <sup>a</sup>
<b>Percentages of GDP</b>									
Non-financial public sector									
Current revenue	28.9	31.1	31.8	30.9	30.6	30.8	30.7	32.0	32.6
Current expenditure	24.5	25.7	26.0	26.4	27.2	27.8	28.0	29.3	28.7
Saving	4.4	5.4	5.8	4.5	3.4	3.0	2.7	2.7	3.9
Capital expenditure	4.0	4.1	4.4	5.3	5.8	4.2	3.8	4.0	4.4
Financial balance	0.4	1.3	1.5	-0.8	-2.4	-1.3	-1.1	-1.2	-0.6
<b>Growth rates</b>									
Money and credit									
Monetary balances of banking system									
Net international reserves	161.1	66.9	45.8	25.5	39.2	45.0	33.5	18.5	10.2
Net domestic credit	97.0	90.7	49.4	38.9	37.4	22.7	38.9	35.9	28.3
To public sector	85.0	17.7	60.1	31.4	46.5	10.1	-5.8	-22.9	-107.3
To private sector	87.6	65.8	70.2	46.8	40.1	50.2	36.2	35.0	28.7
Money (M1)	114.2	91.5	70.1	58.4	39.6	31.7	26.4	21.4	13.1
Local currency savings and time deposits	66.6	76.6	44.1	35.2	24.6	54.7	29.4	19.8	30.4
M2	88.5	84.4	58.3	48.8	34.0	39.8	27.5	20.8	19.9
Dollar deposits	132.3	77.7	45.7	29.5	39.2	30.4	38.6	29.6	20.8
<b>Annual rates</b>									
Real interest rates (annualized, %)									
Deposit rate	-13.1	-3.1	-2.9	-8.7	-4.9	2.2	3.1	-0.3	3.8
Lending rate	20.5	39.8	37.0	29.4	35.5	47.9	54.0	42.9	42.4
Equivalent interest rate in foreign currency <sup>g</sup>	0.4	10.9	9.1	10.3	9.0	9.3	4.4	3.9	...

Source: ECLAC, on the basis of official figures.

<sup>a</sup> Preliminary figures. <sup>b</sup> Based on new pesos at constant 1983 prices. <sup>c</sup> Based on dollars at constant 1995 prices. <sup>d</sup> Percentages of the working-age population; urban areas. <sup>e</sup> Percentages of the economically active population (EAP); urban areas. <sup>f</sup> Includes errors and omissions.

<sup>g</sup> Interest rate on deposits, deflated by the variation in the exchange rate.

Disturbances in the international financial market and their impact in the region affected the foreign exchange market from time to time, causing the peso to rise above the floor of the flotation band. Positive fiscal results and the improving financial situation in the region, together with measures taken by the Central Bank to channel towards the interbank market all private-sector foreign currency sales under the export prefinancing mechanism (which increased supply in that market), pushed the dollar exchange rate back down to the floor of the flotation band. In any case, the real exchange rate (measured against a basket consisting of the currencies of Uruguay's main trading partners) again declined slightly in 1998.

### (c) Monetary policy

Under this foreign-exchange regime, the growth of the money supply depends on demand for money from

the public, the real balances of which increased. In 1998, the money supply grew by more than 13%, an increase of about 4% in real terms. The increase in national-currency deposits was larger (16% in real terms), and foreign-currency deposits increased even more (17% in dollar terms). The growth of the monetary base was due mostly to purchases of foreign currency, while credit to the public sector once again contracted.

Credit to the private sector maintained the rapid growth levels of previous years, especially in the first three quarters. Consequently, the Central Bank raised minimum capital requirements for banks (from 8% to 10% of assets), increased reserve requirements for credit risks, shortened the time limit defining non-performing loans, and laid down minimum income requirements for consumer credit. These measures, together with the new external situation, contributed to a rapid slowing of growth (to 16% per year) in private bank credit. By the end of the year, 80% of credit to the

Table 2  
**URUGUAY: MAIN QUARTERLY INDICATORS**

	1996				1997				1998 <sup>a</sup>				1999 <sup>a</sup>
	I	II	III	IV	I	II	III	IV	I	II	III	IV	I
Gross domestic product <sup>b</sup> (change from same quarter of preceding year)	1.7	0.8	10.3	1.5	3.3	8.4	4.4	4.6	6.7	1.4	5.0	4.2	-1.0
Consumer prices (national) (12-month variation, %)	31.4	28.2	26.3	24.3	23.8	21.2	17.1	15.2	12.4	10.3	10.1	8.7	7.1
Real exchange rate <sup>c</sup> (index: 1995=100)	99.2	98.7	100.1	98.4	97.1	97.2	97.1	96.9	96.4	96.5	96.2	95.8	89.3
Exports, FOB (millions of dollars)	549	580	632	636	583	726	730	687	669	745	728	627	502
Imports, CIF (millions of dollars)	698	769	928	929	822	893	946	1 055	899	926	970	1 014	786
Real interest rates (annualized, %)													
Deposit rate	6.7	0.3	-1.4	6.7	-2.0	-0.8	0.1	1.4	2.9	3.7	3.8	4.7	6.5
Lending rate (non-preferential)	60.0	51.3	46.8	57.9	44.4	43.3	41.9	41.9	42.3	45.5	41.2	40.7	49.1
Money (M1) (change from same quarter of preceding year)	...	...	...	...	24.8	21.4	17.3	16.9	18.6	17.1	16.5	14.4	42.9

Source: ECLAC, on the basis of official figures.

<sup>a</sup> Preliminary figures.

<sup>b</sup> Based on figures after correction for seasonal variations; constant prices in local currency.

<sup>c</sup> Refers to exchange rate for imports.

private sector was denominated in foreign currency and only 20% in national currency, reflecting a high degree of dollarization in the Uruguayan economy.

Lending by the Banco de la República Oriental del Uruguay (BROU), which represents about 38% of overall bank lending, increased more rapidly (19%) than lending by the private financial sector. In particular, national-currency lending expanded much faster than that denominated in foreign currency.

Interest-rate variations were influenced both by the behaviour of domestic prices and by external events. In the first three quarters of 1998, borrowing and lending rates in pesos and dollars showed a downward trend. Growing uncertainties in the fourth quarter led to higher peso borrowing rates, owing to the increased exchange risk premium, and a rise in foreign-currency lending rates, particularly for consumer credit.

#### (d) Trade policy

The special Mercosur tariff reduction regime continued to progress, with a 25% cut going into effect from January onwards in the tariff on products covered by the rollback agreement. Another measure implemented at the beginning of the year was the increase of three percentage points in the common external tariff agreed among the Mercosur countries the previous year. However, negotiations continued on the conditions to be applied to motor vehicle imports from third countries.

The sharp devaluation of the Brazilian real in the early months of 1999 substantially affected Uruguay's ability to compete with Brazil. This gave rise to a series of meetings and consultations involving representatives of the two Governments and the other Mercosur countries, but no further measures have so far been agreed.

**(e) Debt policy**

A process of extension of government debt began in late 1996. Thus, fewer short-term treasury notes were issued, while 15-year treasury bonds were increased. Two international bond issues were floated in 1998, and met with strong demand thanks to the good international credit rating of Uruguay's sovereign debt. The first of these, amounting to US\$ 250 million, was launched in April with a 10-year maturity and a rate of 135 basis points above United States bonds. Another

bond issue was floated in November, amounting to US\$ 150 million for a five-year term, with an additional US\$ 50 million being issued in December because of high demand for the November issue. Interest on the latter issue was somewhat higher —345 basis points— but was still modest in relation to the premiums required from other countries of the region.

Another US\$ 250-million international bond was issued in April 1999 with a 10-year term and a rate of 7.325% (a premium of 212.5 basis points).

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### **3. The main variables**

**(a) Economic activity**

Expansion in demand kept the annual GDP growth rate above 4% during the first half of the year, with increasing real household incomes and bank lending, high investment levels and sustained demand for non-traditional exports. These factors weakened during the second half of the year. On the one hand, international financial turbulence and Brazil's economic troubles affected external demand, which slowed and then contracted in the fourth quarter of 1998. Central Bank measures to restrain the surge in internal household credit held back domestic consumption, which also fell towards the end of the year. These contractionary factors were, however, outweighed by the boom in public and private construction in the second half of the year and the rapid recovery of agricultural output thanks to much-improved weather conditions. With shrinking external demand, much of the additional agricultural supply contributed to rising stock levels, already plentiful at the end of 1998.

Taking the year as a whole, gross fixed capital formation continued to grow rapidly (11%), bolstered by construction (18%) and, to a lesser degree, by investments in machinery and equipment (6%). The annual growth rate of private consumption slowed to 3%, halving the rate of the previous two years. Exports also suffered in the fourth quarter, with shipments increasing by a meagre 1.6%. As in previous years, the volume of imports continued to swell (9%), and the balance of

trade was once again in deficit. The Brazilian currency crisis of early 1999 and its repercussions on economic activity in Argentina worsened external recessionary pressure on the Uruguayan economy in the first few months of 1999, and internal consumption, both public and private, continued to decline.

Production grew in 1998 in all sectors except fisheries. Construction, electric power generation, gas and water were the best performers (14%). The public-sector construction boom (20%) contributed the most to the growth in construction, although the private sector also made a significant contribution (16%). Abundant rainfall enabled the hydroelectric power sector to generate a considerable surplus to export to Argentina, and in the gas and water sector, recent investments helped improve production capacity.

An increase of almost 6% in agricultural production more than made up for the previous year's losses, and a new record was set. Agricultural production has grown by 40% over the current decade, with increases in both livestock and crop-growing. High levels of calving boosted beef production and favourable weather and the use of new technology led to a significant improvement in dairy output; there was also good growth in poultry farming. The improved weather conditions in the second half of 1998 also led to improvements in crop yields, and the 1998/1999 harvest was better than that of 1997/1998.

Manufacturing industry also strengthened, although results varied within the sector and over the

year. Growth was high in the first quarter, boosted by increased output in the oil refinery, where production had been halted in the first quarter of 1997. Industrial output slowed in the second quarter, after which there was a moderate revival, so that output for the year showed an improvement of 2% (but only 0.5% if oil refining is left out of the calculations). The performance of the various sectors was uneven. On the one hand, higher regional demand strengthened food processing and the metallurgy and machinery industry (the latter being helped by growth in motor vehicle assembly), and growing domestic and foreign demand led to higher production in the paper and printing sector. On the other hand, textiles, clothing and footwear declined owing to strong external competition.

Service industries, apart from the infrastructure sector, grew at rates varying from 2% for commerce, hotels and restaurants to 6% for financial services, real estate and business services.

#### **(b) Prices, wages and employment**

The full achievement of the goals of the financial programme helped to fulfil the main economic policy objective: bringing annual inflation down to a single-digit level (8.6%).

On the one hand, the lower devaluation rate tended to slow the rate of increase in prices of tradable goods. Deflation in international prices, particularly for oil, had a similar effect. On the other hand, as in previous years, the prices of private education and health services rose faster than prices overall. The fall in prices of tradables accelerated in early 1999, and in the twelve months ending in April, the consumer price index increased by only 7.5%.

The increase in activity, along with modest price increases, had a positive effect on the labour market. The unemployment rate fell to 10% in early 1998, 1.5 percentage points down on the figure for mid-1997, and stayed close to that level throughout 1998 against a background of simultaneous growth in labour demand and supply. Much of the fall in unemployment was brought about by increasing labour demand; the employment rate rose to 54.3%, more than three points up on the previous year.

In order to reduce inflationary momentum, the procedure for public-sector salary adjustments had been modified in late 1997, with adjustments henceforth being made every six months instead of four. Many wage agreements in the private sector included similar provisions. Both public- and private-sector wage increases exceeded the rate of increase in domestic prices.

#### **(c) The external sector**

The current account deficit increased slightly to 2% of GDP. The result was somewhat better than expected: the merchandise trade deficit increased, while income from tourism declined. Despite international financial disturbances, Uruguay had no difficulty in obtaining financing, and its international reserves continued to grow, rising by about 1.7% of GDP.

Exports of goods increased by 2%. While sales of traditional goods contracted by 13%, those of non-traditional goods rose by 8%, exceeding the former by a factor of almost three. There was a surge in gross exports of motor vehicles to the region and in sales of dairy products, rice, meat and fish. On the other hand, falling demand reduced the value of exports of wool and textiles and of leather and leather products. The international crisis affected Uruguay's exports to the Asian countries, which fell by almost one third, and those to Brazil, which were flat. Nevertheless, sales to Argentina rose by 45%, boosted by motor vehicle exports under the trade mechanism governing the automotive sector.

Goods imports increased by less than 3%, much less than the high levels of previous years. The value of oil imports fell by 35% because of plummeting international prices; however, purchases of consumer and capital goods continued to rise steadily (5%).

Increasing sales to Argentina pushed the share of Mercosur in Uruguay's goods exports up to 55% of the total (18% to Argentina and 34% to Brazil). Almost all incoming tourist trade, which accounts for a quarter of goods exports, comes from the neighbouring countries; hence, about two thirds of the country's total exports were within the subregion. Consequently, the recent devaluation of the *real* is highly significant. Goods purchases are less concentrated, with the Mercosur countries making up 43% of the overall figure.

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## Venezuela

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### 1. General trends

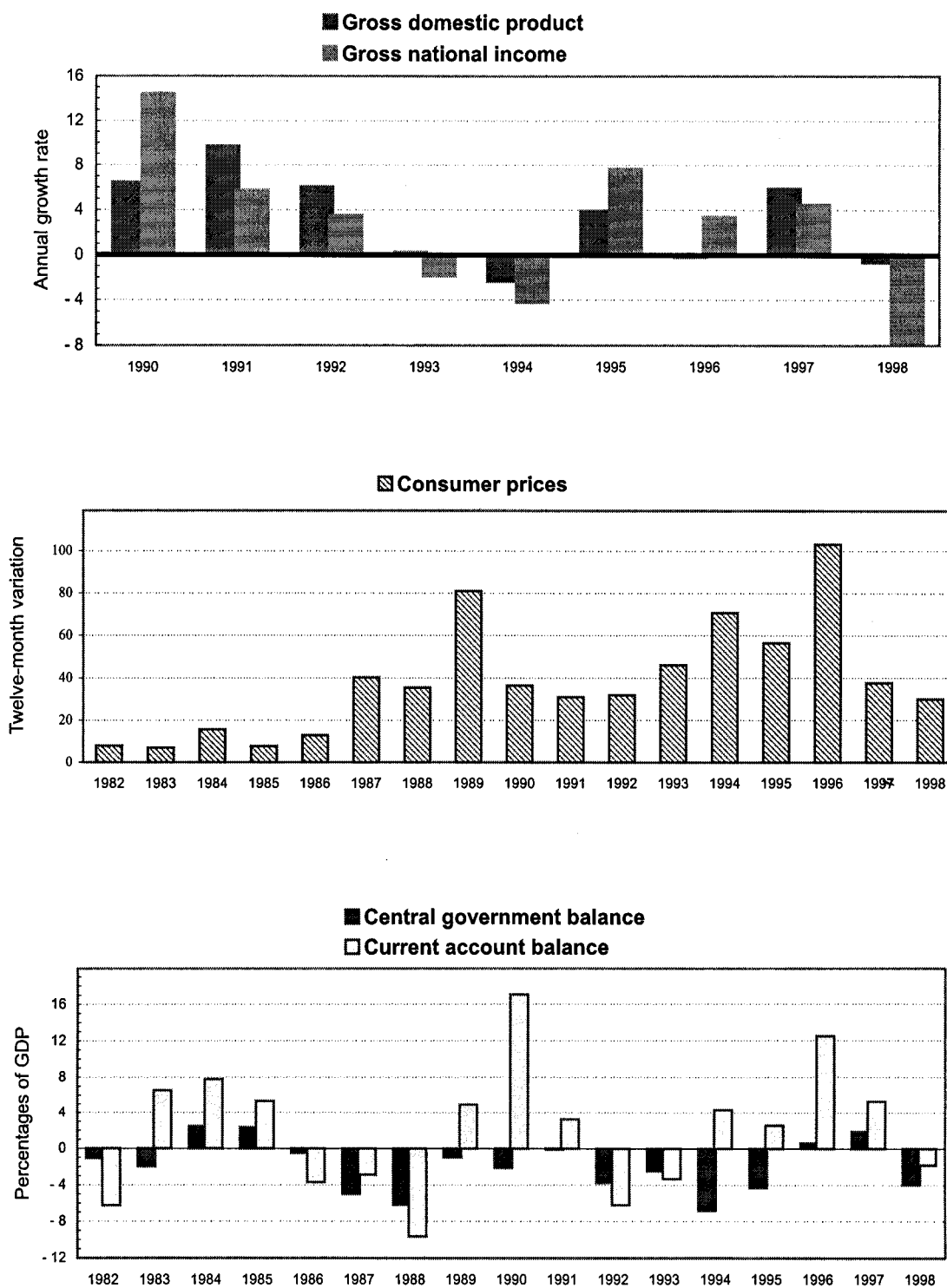
In 1998 and 1999, the Venezuelan economy suffered the full impact of the fall in the price of oil (the country's main source of income), and the effects of this phenomenon were compounded by the repercussions of the international financial crisis. The fact that the unit price of Venezuelan crude oil fell by one third was the main factor underlying the economy's slide into recession in 1998. The year ended with a 0.7% fall in GDP, and the recovery that had begun in 1997 was abruptly halted. The most immediate causes of this setback were the public spending cuts forced on the Government by the decline in fiscal revenues from oil and the rise in the cost of money that resulted from the decision to defend the exchange rate and maintain the anti-inflationary policy.

**THESE TWO FACTORS** were reflected in deficits on fiscal accounts and on the balance of payments (5.6% and 3.5% of GDP, respectively) that contrasted with the previous year's surpluses. In fact, the positive results achieved in 1997 helped to underpin efforts to protect the value of the bolívar, thanks to the massive reserves accumulated in the Central Bank of Venezuela. The small nominal depreciation of the currency, together with a weakening of domestic demand, made it possible to bring inflation down to slightly below 30%. Formal employment declined, while the percentage of workers employed in the informal sector increased, and unemployment appeared to be worsening.

The economic situation was also affected by uncertainty surrounding the congressional and presidential elections held at the end of the year, and then by the climate of political change that followed the election of Hugo Chávez as president. Given the continued weakness of oil prices, the new Administration sought the adoption of legislative measures designed to contain and finance the fiscal deficit forecast for 1999; to this end, it pressed ahead with negotiations on an agreement with the International Monetary Fund (IMF). Despite the upturn in oil prices at the end of the first quarter of 1999, the outlook is for a fall in output considerably sharper than that of 1998, persistent fiscal and current account deficits and a steady decline in inflation, possibly to a level of around 20%.



Figure 1  
VENEZUELA: MAIN ECONOMIC INDICATORS



Source: ECLAC, on the basis of official figures.

Table 1  
**VENEZUELA: MAIN ECONOMIC INDICATORS**

	1990	1991	1992	1993	1994	1995	1996	1997	1998 <sup>a</sup>
<b>Annual growth rates <sup>b</sup></b>									
Growth and investment									
Gross domestic product	6.5	9.7	6.1	0.3	-2.3	4.0	-0.2	5.9	-0.7
Per capita gross domestic product	3.9	7.1	3.6	-2.0	-4.5	1.7	-2.3	3.7	-2.7
Gross domestic product, by sector									
Goods	9.1	10.6	6.0	2.1	-1.4	4.9	2.3	7.4	-2.1
Basic services	1.0	5.7	5.1	1.4	-2.2	3.1	1.6	8.3	5.9
Other services	4.5	7.9	5.5	-1.7	-2.7	0.9	-3.9	2.2	-0.3
Consumption	3.2	9.1	6.9	-0.7	-4.7	1.2	-4.9	4.7	0.4
General government	5.0	15.2	-0.2	-5.2	-5.9	2.6	-7.6	3.6	4.3
Private	2.9	8.0	8.3	0.1	-4.5	0.9	-4.4	4.9	-0.3
Gross domestic investment	-7.9	80.2	38.2	-18.7	-29.3	36.5	-11.0	24.5	-5.2
Exports of goods and services	14.3	4.2	-2.0	12.0	8.1	6.3	7.8	8.7	1.4
Imports of goods and services	-5.7	49.6	26.2	-6.5	-18.5	23.9	-11.2	25.0	3.3
<b>Percentages of GDP <sup>c</sup></b>									
Gross national income	105.6	101.0	97.7	96.3	95.8	97.4	101.2	99.2	91.6
Gross domestic investment	10.9	18.1	23.4	19.0	13.8	18.1	16.0	19.0	17.9
National savings	26.2	21.0	17.5	15.9	17.8	21.0	28.3	25.4	15.5
External savings	-15.3	-2.9	5.9	3.1	-4.0	-2.8	-12.3	-6.4	2.4
<b>Percentages</b>									
Employment and wages									
Labour force participation rate <sup>d</sup>	58.6	60.1	59.6	58.2	59.1	61.6	62.2	63.8	65.2
Open unemployment rate <sup>e</sup>	10.4	9.5	7.8	6.6	8.7	10.3	11.8	11.4	11.2
Real average wage (index: 1995=100) <sup>f</sup>	138.1	130.1	136.5	124.4	104.8	100.0	76.7	96.3	101.5
<b>Growth rates</b>									
Prices (December-December)									
Consumer prices	36.5	31.0	31.9	45.9	70.8	56.6	103.2	37.6	29.9
Wholesale prices	20.4	23.1	26.0	47.4	89.5	...	...	...	...
External sector									
Terms of trade (index: 1995=100) <sup>c</sup>	141.8	119.3	110.4	104.2	103.1	100.0	115.6	112.0	83.0
Nominal exchange rate (bolívaes per dollar)	46.90	56.80	68.40	90.80	149.00	176.75	417.75	488.59	547.53
Real effective exchange rate for imports (index: 1995=100)	140.1	130.6	124.4	121.3	126.4	100.0	119.2	92.6	76.3
<b>Millions of dollars</b>									
Balance of payments									
Current account	8 279	1 736	-3 749	-1 993	2 541	2 014	8 824	4 684	-1 698
Trade balance (goods and services)	9 355	2 698	-1 629	90	4 520	3 829	10 421	6 838	14
Exports	18 806	16 388	15 514	16 119	17 679	20 753	25 258	25 120	18 941
Imports	9 451	13 690	17 143	16 029	13 159	16 924	14 837	18 282	18 927
Capital and financial account <sup>g</sup>	-7 238	135	2 699	2 262	-3 901	-3 400	-1 793	-1 434	-1 794
Overall balance	1 041	1 871	-1 050	269	-1 360	-1 386	7 031	3 250	-3 492
Variation in reserve assets (- indicates an increase)	-4 376	-2 645	845	144	1 173	1 910	-6 296	-2 625	3 931
<b>Percentages</b>									
External debt									
Gross debt (as a percentage of GDP)	73.1	67.3	63.6	68.0	70.5	49.7	50.4	36.7	32.3
Net interest (as a percentage of exports) <sup>h</sup>	5.9	-0.2	5.4	6.2	3.9	3.6	1.9	0.4	0.4

Table 1 (concluded)

	1990	1991	1992	1993	1994	1995	1996	1997	1998 <sup>a</sup>
<b>Percentages of GDP</b>									
Central government									
Current revenue <sup>i</sup>	22.4	22.8	17.2	16.5	17.1	15.7	19.2	23.1	16.5
Current expenditure	19.0	17.8	15.7	14.3	17.4	15.7	15.1	17.3	16.4
Saving	3.4	5.0	1.6	2.2	-0.2	-0.1	4.1	5.8	0.1
Capital expenditure (net)	2.6	2.1	3.2	2.8	2.4	2.8	2.1	3.0	3.3
Net loans granted	2.9	3.0	2.2	1.9	4.2	1.4	1.4	0.9	0.8
Financial balance	-2.1	-0.1	-3.8	-2.5	-6.8	-4.3	0.6	1.9	-4.0
<b>Growth rates</b>									
Money and credit									
Monetary balances of banking system									
Net international reserves	69.4	51.0	18.9	11.7	35.5	45.1	220.0	48.0	-4.2
Domestic credit <sup>j</sup>	34.0	21.0	30.0	77.3	132.2	74.8	...	...	835.0
To public sector	0.6	-63.2	191.0	254.9	182.3	110.7	-77.7	26.3	229.8
To private sector	25.1	47.9	33.1	12.0	6.5	47.8	100.0	115.6	3.1
Money (M1)	41.2	51.2	8.3	10.6	129.9	33.0	88.5	83.6	6.6
Local currency savings and time deposits	12.9	-32.8	-52.2	37.8	-6.9	28.1	294.3	-58.6	...
M2	60.9	49.5	18.4	25.7	56.3	36.3	-15.6	44.8	31.5
<b>Annual rates</b>									
Real interest rates (annualized, %)									
Deposit rate	-2.3	3.9	7.0	16.9	-11.0	-17.7	-34.6	-24.4	0.2
Lending rate	3.6	11.3	15.0	24.8	2.6	-5.2	-26.7	-19.4	6.8
Equivalent interest rate in foreign currency <sup>k</sup>	15.3	12.6	9.1	29.6	9.4	-1.4	-2.0	9.5	...

Source: ECLAC, on the basis of official figures.

<sup>a</sup> Preliminary figures. <sup>b</sup> Based on bolívars at constant 1984 prices. <sup>c</sup> Based on dollars at constant 1995 prices. <sup>d</sup> Percentages of the working-age population. <sup>e</sup> Percentages of the economically active population (EAP). <sup>f</sup> From June 1992 on, includes food and transport allowances. <sup>g</sup> Includes errors and omissions. <sup>h</sup> Refers to net interest as shown on the balance of payments, divided by exports of goods and services. <sup>i</sup> Includes as expenditure, net loans granted, extrabudgetary expenditure and Central Bank losses, which in 1995 amounted to 2.8% of GDP. <sup>j</sup> Apart from loans to the public and private sectors, includes the net amount of "Other accounts". <sup>k</sup> Interest rate on deposits, deflated by the variation in the exchange rate.

## 2. Economic policy

As usual in economies that are dependent on oil revenues (which are generally extremely volatile), economic policy was geared towards dealing with external contingencies, with a view to moderating their impact on the State's payment capacity and on macroeconomic equilibria. The recession helped in the fight against inflation, which was based on limiting the depreciation of the bolívar as a counterweight to inflationary pressures arising from the public sector's inability to adjust spending to reduced fiscal revenues.

The panorama was further complicated by the uncertainty inherent to a period of congressional and pres-

idential elections. The election, in December 1998, of a president who was independent from the traditional political parties led to expectations about the future direction of economic policy, particularly in view of announcements regarding policy changes and the holding, in late April 1999, of a referendum on the establishment of a constituent assembly. In this framework, the new president announced that he intended to limit the projected deficit in public finances and obtain the necessary funding abroad, even if that meant refinancing external obligations and negotiating an agreement with IMF.

Table 2  
VENEZUELA: MAIN QUARTERLY INDICATORS

	1996				1997				1998 <sup>a</sup>				1999 <sup>a</sup>
	I	II	III	IV	I	II	III	IV	I	II	III	IV	I
Gross domestic product (change from same quarter of preceding year)	0.1	-0.8	-1.0	0.9	0.7	8.6	8.7	5.5	9.7	1.7	-4.5	-8.2	...
Consumer prices (12-month variation, %)	78.2	108.1	115.5	103.5	75.0	43.6	39.2	37.6	38.2	39.1	34.4	29.9	27.6
Real effective exchange rate <sup>b</sup> (index: 1995=100)	112.7	132.0	122.3	109.8	101.2	96.0	90.3	83.0	79.1	76.1	76.4	73.4	69.6
International reserves (Millions of dollars)	9 983	10 907	12 684	15 229	15 976	16 655	18 330	17 818	15 796	15 499	13 006	14 849	13 442
M1 (change from same quarter of preceding year)	...	...	...	...	66.5	90.5	109.6	58.4	69.1	39.0	18.8	6.6	-1.6
Real interest rates (annualized, %)													
Deposit rate	-43.8	-51.0	-23.9	-19.5	-38.5	-25.3	-17.5	-16.2	-10.5	-4.7	9.2	6.6	0.9
Lending rate	-35.6	-42.3	-15.8	-13.2	-34.6	-20.1	-11.8	-11.1	-4.2	0.3	19.8	11.3	6.5

Source: ECLAC, on the basis of official figures.

<sup>a</sup> Preliminary figures. <sup>b</sup> Refers to exchange rate for imports.

The economic programme announced by the new Administration under the title "Project Bolívar 2000" consists of three sets of measures that are to be applied in sequence. The first of these is aimed at refurbishing part of the country's basic infrastructure in order to improve the situation of the poorest sectors of the population, with the participation of military personnel and civilian volunteers. The second involves redistributing State-owned land and implementing job-creation projects. The third group of measures consists of longer-term development projects.

#### (a) Fiscal policy

Central government's financial management in 1998 was constrained by the sharp fall in fiscal revenues resulting from the collapse of oil prices on the world market. The original budget estimates had been based on an average price for oil exported by Venezuela of US\$ 15.50 per barrel, which was already lower than the price of US\$ 16.30 obtained a year earlier. However, the headlong drop in prices brought the average for 1998 to below US\$ 11. Thus, the revenues

received by central government from this item fell to the unprecedentedly low level of 6.2% of GDP –less than half the 1997 figure and one third of the earnings obtained in a good year like 1990.

Successive downward adjustments to the estimated price of oil went hand-in-hand with other spending cuts. These cuts, which were estimated at 11% of the original budget, were not fully implemented; as a result, total government spending hardly changed at all as a percentage of GDP, and edged down from 21.2% in 1997 to 20.5% in 1998. The greatest cuts were made in wages, as the Government was unable to meet some of its commitments on labour-market liabilities and collective labour conventions.

Attempts to partially make up for the cut in oil earnings with higher receipts from other sources met with little success. Non-oil revenues rose only slightly, although they were higher than 10% of GDP for the first time since 1986. The largest increase in revenues came from customs duties, in the wake of higher imports.

As a result, central government accounts ended the year with a deficit of 4% of GDP (excluding proceeds

from privatization). To bridge the gap, the Administration issued debt on international markets; however, the terms on these markets were much more stringent, and between August (when Russia suspended payments) and November, they became practically prohibitive. Accordingly, most financing was obtained from domestic sources, in particular by drawing on deposits held by the National Treasury at the Central Bank and by issuing domestic debt.

The drop in oil revenues also translated into a 50% cut in the earnings of the State oil company *Petróleos de Venezuela S.A. (PDVSA)*, which barely topped 7% of GDP. The outcome of this was that total public-sector income shrank from 32% to 21% of GDP between 1997 and 1998. As total spending declined by a much smaller proportion (1.7% of GDP), the public-sector deficit was equivalent to 6.6% of GDP (or 5.6%, including privatization proceeds).

The 1999 budget bill was not approved by Congress, so the previous year's budget had to be rolled over, with the consequent potential for a substantial deficit, given the continuing decline in oil prices. The new Administration, which took office in February 1999, introduced measures designed to cut spending and hold the rise in minimum wages for public-sector workers to 20%, in line with expected inflation. It was also granted special powers by Congress to take steps to strengthen tax collection. Such measures included a levy on financial transactions, a broadening of the tax on luxury consumption and wholesale sales —so as to turn it into a genuine value-added tax— and income-tax reform. Meanwhile, the budgetary outturn for the first quarter posted a cash-flow deficit equivalent to 1% of GDP, and the Government had to raise funds by issuing treasury bills on the domestic financial market.

#### **(b) Monetary and foreign exchange policy**

The counter-inflationary policy implemented by the Central Bank continued to be based on a currency band of 7.5% on either side of a central parity, subject, since January 1998, to devaluation at 1.28% per month, in line with the inflation target. This policy was aided by the high level of international reserves, particularly when the bolívar came under speculative attack. Speculation became especially virulent in August, owing to the unfavourable external situation and the continuing real appreciation of the national currency. As inflation turned out to be higher than expected, and thus greater than the nominal depreciation during the year (the exchange rate moved from 504 to 564 bolívars to the

dollar), the real value of the local currency appreciated by 18% in 1998.

In its defence of the exchange rate, the Central Bank supplemented currency sales in the foreign exchange market by issuing credit instruments on the money market. The two policies together made it possible to moderate the expansion of primary money that had resulted, basically, from the drawing down of deposits held by central government and by PDVSA in the Central Bank and from the redemption of expiring monetary stabilization bonds. Consequently, the monetary base shrank in the first eight months of 1998, although later on, when external pressure and monetary policy eased temporarily, it grew again, ending the year with a 24% expansion.

The Central Bank's tight monetary policy (which included raising the rediscount rate and increasing penalties for non-fulfilment of the reserve requirement) and the Government's intervention in the domestic securities market to finance part of its deficit led to a gradual rise in interest rates during 1998, given the increased perception of risk and the prevailing expectation of devaluation. By mid-September 1998 (when Central Bank intervention was especially intense), deposit rates rose from 15% to 60%, and lending rates went up from 24% to approximately 75%, before easing back moderately, as confidence among economic agents was restored. This meant positive real interest rates after a long period of highly negative ones.

High interest rates on loans, combined with the recessionary climate, produced a further slowdown in bank lending and a worsening of non-performing loan indices, which, in turn, led to higher risk provisions. As a result, money supply (M1) grew by just 7% in nominal terms, a figure that was considerably below the inflation rate. Positive real interest rates on deposits encouraged the use of time deposits; thus, broader liquidity (M2) posted a 19% increase which, although greater than the expansion of M1, was still below inflation.

In the first quarter of 1999, the Central Bank continued to defend the bolívar, and the exchange rate was held to 590 per dollar by the end of April, thanks in part to higher oil prices. In implementing this policy, the Central Bank continued to sell foreign exchange, while limiting open-market transactions with its own monetary stabilization bonds. This enabled it to issue treasury bills, given the need to finance the fiscal deficit in an atmosphere of tight credit and falling interest rates (particularly from mid-February onward). The decline in international reserves caused the monetary base to shrink in the first quarter, despite the expansionary

effect of a further drawing on central government deposits in March, when the Government found itself especially short of funds. All components of liquidity contracted as a result, especially M1.

### (c) Structural reforms

The processes of strengthening social security and privatizing public-sector assets continued in 1998, with

the latter translating into sales worth 1% of GDP. However, attempts to privatize the large aluminium industry failed once again, and this issue was left pending. At the end of the year, a partial reform of the customs regime was decreed, and the Macroeconomic Stabilization Investment Fund was finally approved. This is an important tool for managing oil-based natural resources, and has the potential for smoothing out fluctuations in the Venezuelan economy caused by shock waves from the world oil market.

## 3. The main variables

### (a) Economic activity

In early 1998, the economy was still under the momentum that had enabled it to recover by nearly 6% the year before. Subsequently, however, the rate of activity slowed down steadily, falling sharply from the third quarter on, as it was weakened by the cuts in oil production and in public spending that followed upon the collapse of crude prices and the agreement among oil-producing countries to restrict the amounts they would supply to the market. Over the year as a whole, GDP fell by 0.7%, and this situation affected both the petroleum sector and the rest of the economy.

The decisive factor in the behaviour of aggregate demand was a 9% reduction in public-sector investment that is attributable, above all, to cuts in the oil investment programme and, to a lesser extent, to budgetary adjustments made by central government. The decline in public-sector investment easily offset the more-than-4% expansion of public consumption.

High interest rates and political uncertainty restrained private-sector spending, which lost the momentum it had shown the year before. Consumption was largely unchanged, as was private investment, where stagnation contrasted with the vigorous upturn (23%) recorded in 1997. In addition, the real appreciation of the bolívar and expectations of devaluation diverted part of private-sector demand towards imports, which grew by over 3%. Exports, on the other hand, were up only slightly (1.4%), and this expansion was driven by non-traditional products seeking an outlet abroad to make up for weak domestic absorption.

The public sector's influence on GDP was particularly evident in the manufacturing sector, which dropped back by nearly 5% as a result of a sharp cut in public-sector manufacturing. Apart from sugar refining, all branches of the sector posted worse results than the previous year, especially the manufacture of vehicle tires, steel products and aluminium. The number of vehicles produced fell from 157,000 to 126,000 but, even so, this is still the second highest level of all time.

The large mining sector reacted to the slowdown in oil drilling activity, which fell by nearly 1%. Agriculture also posted negative results, mainly owing to a poor grain harvest. Other sectors that declined or stood still included construction, commerce, transport and storage, and services to companies. The communications sector was the only one to achieve strong growth (over 20%). Livestock production, electric power, gas and water, financial services and insurance, along with personal and social services, all ended the year with slight improvements.

### (b) Prices, wages and employment

As economic activity slowed down during the year, the number of workers employed in formal activities declined. On average, in the second half of the year, there were 9,000 fewer jobs than in the same period a year earlier, with many of the losses occurring in the oil sector. Laid-off workers, together with surplus new entrants to the labour market, found work in the informal sector, which absorbed nearly 338,000 people during the same time span. This made it possible to hold the

open unemployment rate at 11% during the second half of 1998, which was close to the levels of the two previous six-month periods. However, the percentage of workers in the informal sector, which had stood at 47.7% in the second half of 1997, rose to 49.8% a year later. The available data pointed to a significant rise in the open unemployment rate as the recession stretched into 1999.

The same factors that had a negative effect on activity and employment, including the scant nominal depreciation of the currency, helped to keep price rises in check. As a result, the downward, albeit fluctuating, trend that had been evident in inflation since the adoption, in mid-1996, of "Agenda Venezuela" continued. In early 1998, the downward course of the monthly rate was reversed, as it climbed from 2% in January to 3.4% in April; however, it then resumed its decline and finished the year below the January figure. The monthly inflation figures for March and April 1999 came in at 1.2% and 1.1%, the lowest rates in the ten years since price controls were discontinued in the context of the adjustment programme of 1989.

For 1998 as a whole, the consumer price index (CPI) reached 30%; although high, this figure was down from the previous year's 37.6%. Every product group in the CPI shopping basket saw a slowdown, with clothing and footwear prices going up the least, followed by household expenses. Import prices rose by less than those of locally produced goods, and this was reflected in the more modest increase in prices of durable goods (less than 9%) as compared to non-durables (27%). As usual, prices of services rose faster (35%), but they also slowed down more, thereby highlighting the effect of weak domestic demand. As a result of this, the trend of the CPI began to converge with wholesale and producer prices, which do not cover services. As regards the sectoral sources, agricultural goods accounted for most of the CPI increase (46%), suggesting that overall inflation would have been lower had it not been for the poor harvests, particularly in March and April.

On 1 May 1998, the minimum wage was raised from 75,000 to 100,000 bolívares, thereby preserving purchasing power in the lower wage brackets. On the same date a year later, a further 20% increase took effect for public-sector workers, and this was extended to private-sector employees as a result of negotiations between Government, employers and labour unions. Overall, average incomes for both white- and blue-collar workers rose more than inflation in 1998 —by over 5%, in real terms. Thus, real wages continued to climb back from the steep fall they had experienced

in the high-inflation period between 1994 and 1996, although they were still more than 25% down from their 1993 level. Moreover, the recovery was concentrated in private-sector wages, inasmuch as public-sector workers saw their purchasing power decline. Even so, real wages in the public sector were still above their private-sector equivalents.

### (c) The external sector

The external shock that hit the Venezuelan economy was clearly reflected in the balance of payments, where both the current and the financial accounts recorded large deficits. This first current account deficit in five years approached US\$ 1.7 billion —a deterioration of nearly US\$ 6.4 billion with respect to 1997 and 10.6 billion compared to 1996. The magnitude of the deficit was mainly due to the steep fall in oil revenues, which, at US\$ 12.23 billion, were down by US\$ 6 billion from 1997, when oil had accounted for nearly 80% of Venezuela's merchandise export earnings.

Other exports, mainly consisting of commodities (at various degrees of processing) and derived products, grew slightly in value terms, boosted by a rise of about 15% in the volume of private-sector shipments. Sales of gold and petrochemical products increased, and this offset the decline in exports of aluminium, steel, cement and fish products. Non-oil exports continued to be sent mainly to Colombia and the United States.

Merchandise imports grew rapidly in the first half of the year, driven by the economy's initial momentum, the real appreciation of the bolívar and imports of equipment for the oil industry in connection with recent agreements to open up the sector to foreign capital. In the second half of the year, there was a slowdown, as domestic demand weakened. For the year as a whole, imports were more than US\$ 1 billion above their already high 1997 level —an increase of nearly 8% in value and 6% in volume terms.

The financial-account deficit compounded that of the current account to produce an overall deficit of nearly US\$ 3.5 billion. This was mostly attributable to a decrease in medium- and long-term inflows to the private sector from foreign direct investment and borrowing, and to private short-term capital outflows.

Net short-term capital outflows were estimated at more than US\$ 4.6 billion in 1998. Foreign direct investment was down by US\$ 1.3 billion on the previous year's figure —which had been particularly high as a result of the opening up of the oil industry to foreign capital—, but it still amounted to a substantial US\$ 3.7

billion. Reduced entry of medium- and long-term loans to the private sector resulted in a shrinking of the outstanding external debt held by the private sector, which dropped below US\$ 4.2 billion. Income received by the public sector from the issuance of Republic Bonds to a value of US\$ 488 million on the international market, together with net borrowing of US\$ 1.235 billion by the State oil company PDVSA, made it possible to amor-

tize the public-sector external debt, so that the balance outstanding was reduced to less than US\$ 26.5 billion.

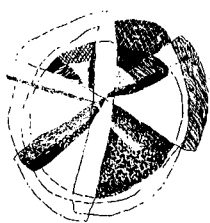
The external deficit was financed mainly with foreign exchange reserves held by the Central Bank; these were run down from US\$ 17.818 billion at the end of 1997 to US\$ 14.849 billion at the end of 1998. The latter figure was still equivalent to nine months' imports of goods and services.





## Part Three

### Caribbean countries





## Economic trends in the Caribbean

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### 1. Introduction and synthesis

The pace of economic activity was sustained in the Caribbean in 1998, with the subregional product increasing by an average of 2%. Nevertheless, performance was relatively uneven both among the countries and across production sectors. Real-sector activity was bolstered by the relatively strong performances of construction and tourism. Construction was boosted by strong private-sector investment and, in the countries affected by hurricane damage, by the necessary reconstruction and repair work. Manufacturing performance, though mixed, was relatively weak, mainly because of structural factors. In most countries, the sector has not undertaken the restructuring process needed to face external challenges, and productivity and efficiency levels are usually low. Real-sector activity suffered as a result of the decline in agricultural output, which was hurt by hurricane damage, generally adverse weather conditions and worsening commodity terms of trade.

**TRADITIONAL AGRICULTURAL** commodities were particularly hard hit, with sugar output contracting by roughly 15%. Similarly, banana production declined by an average of about 6% despite moderate growth in the countries belonging to the Organization of Eastern Caribbean States (OECS). Agricultural value added weakened in Belize, Guyana, Jamaica and Trinidad and Tobago, while output improved in the OECS countries. Strengthened activity in the OECS

was explained by growth in banana output in response to measures aimed at restructuring and streamlining the industry to improve its competitiveness. This was particularly important to these countries in light of the industry's substantial contribution to output and employment and the adverse ruling of the World Trade Organization (WTO) concerning the European Union's banana regime, which had provided these countries with preferential access to the European market.

Generally, money growth accelerated somewhat in 1998 due to an increase in credit to the public sector in some countries. In addition, liquidity in the banking system remained fairly high. The persistent slackening of monetary restraint in the latter part of the year to accommodate import demand continued, with its attendant adverse current account effects.

Government finances generally weakened in the region in 1998. Finances stabilized in Jamaica, however, and improved in the Bahamas. Even where government finances showed an improvement on the current account, however, these advances were often offset by higher capital expenses.

Prices remained relatively stable during the year thanks to lower imported inflation from trading partners and the generally dampened economic activity in the region. Some price rises were triggered by the short-

age of domestic agricultural output occasioned by adverse weather conditions, but these increases did not outweigh the beneficial effects of the above factors.

Unemployment remained relatively stable; it declined moderately in Jamaica, Barbados and Aruba, but was up in Belize. Employment gains in the countries came primarily from construction, tourism and services. Meanwhile, youth and female unemployment remained at rather high levels.

The external payments accounts of the subregion worsened in 1998, largely on account of declining merchandise positions. The trade deficits of most of the countries shifted upward in response to worsening commodity terms of trade and contracting commodity exports. The attendant weakening of their current account positions was only partially compensated for by capital inflows.

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## 2. Economic policy

### (a) Monetary developments

Record levels of foreign investment and strong bank capitalization supported robust monetary expansion in the **Bahamas**. The broad money supply (M2) grew by 15.3% to US\$ 2,843,500,000 following slower growth of 10.7% in 1997. Fixed-term deposits, which comprised 63.6% of broad money, registered strong growth of 16.4% (US\$ 254.8 million), compared with 8.9% growth in 1997. Savings deposits also showed a robust growth rate of 11.5% (US\$ 37.8 million). The expansion of the overall money supply (M3) climbed to 15.8%, up from 11.1% the previous year. Foreign-currency deposits, which differentiate M3 from M2, increased by a steep 46.4%, which was comparable to the 43.8% growth seen in 1997. Narrow money (M1) grew by 16.4%, which was marginally slower than the year before.

Boosted by strong lending to the government and public sectors, domestic credit expanded by 12% (US\$ 366.4 million), as compared to 10.2% in 1997. Net credit to the government sector moved up by 7.8% (US\$ 32.8 million), while disbursements to the rest of the public sector grew sharply (by 54.1%, or US\$ 47.9

million). The pace of expansion of credit to the private sector slowed to 11.2% (US\$ 285.7 million) owing in large part to a Central Bank directive which curtailed the annualized growth rate of credit in the first half of the year. Consumer lending was down sharply as a proportion of personal loans, slipping to 66.8% versus 88.4% in 1997. Banking system liquidity remained buoyant, with a 34.1% growth rate in net available cash reserves in the banking system. Average deposit interest rates moved up by 30 basis points to 5.6% while average loan rates fell by 50 basis points to 12.3%, resulting in a marginal decline in the interest rate spread.

Liquidity in the banking system in **Barbados** tightened in 1998, following a strong build-up in 1997. The contraction in liquidity was accounted for by increased investment in government paper by non-banks to take advantage of higher returns, a decline in foreign exchange earnings and a faster expansion of credit, especially in the tourism sector and in personal loans, as a result of the buoyancy of economic activity. By year's end, the excess liquidity ratio stood at 10%, down from 14.8% in 1997. Domestic deposits were up marginally by 1.4% while credit to the non-financial private sector

Table 1  
**CARIBBEAN SUBREGION: GROSS DOMESTIC PRODUCT**  
*(Annual growth rates)*

	1991	1992	1993	1994	1995	1996	1997	1998 <sup>a</sup>	1991-1998
<b>Caribbean subregion</b>	<b>1.8</b>	<b>0.9</b>	<b>0.5</b>	<b>3.3</b>	<b>2.5</b>	<b>3.2</b>	<b>2.0</b>	<b>2.0</b>	<b>2.0</b>
Antigua and Barbuda	4.1	1.0	3.5	4.8	-4.3	5.5	4.6	2.8	2.7
Barbados	-3.5	-5.4	1.0	3.6	2.5	5.1	3.0	4.4	1.3
Belize	3.4	8.9	4.0	1.6	3.5	1.0	4.0	1.6	3.5
Dominica	2.6	3.0	2.2	2.1	2.3	2.9	2.7	3.5	2.7
Grenada	3.7	1.0	-1.1	3.4	3.0	3.2	4.7	5.0	2.9
Guyana	10.2	11.2	3.1	17.7	2.4	9.2	6.1	-1.3	7.2
Jamaica	0.3	2.5	1.8	1.9	1.7	-0.5	-2.3	-0.7	0.6
Saint Kitts and Nevis	3.4	3.6	6.7	3.3	3.1	5.5	6.3	4.0	4.5
Saint Vincent and the Grenadines	1.6	6.7	2.4	-2.6	7.8	1.7	3.2	5.5	3.2
Saint Lucia	-2.0	7.3	0.4	1.9	0.7	0.5	0.9	2.9	1.6
Suriname	4.4	-1.9	-8.5	-4.0	-1.7	20.7	3.6	0.0	1.3
Trinidad and Tobago	3.5	-1.1	-1.2	4.2	4.1	4.0	4.2	3.6	2.6

Source: ECLAC, on the basis of official figures converted into dollars at constant 1995 prices.

<sup>a</sup> Preliminary figures.

increased by 11%. As is usually the case in a context of stable economic activity, the personal sector absorbed most of the increase in the form of loans to finance cars, home improvements and the acquisition of real estate.

Broad money (M2) registered strong growth of 18.5% as against 11.1% in 1997. Meanwhile, the growth rate of narrow money decelerated to 3.6%, down from a strong increase of 22.6% in 1997. Monetary policy remained largely unchanged, with the Central Bank's discount rates remaining constant at 4% and 9%. Accordingly, commercial bank interest rates were relatively stable, with average deposit rates at 4.2% while loan rates fell by 40 basis points to 11.1%.

Influenced by the weakened growth of economic activity, especially in the export sector, broad money (M2) growth in **Belize** slowed to 8.1% from 13.6% in 1997. As in 1997, money growth was stimulated by the upswing in domestic credit to the public and private sectors. Narrow money (M1) expanded by 10.8%, the highest rate in the last five years. Demand deposits quadrupled, while cash outside banks moved up by 6%. Growth in quasi-money, however, slowed from 12.1% to 7.1% as part of a trend related to the significant draw-down of deposits for Christmas purchases. This type of growth in consumer spending needs to be held in check because it feeds through into an expansion of the current account deficit. Savings deposits grew by

4.1%, versus 6.7% in 1997, while time deposits increased by 8.1%, which was more than 5% less than a year earlier. Average deposit rates slipped by 70 basis points to 6% during the year, while loan rates declined by 30 basis points.

Meanwhile, the net foreign assets of the banking system declined significantly, by 27.6%. Central bank foreign assets were drawn down substantially (by over 24%) to accommodate the demand of commercial banks for payments for imports of goods and services.

Mindful of the nexus between stability and growth, monetary policy in **Guyana** continued to be directed towards achieving stability in prices and in the money and foreign exchange markets. Growth in broad money (M2) slowed to 6.6%, compared with 15.2% a year earlier due to weakened economic activity and sluggish demand for credit by the private sector. Narrow money (M1) growth also decelerated to 2.1% in contrast to 20.9% in 1997.

Credit to the private sector grew by 15.5%, following growth of 23.6% in 1997. The bulk of this credit went to the manufacturing sector, which has recently rebounded somewhat, and to mortgages. The Central Bank intervened in the financial system to sterilize the high level of excess liquidity through open market operations. With relatively firm monetary control, interest rates in the banking system remained fairly stable.

In **Jamaica**, a number of monetary policy targets were set for 1998 in order to contribute to the stabilization effort. Base money was targeted to grow at a slower pace to facilitate a reduction in inflation to a range of 6%-8% and to protect the value of the local currency. Lower inflation and lower reserve requirements were expected to induce a reduction in interest rates and to boost productive investment. However, the anticipated interest-rate and investment-promotion effects did not materialize.

During the year, base money contracted by 2%, largely as a result of a fall in statutory reserves. Narrow money (M1), however, was up by 5.4%, compared with a decline of 0.5% the previous year. Cash outside banks rose by 8.5%, or just over half as much as the year before, while demand deposits were up by 3.1%. In 1998, the broad money supply (M2) grew at the slower pace of 7.2%, around the same rate as inflation. This was indicative of the authorities' success in containing both money growth and inflation.

With respect to the components of broad money, quasi-money increased by 8%, sharply down from a growth rate of over 20% in 1997. Savings deposits rose by 4.4%, in contrast to the exceedingly robust growth rate of 31% a year earlier. However, time deposits expanded by 19.1% after contracting by 4.4% in 1997. This rebound was fueled by greater confidence on the part of depositors in the financial system and the wider interest rate spread between savings and time deposits.

The primary sources of money growth during the year were the more than 100% (J\$ 46.7 billion) increase in credit to the public sector and a build-up of international reserves. Notably, private sector credit contracted by 18%, largely as a result of the purchase by the Financial Sector Adjustment Company (FINSAC) of J\$ 8.4 billion in non-performing commercial bank loans. The general growth in public-sector credit and the reduction in commercial loans to the private sector reflect the fragile position of the banking sector in the wake of the financial crisis and illustrate its negative impacts on private investment.

Net foreign assets contracted by 4%, thus helping to contain the growth of the money supply. The 10.7% rise in the net international reserves of the Bank of Jamaica was more than offset by the 73% fall in commercial banks' foreign assets. Monetary policy during the year relied primarily on indirect instruments to influence money and credit markets. Base money management was the main tool used to control short-term liquidity. Cash reserve requirements were reduced, however, to encourage commercial banks to reduce in-

terest rates in order to stimulate investment. Although the 30-day reverse repurchase rate—the main signal rate of the Bank of Jamaica—fell by 7%, the average weighted deposit rate shifted upward by 1.4 percentage points to 15.5%. The average loan rate fell by 2% to 33%, however. With growing uncertainty in emerging markets, the Jamaican dollar came under some pressure in the second half of the year as local investors sought to increase their holdings of foreign assets. As a result, the Central Bank supplied US\$ 112.5 million to maintain confidence in the integrity of the local currency.

Towards the end of 1998 the broad money supply in the **Netherlands Antilles** grew moderately as a result of an increase in net international reserves in the fourth quarter of the year. The total liabilities of the Bank Van De Nederlandse Antillen rose by 1.5% in 1998, from NAf 774.2 million to NAf 785.7 million. Growth in private sector credit was marginal and well within the growth limit of 2.25% of the monetary cash reserve arrangement. In 1999 the Government was expected to continue with the fiscal consolidation effort it began in 1998.

In **OECS**, broad money (M2), which averaged EC\$ 3,883,300,000 between 1994 and 1998, grew by 12.5% to EC\$ 4,862,000,000 in 1998, up from growth of 9.6% in 1997. Quasi-money expanded by 12.3%, supported by growth of 17.6% and 9.8% in time and savings deposits, respectively. Growth in narrow money (M1) accelerated to 13.2% from 9.2% the previous year. Demand deposits increased by 14.7%, while cash outside banks rose by 10.1%.

Domestic credit expansion slowed to 7.2%, down from 13.3% in 1997. This largely reflected a slowdown in the growth of credit to the private sector, which rose by 8% as compared to 13.3% in 1997. Credit channelled to businesses moved up marginally by 7.5% as against 6.2% the previous year. Liquidity in the banking system slackened, with the loans and advances/deposits ratio falling to 86% from 88.6% in 1997. Overall, events relating to monetary variables sparked as a steep rise in net foreign assets, which jumped up by 50% to EC\$ 990.8 million on the heels of a decline of 6.2% the previous year.

The main plank of monetary policy in **Trinidad and Tobago** during the year was the management of liquidity and credit with a view to maintaining the stability of the local currency. In keeping with this policy, the Central Bank imposed statutory reserve requirements on non-depository funding instruments for the first time. Monetary policy was generally less tight than in 1997, but the Central Bank continued with its efforts to

manage liquidity in such a way as to dampen any movements in demand that could affect the exchange rate. The Central Bank's interventions in the foreign exchange market led to the sale of US\$ 35 million to commercial banks. Open-market repurchase agreements were also introduced as an instrument of liquidity management.

Liquidity fluctuated during the year, ranging from a fairly high level during the first quarter to reduced levels during the third quarter, followed by some improvement in the final quarter. The Central Bank intervened in the market from time to time to mop up excess liquidity. In response to the Bank's liquidity management policies, interest rates shifted upward. Commercial banks' prime lending rate was raised from 15% to 17.5% as a result of the increase in reserve requirements. Meanwhile, savings- and time-deposit median interest rates were up by between 29 and 90 basis points.

Commercial bank credit declined by 3.1%, compared with robust growth of 23% a year earlier, due in part to the rise in the cost of finance. Disbursements to the private sector (75% of the total) were about 7% of what they had been the previous year. One disturbing trend in this respect has been the continued flow of a major portion of the credit supply into consumer lending, especially for the purchase of motor vehicles and consumer durables. Consumer loans rose by 13.5% while loans to businesses were up by 13%. Credit to the central government fell by 1%, however.

Deposit inflows associated with improved economic activity led to growth of 12.3% in broad money (M2), up from 11.6% in 1997. Time deposits grew sharply (by 22.9%) versus a decline of 2.3% the previous year. Savings deposits increased by 12.3% and were thus marginally stronger than a year earlier. Narrow money (M1) grew by roughly 6% after posting a strong upswing of 19% in 1997. This was largely the reflection of a 5.4% decline in demand deposits, which was too sharp to be offset by the 6.6% rise in cash outside banks. Foreign-currency deposits recorded strong growth of about 32% compared with an increase of 10.6% in 1997.

#### (b) Public finance and fiscal policy

By the end of 1998, the total revenue received by the Government of **Aruba** had increased by 4.6% to Af 647.6 million from Af 619.4 million one year earlier. Tax receipts were 7.2% above the 1997 figure of Af 499.7 million. Non-tax revenue increased by 6.5% in 1998 to Af 95.6 million. Total expenditure measured on a cash basis (including expenditure on projects

funded by development from the Netherlands Aid) is estimated to have fallen by 2.3% in 1998, possibly as an effect of payment arrears. The fiscal balance yielded a deficit of Af 28.5 million, a somewhat improved position as compared to the deficit of Af 72.5 million posted at the end of 1997.

Indications are that despite an increase in revenues, the collection system did not function efficiently and tax evasion was therefore a problem. The newly-elected Administration introduced a policy to restore fiscal discipline in mid-1998 and instituted cost-cutting measures. Strict monitoring of expenditure was introduced, and this contributed to a decline in the fiscal deficit to 0.9% of GDP. Tightened fiscal discipline is expected to improve the tax take in 1999 and reduce the amount of arrears owed to suppliers.

At the end of 1998, the government debt amounted to Af 1,304,000,000 (34% of GDP). One third of that debt was owed to external creditors, primarily the Netherlands Government. Most of the external debt is on concessional terms (at rates of 2.5% or lower).

In the **Bahamas**, the fiscal consolidation target for fiscal year 1997-1998 was largely achieved through improved expenditure management and stronger revenue outturn. The overall fiscal deficit contracted sharply, decreasing by 50.1% to 1.7% of GDP, down from 3.6% in 1997.

Revenues and grants grew by 11.6% —the first double-digit increase in five years— to reach roughly 18.5% of GDP. This relatively strong performance was built on economic growth and improved tax administration and collection. Recurrent revenues shifted upward by 6% to B\$ 731.4 million, or 17.7% of GDP. Tax performance was fairly even, with all the major categories recording growth in receipts. Revenue from selected taxes on services rose sharply, by 26.5%. Proceeds from taxes on international transactions, which comprised roughly 60% of total revenue, grew by 10.4% to B\$ 455.7 million. Business and professional fees also contributed with a 2.4% increase in receipts. Other taxes, which include a property tax and a motor vehicle tax, registered a 12% increase in proceeds.

Total expenditure, including the balance on lending to public entities, rose slightly (by 1%) to B\$ 835.4 million, or roughly 20% of GDP. Recurrent spending climbed by 5%, but remained at about 17% of GDP. Recent pay increases contributed to an 8.6% rise in outlays on wages and salaries. Interest payments rose marginally by 1.4% while transfers and subsidies were down by 6%.



Capital outlays and net lending contracted by 17.3% to 3% of GDP, mainly due to lower investment in road, water-supply and other infrastructure projects. The 1998 fiscal deficit was financed primarily through domestic borrowing totalling US\$ 127 million (US\$ 6 million in domestic loans and US\$ 121 million in government bonds).

Public-sector foreign currency debt declined by 10.2% to US\$ 348.7 million. Liabilities of the central government (36.5% of the total) contracted by 10.6%. Public corporations also made net debt repayments. Debt service payments, measured as a proportion of exports of goods and non-factor services, fell to 3.9% from 5.5% a year earlier.

The fiscal position of the central government of **Barbados** weakened somewhat in 1998, following a strong improvement the year before. The central government's fiscal deficit moved up by 1.3% but remained at 0.9% of GDP after falling by almost 70% in 1997. A stronger 9.8% increase in current expenditure coupled with growth of only 7.2% in current revenues led to a 7.3% drop in the current account surplus, which thus shrank to 4.5% of GDP. In the expenditure account, spending on wages and salaries was up fairly sharply by 13.8% to 12.5% of GDP, on the heels of a rise of 2.2% the previous year. This upswing resulted largely from the wage settlement reached with public-sector workers, which was retroactive to 1997. Interest payments were up by 7.4% after falling by 11.6% a year earlier. Transfers and subsidies increased by 10.5% owing to increased outlays for pensions and the settlement of outstanding obligations to the University of the West Indies.

Current receipts, which amounted to 33.3% of GDP, were up by 7.2%, or half as much as the previous year. Direct tax receipts rose by 7.1%, which was somewhat slower than in 1997, owing in part to a fall in property tax proceeds. Indirect tax revenues climbed by 5.1%, after significant growth in 1997. VAT receipts showed vigorous growth of 10.1%.

Deficit financing took the form of increased holdings of government paper by the National Insurance Scheme on the order of BDS\$ 126.2 million. Meanwhile, commercial banks reduced their government lending by BDS\$ 32.6 million, and lending from the Central Bank was down by BDS\$ 30.2 million. Total external indebtedness fell by 1.8% in 1998 to 7.4% of GDP, after a decline of 4.3% in 1997.

Fiscal accounts weakened slightly in **Belize**, with the deficit rising from 2.1% of GDP in 1997 to an estimated 2.3% in 1998. This outturn resulted from growth in net capital spending, as the current account surplus

strengthened in 1998. Capital expenditure grew by 16.2% —almost twice as much as in 1997— to BZ\$ 95.1 million, or 7.5% of GDP. In contrast, capital revenue declined by 11.8%, following an increase of 9.7% a year earlier.

Current spending grew moderately (by 3.1%) to roughly 20.6% of GDP. Public-sector wages and salaries increased by 7.8%, while transfers and subsidies were up by 6.2%. Growth in these categories, however, was offset by a welcome 10.8% fall in interest payments.

Current revenues were up by 5% to 23.6% of GDP. Tax receipts, which averaged \$ 205.2 million between 1994 and 1998, grew by 2.5%, largely on account of increases in taxes on income and profits (15.6%), taxes on international trade (5.1%) and property taxes (7%). Income taxes generated improved revenues following the introduction of the Income Tax Amendment Act in 1998. Higher receipts from taxes on international trade were attributable to increased revenues from duties on fuel imports.

Central government finances weakened in **Guyana** in 1998, with the fiscal deficit widening from 6.7% of GDP in 1997 to 9.5% in 1998. This deterioration in the fiscal position was explained largely by a relatively sharp decline in revenue, as total revenue and grants fell by 7.4% to about 37% of GDP. Recurrent revenue fell by 2.8% or roughly 36% of GDP, down from 31% in 1997. Tax revenue edged down by 1.5%, while non-tax receipts slipped by almost 100%. Capital revenue and grants contracted substantially (by over 59%), mainly owing to a 70.4% fall in grant receipts. The overall reduction in revenue was primarily due to the disruption of economic activities and public administration in general during the political disturbances following the general election of 1997 and to the drought conditions associated with El Niño, which adversely affected growth in high tax-incidence sectors.

Total expenditure declined by 3.1% (half the rate for total revenue and grants) to stand at 46.5% of GDP, up from 40.4% in 1997. Current expenditure grew by 7.1%, compared with growth of 17.3% the previous year, to reach 32.5% of GDP. Allocations for wages and salaries were up by 9.6% —four times the rate for a year earlier— to stand at about 11% of GDP. Interest payments edged up by 1.1% to account for 11.2% of GDP, up from 9.3% the previous year. In contrast, capital expenditure declined significantly (by 20.4%) to a level equivalent to 14.1% of GDP. The fall in capital expenditure reflected reduced capital spending by public enterprises and enabled them to post a surplus.

The Government financed the deficit through a mixture of domestic debt, external loans and grants. Meanwhile, the stock of external debt, which averaged US\$ 1,721,000,000 between 1994 and 1998, contracted by 1.1% in 1998 as a result of higher net outflows to multilateral and bilateral creditors. The country benefited from a debt write-off of US\$ 253 million under the Heavily Indebted Poor Countries (HIPC) initiative in 1998.

The Government of **Jamaica** set itself a number of fiscal objectives, including a reduction in the fiscal deficit to 4.6% of GDP. This target was not achieved, however, as the fiscal deficit dropped by only 5.3% to stand at 8.2% of GDP, almost twice the planned figure. Total revenue and grants rose by 11.5% to account for 32% of GDP. Current revenue expanded by 12.4%, or almost double the growth rate for 1997. Tax revenues, which have averaged J\$ 44,954,600,000 over the last five years, moved up by 13.1% to 28.9% of GDP. On the other hand, non-tax receipts fell slightly (by 0.4%). In contrast the 1.7% decrease in capital revenue, levies and grants brought this variable down to 1.7% of GDP.

Total spending grew at the slower pace of 8.8% in 1998, moving up to 39.5% of GDP as a result of the fall in this aggregate. Recurrent expenditure registered stronger growth of 17.5%, growing to 36.6% of GDP from 32.7% in 1997. There was an encouraging reduction in the growth rate for spending on wages and salaries, one of the most intractable outlays, which grew by 9.8% —just under half the rate for 1997. Interest payments, which represent a significant claim on resources, rose by 40.8% to 14.9% of GDP, after declining by 10% in 1997. Recurrent revenue and spending developments led to a sharp 50% increase in the current account deficit, driving it up to 6.3% of GDP.

Given the country's recurrent dissaving, resources were not freed up for capital spending. Capital expenditure contracted substantially —by 43.1%— to account for only 3% of GDP. Gross investment, which averaged J\$ 8,899,500,000 for the five-year period up to 1998, was down by 70.4%, falling to 3% of GDP from 10.6% a year earlier. This reflected a return to the pre-existing growth trend for gross investment after the considerable outlays made for debt acquisition under FINSAC in 1997. Outlays on debt amortization increased by 20%, just over a third of allocations for 1997. Debt servicing, which has been the bane of the fiscal consolidation effort, recorded steeper growth of 29.6%, thus climbing to the considerable ratio of 29.8% of GDP. In fact, it is difficult to see how fiscal consolidation and

overall macroeconomic stabilization can take place without some way being found to alleviate the strain of debt service payments. This may be an essential condition for a return to stable long-run growth.

The total external debt went up by a negligible 0.9% to US\$ 3.3 billion, compared with a rise of 1.4% in 1997.

In the **Netherlands Antilles**, the general government recorded a surplus computed on a cash basis in the fourth quarter of 1998. The figure was slightly higher than the surplus posted at the end of the corresponding period of the previous year. This favourable situation was attributed to an increase in revenues that outstripped the increase in expenditures for the period in question. The increase in revenues was mainly due to an upturn in import duties associated with the growth in transshipment activities to the European Community and a windfall in inheritance and gift taxes. For the year, however, the cash deficit of the general government deteriorated to NAf 85 million, the result of increased expenditures. A considerable portion of the increase in expenditures was due to the reduction made by the central government in arrears to the civil servants pension fund.

Most **OECS** Governments' objectives for their 1998 budgets included fiscal reform and strengthened public sector finances. Current account savings were to be used to partially finance capital projects, thereby reducing the need for debt instruments. The extent to which individual Governments were able to achieve these objectives depended on the level of growth in activity and the buoyancy and revenue elasticity of taxes, along with the extent of inertia in public spending, which is exceedingly sticky upwards. Aggregate finances weakened in this group of countries in 1998. The overall fiscal deficit climbed by 60% to \$ 250.4 million or 3.6% of GDP. Improvement in the current account was offset by a deterioration in the capital account. The current account surplus moved up by an encouraging 31.9% to 1.4% of GDP. Current revenues rose by 7.6%, almost twice the pace for 1997, to stand at 25.3% of GDP. Tax receipts were up by 8.8%, proceeds from taxes on income and profits grew by 6.6%, i.e., at the same pace as in 1997, while revenue from taxes on domestic goods and services rose, but at a slower rate (8.5%). Taxes on international trade, which have accounted for an average of 58.4% of tax revenues over the last five years, increased by 10% in 1998, reflecting these small open economies' strong propensity to import basic consumer, intermediate and capital goods. Non-tax receipts rose marginally (by 1.1% to amount to 3.5% of GDP).

Recurrent expenditure grew by a slightly higher rate (6.5%) to a level equivalent to 23.9% of GDP. Spending on wages and salaries, which has averaged over 50% of current expenses for the last five years, was up by 6.5%, or 23.9% of GDP. Growth in outlays on goods and services and interest payments accelerated to 8.3% and 8.4%, respectively. Meanwhile, spending on transfers and subsidies grew at a slower rate (7.7%) to account for 3.8% of GDP. Under this heading, pension payments grew by 9.7% to 1.4% of GDP.

Capital revenues and grants were up by 41.7%, over half the rate of growth for 1997. Capital spending and net lending, however, recorded stronger growth of 47%, which brought this item up to 8.6% of GDP. These developments led to a 51.1% increase in the capital account deficit, which thus amounted to 5% of GDP.

In **Trinidad and Tobago**, the central government's finances worsened substantially in 1998, with its fiscal position moving from a surplus of 0.1% of GDP in 1997 to a deficit of 1.2% of GDP. The deterioration in public finances resulted largely from the reduction in total revenue, as growth in total spending was held in check. Recurrent revenues were up by 6% to 29.2% of GDP, compared with a decline of 4.3%

(27.1% of GDP) in 1997. Oil revenues slid by 17.5%, just over half the rate of decline for 1997. Tax receipts shifted upward by 8.7% to 27% of GDP, with all tax categories showing improved returns. Proceeds from income and property taxes rose by 8.1% and 6%, respectively. Meanwhile, revenues from taxes on goods and services and on international trade were up by 26.8% and 29.9%. Non-tax receipts, however, which came to 2.1% of GDP, dropped by 18.6%.

Growth in recurrent spending, which has been on an upward trajectory for some time, was contained to 2%, and this variable thus amounted to the equivalent of 30.5% of GDP. After declining by 7.6% in 1997, outlays on the wage bill grew fairly sharply —by 9.4%— and consequently represented a major drain on resources. Interest payments grew at the slower pace of 3.3% to 5.3% of GDP, while growth in transfers and subsidies turned upward by 7.5% after dropping by 6.8% in 1997. The current account surplus contracted by 13.4% to 0.8% of GDP.

The capital account deficit rose steeply —by almost three times the 45.3% increase recorded in 1997— to 2.1% of GDP. External indebtedness declined by 7.2% in 1998 to stand at 24.7% of GDP following a more robust reduction of 17.8% a year earlier.

### 3. Economic activity, inflation and employment

#### (a) Economic activity

In **Aruba** real GDP is estimated to have grown by some 3% in 1998, while prices increased by 2%, largely as a result of low rates of inflation in its major trading partner countries. This combination of satisfactory growth and low rates of inflation has been in evidence since the mid-1990s, when significant investment in the hotel sector completed the transformation of the country into a tourism-based economy.

Whereas in 1997 growth was driven by domestic demand, growth in 1998 was largely externally driven. The adoption of a contractionary fiscal policy led to a substantial decline in domestic demand.

Tourist arrivals increased by less than 1% in 1997 and 1998. This represented a significant loss of

momentum when compared with previous years. Adverse economic conditions in Colombia, reduced airline service between Aruba and Brazil, and a decline in marketing efforts resulting from reduced government funding accounted for this weak performance. Since there was no increase at all in the number of hotel rooms, the small upturn in arrivals of stay-over visitors boosted the hotel room occupancy rate in both 1997 and 1998. Tourism revenues rose in response to an increased average length of stay and a higher level of expenditure per tourist (from data provided by commercial banks) as the country successfully marketed itself as an upscale tourist destination. The major part of tourism earnings was generated by tourists from Latin America, especially Venezuela.

Cruise tourism declined in 1998 for the second consecutive year as difficulties in a nearby cruiseship destination led to a fall-off in arrivals and consequently a decline in calls at Aruba.

Whereas revenue earned per hotel room in Aruba is among the highest in the Caribbean, at 1.4% of sales in 1998, gross operating profits were substantially below the Caribbean average of 13.6%.

In the **Bahamas**, the pace of economic expansion picked up slightly in 1998. Real GDP grew by 3.2%, compared with an increase of 3% a year earlier. The marginal improvement in activity was largely driven by construction and the financial services sector, as tourism value added contracted during the year. The momentum of the construction sector carried over into 1998, buoyed by significant investment in the commercial sector. One development of note was the Sun International's US\$ 350 million hotel expansion project (phase II) on Paradise Island. Commercial construction was complemented by residential activity that thrived on the attractive interest rate environment. With these developments, housing starts for the first 10 months of 1998 increased by 21.6% to US\$ 104.5 million.

Output in agriculture and fisheries was mixed, following marginal growth in 1997. Fish production contracted by 6.5% to US\$ 65 million. However, bolstered by strong poultry and meat production, farm output grew by 2.7% to US\$ 56.9 million.

Meanwhile, tourism capacity temporarily declined as a result of large-scale investments in the refurbishing, upgrading and expansion of the hotel sector that adversely affected capacity. Activity slackened in both the stopover and cruise subsectors, resulting in a decline of 3.1% in total visitor arrivals, which thus stood at US\$ 3.35 million. This came on the heels of marginal growth (1.1%) in 1997 and a strong growth rate of 5.5% in 1996. Cruiseship arrivals fell by 1.2% to 1.73 million.

The non-tradables sector provided the impetus for fairly strong output growth —4.4%— in **Barbados** in 1998. Value added in this sector expanded by 5.8%. Robust growth of 14.9% in construction activity, more than twice the rate for 1997, boosted non-tradable output. This upsurge in construction was driven by private-sector building activity. After six years of growth, however, capacity constraints in terms of equipment, materials and skilled labour had become evident by year's end. Contrary to expectations, though, this does not seem to be fuelling inflationary pressures, as the rate of inflation actually declined in 1998.

Output in the tradable goods sector was up marginally (by 1.3%). The tourism sector registered growth of 6.5%, compared with a sluggish 2% in 1997. Tourism activity was bolstered by stopover visitor arrivals, which were up by 8.5%, mainly as a result of a 19.7% increase in visitor arrivals from the United Kingdom. Manufacturing output maintained its pace of growth, thanks to both domestic and foreign demand for manufactures. The results for the various subsectors were mixed, however, as strong demand in some industries was offset by declining competitiveness in others. Growth was strongest in the "other non-metallic minerals" subsector, where demand was boosted by the construction boom. Meanwhile, sugar production contracted by 25.7% on account of lower yields and a decline in the area harvested. Growth in the international business sector continued in 1998, but would have been even higher had it not been for the significant decline in the informatics industry.

Economic activity slowed in **Belize** in 1998, with output growing by only 1.6%, compared with 4% in 1997. Value added in the primary and secondary sectors contracted, and this decline was just barely offset by growth in services. Following robust growth of 12% in 1997, agricultural value added declined by 9.2%. Sugar-cane deliveries fell by 2.5%, reflecting lower cane quality, higher rainfall during the early part of the season and the continued closure of the Petrojam sugar processing facility. Citrus deliveries declined by 18%, mainly due to agronomic and labour problems, which were compounded by the drought triggered by El Niño and low prices. The fall in prices was consistent with the slack demand for commodities on the international market. In 1998, 50,904 metric tons of bananas were produced. However, efforts by exporters to find alternative markets for the output in excess of the European Union quota have been unsuccessful and, as a result, the acreage under cultivation has been reduced to 3,623 acres from 5,388 acres in 1997. Nevertheless, the reduction in value added in the primary sector was offset somewhat by a healthy 36.2% upswing in the fisheries subsector that was attributable to a near doubling of farmed shrimp production.

The value added in the services sector grew by 4%, with a strong contribution coming from the commerce, restaurants and hotel subsectors, which expanded by 6.6%. Tourism activity was quite vigorous, and this was reflected in a 6.4% increase in tourist arrivals. Output in the transport and communications and public administration subsectors was up by 2.5% and 1.9%, respectively.

In **Guyana** real GDP declined by 1.3% in 1998, following strong growth (6.1%) the previous year. The decline in real value added after an average annual increase of 5.3% during the preceding five years was due to a number of unfavourable developments, including the continued impact of adverse weather conditions on agricultural output, declining commodity terms of trade, and sluggish demand for the country's exports as a result of the Asian financial crisis' dampening effect on output abroad.

Value added contracted in all sectors, except fishing, gold production and construction. Agricultural output fell on account of declines of 7.6% and 0.7% in sugar-cane and rice production. Both crops were adversely affected by drought conditions, which impacted negatively on yields per acre. Forestry production plummeted by over 24% to the lowest level of output in recent years, owing to slack international demand and lower prices for forestry products. In contrast, the fisheries subsector recorded robust growth of 11%.

Output in the mining and quarrying sector was up by 2.7%, but among the subsectors performance was mixed. Production of gold rose by 4.2%, while output of bauxite fell by 8.2%. Manufacturing activity was down fairly sharply —by 8.6%— despite higher production of beverages and pharmaceuticals. Generally, the manufacturing sector was affected by financial difficulties, including the high cost of credit and weakened demand due to lower income levels.

Construction value added was up by 4.7%; this upturn was driven by housing and residential activity, since there was a slowdown in public-sector projects. Services value added increased as well (1.4%), thanks to the momentum provided by the rental and dwellings and financial services subsectors.

Real output declined in **Jamaica** for the third consecutive year, owing to macroeconomic disequilibria, which have filtered through to affect aggregate supply. Output contracted by 0.7%, compared with a decline of 2.3% in 1997. Value added in the production sector was down by 2.3%, after falling by 4.1% the previous year. Agricultural production declined by 0.3%, an improvement over the 14.6% contraction observed in 1997. As in 1997, value added weakened in both domestic and export agriculture. Domestic agricultural output fell by 1% while agricultural output for export was down by 1.7%. Reduced agricultural output resulted from drought conditions, industrial action, worsening terms of trade and increased competition from imports.

Exports of traditional crops slipped substantially, falling by 30%. Sugar-cane production fell by 7.6% owing largely to the effects of a drought and labour unrest. Banana output dropped by 8.9%, reflecting adverse weather conditions and the transitional impact of restructuring initiatives designed to enhance efficiency and competitiveness.

Manufacturing, which recorded an average rate of decline of 2.8% between 1995 and 1998, was down by 4.2% in 1998. Manufactured exports contracted by 11.4%, largely as a result of an 11.8% fall in garment exports. The sector continues to be affected by high interest rates, insufficient new and replacement capital, and weak competitiveness. The impact of high interest rates on the affordability of credit was highlighted by the decrease of over 32% in credit to the sector in 1998.

Value added in the mining and quarrying sector was up by 2.6% versus a rate of 3.3% the previous year. This brighter spot in overall commodity performance was in part the result of stable industrial relations and the issuance of a memorandum of understanding linking wage increases to improvements in performance. Bauxite output was at its highest level in a quarter century, up by nearly 6% over the 1997 level. Receipts were affected, however, by a softening of metal prices, which were down by 7%.

Services, which accounted for over 75% of real output in 1998, grew marginally by 0.5%. The performance of the various subsectors was mixed. Electricity and water recorded growth of 6.4%, with electricity generation and sales up by 6.5% and 7.2%. Water and sanitation services were up by 5.5%. Transport, storage and communications maintained a growth rate of 5.6% in 1998, reflecting strong investment in communications systems. Meanwhile, finance and insurance services contracted by 1.4%, with this decline being attributable to the weak interest income and output of the fledgling Financial Sector Adjustment Company (FINSAC) and the all-round weakness of the financial sector.

In the **Netherlands Antilles**, an estimated drop in real GDP of 0.5% in 1998 summed up a year of declining economic activity marked by sluggish domestic spending; this state of affairs was largely due to uncertainty on the part of both consumers and investors regarding the Government's policy response to the financial and economic crisis. The export sector registered a weak performance as a result of developments in the international financial and business services sector and the impact of Hurricane Georges on the tourism sector in St. Maarten.

This overall weak export performance resulted from mixed sectoral developments. In the tourism sector, an increase in the number of stay-over visitors was accompanied by an increase in foreign exchange income, but the number of cruiseship passengers declined because of a decrease in cruise calls. The performance by island varied. In Curaçao, a moderate upturn in the number of stay-over tourists and an increase in foreign exchange earnings were observed, but cruise tourism declined. In Bonaire, the number of cruise tourists was lower. St. Maarten was affected by Hurricane Georges in September 1998. Although the hurricane did not cause much damage, the growth in the number of stay-over and cruise tourists slowed, while foreign exchange earnings declined. The free zone in Curaçao performed well and registered growth in both re-exports and the number of visits.

The transportation sector turned in a mixed performance. The national carrier, Air ALM, recorded growth in the number of passengers, but the amount of freight handled continued to decline. A recently established strategic alliance with two other airline companies is expected to increase the chances of the company's return to profitability. Activity in the Curaçao harbour increased, as measured by total cargo movements and the number of ships piloted. On the other hand, the port in Bonaire experienced a sharp decline in the number of ships piloted. A fall in the number of tanker arrivals was the main explanation for this. The opposite occurred in St. Eustatius, however, where oil transshipment and storage activities increased significantly.

Real output grew by 3.8% in the OECS countries in 1998, relative to a slightly weaker rate of 3.1% in 1997. Higher growth was based on increased value added in agriculture, construction, distribution activities, communications and government services. The recovery in agricultural output was propelled by a 3.2% increase in banana production of that brought it to 141,839 tons, following a contraction of 28.2% in 1997. The upswing in the banana industry resulted from measures to improve productivity and fruit quality. The quality rating of the fruit exported by OECS moved up to an average 88 Percentage Units Within Specification (PUWS) in 1998, from 84 PUWS in 1997. Cocoa production rebounded, with growth of 39.8%, from a major decline in 1997. Meanwhile, sugar-cane output in St. Kitts, which was hurt by Hurricane Georges, declined by 18.6%, following strong growth (50%) in the previous year. Output of nutmeg in Grenada fell by 12.7%, compared with growth of 15.2% in 1997.

Manufacturing value added registered weaker growth (0.8%). Sectoral activity was mixed however, with sugar production contracting by 25.1%. The marginal growth in the sector, stemmed mainly from a 20% increase in soap production in Dominica and a 14.4% expansion in the output of cardboard boxes used in the banana industry.

The strength of the construction industry was maintained in 1998, with growth of 9.24%, compared with 7.35% in 1997, and an average growth rate of 5.68% between 1994 and 1998. Construction activity was buoyed by private-sector residential and commercial construction, while public-sector projects included new investment in infrastructure and rehabilitation in St. Kitts and Nevis and in Antigua and Barbuda, which were affected by Hurricane Georges.

The services sector turned in a quite uniform performance, with all subsectors recording growth rates for 1998 similar to those registered the year before. Activity in the hotel and restaurant subsector grew marginally (by 0.48%) in 1998, following growth of 7.28% in 1997. This reflected a depressed level of value added in the tradables tourism sector. Meanwhile, growth was strong in banking and insurance (8.3%) and communications (6.6%).

Buoyed by the favourable performance of the petroleum sector despite the international crisis and by continued vigour in the non-petroleum sector, economic activity picked up in **Trinidad and Tobago** in 1998. Real value added increased by 3.6%, following growth of 2.9% in 1997. Growth in goods-producing and non-goods-producing sectors was up by 3.1% and 4%. While all non-exportable activities registered growth, the performance of foreign-exchange-generating sectors was dampened somewhat by the sharp decline in agriculture.

Output in the petroleum sector rebounded, growing by 5%, after declining by 2% in 1997. Output in the petrochemicals subsector climbed (by 22.1%) at the highest rate in the last four years, boosted by the start-up of two world-scale ammonia plants and a methanol plant. With a more than 77% increase in the daily cracking capacity of the oil refinery and a 46.6% rise in refinery throughput, refinery output rose by 46.2% in 1998. Production of natural gas was up in response to higher demand. Meanwhile, output of methanol and nitrogenous fertilizers increased by 28.1% and 20.7%.

Growth in real value added in the non-petroleum sector continued to be strong, at 3.2%. Construction activity was up by 13.5% thanks to large-scale investments in the energy sector. Value added in distribution

and electricity grew by 12.8% and 5.8%. Agricultural output was down, however, by 14.7%, largely because of the impact of adverse weather conditions and froghopper infestations in the sugar industry. Output of manufactures strengthened somewhat, with growth of 3.9%, sustained by an upswing of 30.6% in wood products, 19.0% in beverages and tobacco, and 5.6% in chemicals and non-metallic products. The sector's performance would have been even more impressive had it not been for the 14.3% and 6.2% declines in the output of the garment and footwear and the food processing industries. The regional garment sector has long been affected by relatively low productivity and production inefficiencies.

### (b) Prices

In **Aruba** the rate of inflation, as measured by the consumer price index, continued on the downward path it has been following ever since 1993, with the only exceptions being 1995 and 1996, when the rate of price increases remained unchanged. In 1998 the rate of inflation was on the order of 1.5%. The descent of inflation was associated with a drop in oil prices and the consequent price decreases registered for water, electricity and transport and communications. Since much of Aruban consumption consists of imports, low inflation rates in the Netherlands and the United States of America also contributed to the low level of inflation recorded.

Real wage increases appear to have moderated during the period 1994-1998. Labour force survey data indicate that the nominal average wage increased by 4.2% annually between 1994 and 1997, while the annual inflation rate for the same period averaged 3%.

Consumer prices rose by 1.3% in the **Bahamas** in 1998, up from 0.5% in 1997. Education costs were up sharply (by 9.7%), after having declined by 3.5% in 1997, owing to increases in tuition costs. Food prices were up by 2.2% while average prices for clothing and footwear rose by 1.7%, as compared to 0.3% in 1997. In contrast, the cost of entertainment and services (2.1%) and transport and communications (0.7%) remained fairly stable.

Inflation fell by 1.4% in **Barbados** in 1998, in contrast to an increase of 3.6% the previous year. Average prices declined in response to domestic and external developments. These included the zero-rating of a market basket of food items in October 1997 and a reduction in the common external tariff (CET) to 20% from 25% a year earlier. In addition, lower import prices (as the

United States dollar appreciated) and declining oil prices affected domestic prices favourably. The subindex for fuel and electricity was down by 9% from the 1997 level thanks to the beneficial impact of lower fuel prices.

Inflation in **Belize** slowed to 0.8%, down from 1% the year before. The lower rate of inflation in 1998 reflected the general decline in the cost of living. For tradable items, the list of zero-rated commodities for the value added tax was increased and the maximum rate of import duties under the common external tariff of the Caribbean Community (CARICOM) was reduced to 25% from 30%. Importers also benefited from lower prices for goods imported from Mexico and CARICOM countries and from the 2.7% reduction in United States export prices. All of these factors impacted favourably on domestic prices, given the openness of the economy. The prices of food, beverages, transport and communications, which account for 51% of the index, all declined, pulling average prices downwards. Price decreases were also recorded for clothing and footwear (3.7%) and personal care (1.1%).

The variation of the consumer price index was held to 4.8% in **Guyana**, up slightly from 4.1% the previous year. Increases in the prices of food, communications and transportation, and medical and personal care contributed to the marginal upward movement in inflation. On the other hand, upward pressure was dampened by favourable changes in the prices of clothing and footwear and a stable monetary policy.

Consumer prices rose by 7.9% in **Jamaica** in 1998. The continued decline in inflation since 1997 was an important achievement for the Government's stabilization strategy. The moderation of inflation was associated with restricted money growth, relative exchange rate stability and low imported inflation from major trading partners. Moreover, the inflationary pressures that were triggered by shortages of domestic agricultural products in 1997 abated with the return of normal weather patterns. Inflation during the year was associated with increases in the prices of food and beverages (4%), miscellaneous expenses (23.3%) and transportation (26.8%). The transportation subindex rose as a result of increases in bus fares, airfares and gasoline prices; the latter triggered widespread riots in 1998.

Consumer prices declined in the **Netherlands Antilles** in the fourth quarter of 1998, mainly as a result of a downturn in oil, electricity and water prices and low inflation rates in the country's major trading partner countries (the Netherlands and the United States).

Table 2  
**CARIBBEAN SUBREGION: CONSUMER PRICES**  
*(Average annual variation)*

	1993	1994	1995	1996	1997	1998
Anguila	3.7	3.4	4.0	1.4	3.6	...
Antigua and Barbuda	1.5	7.1	6.2	4.1	...	...
Aruba	6.4	4.7	3.1	3.1	2.8	1.5
Bahamas	2.7	1.3	2.2	1.4	0.5	1.3
Barbados	1.2	0.1	1.8	2.4	7.7	-1.3
Belize	1.5	2.6	2.9	6.4	1.0	0.8
Dominica	1.5	0.0	1.3	1.7	2.5	1.0
Grenada	3.5	1.8	2.1	3.2	0.8	...
Guyana	10.0	16.1	12.2	7.1	3.6	5.0
Jamaica	30.1	26.6	25.6	15.8	9.2	9.6
Montserrat	0.7	2.8	4.4	...	...	...
Saint Kitts and Nevis	1.4	1.3	2.6	3.1	11.3	...
Saint Lucia	1.1	2.7	5.8	1.0	0.0	...
Saint Vincent and the Grenadines	4.3	1.0	1.7	4.4	0.5	2.1
Suriname	143.5	368.5	235.6	-0.7	7.1	21.1
Trinidad and Tobago	10.8	8.8	5.2	3.4	3.7	4.8

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

Inflation was subdued in the OECS countries during the year under review. Average consumer prices drifted upward by 2.3%, reflecting low imported inflation from major trading partners and the stability of the pegged exchange rate.<sup>1</sup> Among the member States, inflation ranged from a negative rate (-0.2%) in Montserrat, which has been ravaged by volcanic eruptions, to an increase of 3.6% in St. Lucia. Moderate price rises were recorded in St. Kitts and Nevis (0.9%), Dominica (1.5%) and St. Vincent and the Grenadines (3.3%).

Aggregate price pressures were generated in **Trinidad and Tobago** during the year by the higher prices of some agricultural products that were affected by poor weather and by the introduction of a national minimum wage in April. Implementation of the minimum wage triggered price surges in some sectors, which pushed up the overall index. Average inflation steepened to 6.5% from 3.5% a year earlier. The heavily weighted food subindex shifted upward sharply, rising by an annual average rate of 15.1% due to shortages of vegetables, citrus fruit and other products that were affected first by drought and then by

flooding. Beverage and tobacco prices rose by 4.1%. Wholesale price rises moderated, however, with the all-items producers index standing at 1.4%, as compared to 1.9% the previous year.

### (c) Employment

In most cases, the labour force surveys conducted by countries in the subregion are subject to significant lags, and employment and unemployment data are therefore rather sparse. Regional action is required to provide funding, establish more standardized methodologies and supply manpower for conducting these important surveys. This section reports on the few countries for which such data are available.

Labour force dynamics in **Aruba** are affected significantly by immigration patterns. Net immigration rose from less than 600 in 1989 to nearly 6,000 in 1993, after which the flow dwindled. Indications are that the trend was maintained in 1998. The unemployment rate declined slightly in 1998 to a level of 0.6%, down from 0.7%, one year earlier.

<sup>1</sup> The EC dollar has been pegged to the United States dollar at the rate of US\$1=EC\$2.70 for over 20 years.



Stronger economic activity in **Barbados** in 1998 contributed to job growth and helped to reduce unemployment. Consequently, unemployment, which averaged 16% over the preceding five years, fell to 11.8%, from its 1997 level of 14.5%. The construction boom boosted male employment significantly, resulting in a 2% fall in the male unemployment rate, which thus fell to 8.3%. Unfortunately, however, female unemployment remained above 15%, as many jobs that are mainly held by women—in such industries as electronics, textiles and informatics—were lost as companies streamlined to improve competitiveness.

In **Belize**, dampened economic activity spurred an increase in the unemployment rate to 14.3%, from 12.7% in 1997. Weakened activity in agriculture and manufacturing led to higher unemployment in these sectors. These declines, however, were only partially offset by growth in employment in the buoyant services sector.

Thanks to a contraction of the labour force and a rise in the level of employment, the unemployment rate in **Jamaica** declined by 1% to 15.5% in 1998. The unemployment rate among males, with a participation rate of 73.9%, fell to 10%, from 10.5% in 1997. Similarly, the unemployment rate among females, who had a participation rate of 57.8%, contracted to 22.1% in 1998 from 23.5% a year earlier. Youth unemployment, although high, fell from 33.4% to 26.5%.

The goods-producing and services sectors displayed mixed employment patterns. Employment in services sectors was up by 2.4% as a result of improved job creation in wholesale and retail commerce, hotel

and restaurant services, and personal services. In contrast, goods-producing sectors experienced job losses, with employment down by 1.8%. This slump was associated with lower employment in manufacturing and agriculture. Manufacturing employment fell mainly because of the closure or relocation of several apparel plants in the export processing zone (EPZ). A disturbing development in the labour market in 1998 was that one fourth of all unemployed persons reported that they had been out of a job for more than a year, which, in effect, means that they were among the chronically unemployed.

The average weekly wage rate of workers rose by 16.2% in seven of the eight sectors assessed. This far exceeded the average inflation rate of 7.9% and could undermine product competitiveness. Only in the construction and manufacturing sectors were increases in wage rates in line with government guidelines.

In the **Netherlands Antilles**, the unemployment rate rose to 15.8% as a result of sluggish economic activity.

Unemployment declined for the fifth consecutive year in **Trinidad and Tobago**, dropping from 15% in 1997 to 14.2% in 1998. Youth unemployment fell to 29% from 34.6% the previous year, but was still above the national average. Female unemployment remained relatively high at 18.9%, while male unemployment stood at 11.4%. Construction, services and manufacturing were the main engines of growth in employment, with construction absorbing more skilled workers. Agriculture suffered job losses on account of reduced activity, however.

Table 3  
CARIBBEAN SUBREGION: UNEMPLOYMENT RATE  
(Percentages)

	1993	1994	1995	1996	1997	1998
Barbados	24.3	21.9	19.7	14.3	12.2	11.8
Belize	9.8	9.0	12.5	13.8	12.7	14.3
Jamaica	16.3	15.4	16.2	16.0	16.5	15.5
Netherlands Antilles	13.6	12.8	13.1	14.0	...	...
Trinidad and Tobago	19.8	18.4	17.2	16.3	15.0	14.2

Source: ECLAC, on the basis of official figures.

#### 4. International trade and payments

At the end of 1998 the balance of payments of **Aruba** closed with a US\$ 89.3 million surplus. This contributed to a 41% increase in the net foreign assets of the banking system. As a result, the end-of-period non-oil merchandise import coverage ratio rose to 3.9 months.

The current account deficit had shrunk to US\$ 28.3 million by year's end. This improvement was due largely to the significant decline in the deficit on transactions in the oil sector, which plunged from US\$ 179.3 million in 1997 to US\$ 2.6 million in 1998.

The goods and services account of the free-zone sector shifted from a surplus of US\$ 10.5 million in 1997 to a deficit of US\$ 3.9 million at the end of 1998, as export receipts were outstripped by payments for imports. A large portion of this deficit may be accounted for by stockpiling. If the oil and free-zone sectors are excluded, then the current account deficit contracted to US\$ 21.8 million, down from US\$ 27.3 million one year earlier.

The overall balance-of-payments surplus of the **Bahamas** more than doubled to US\$ 119.3 million, equivalent to 2.9% of GDP. The growth of the current account deficit moderated to 25.9% —a third of the rate for 1997— and the shortfall thus stood at 14.3% of GDP. The deficit on goods and services, which averaged US\$ 179.3 million over the previous five years, grew by 19.6% after more than doubling in 1997. Notably, net invisible receipts declined by 17.7% owing to the decrease in net tourism inflows caused by the reduction in hotel capacity and to a doubling of net spending for construction services associated with tourism plant expansion and upgrades. This was partially compensated for by a 5.7% drop in the trade deficit, which thus came to 25.5% of GDP, due to a credit squeeze aimed at dampening demand for consumer durables. In addition, exports were up by 5.5%.

The deficit on the income account widened by 24.3%. Net factor payments abroad moved up by 28% to US\$ 190.1 million due to higher outflows of labour income, while net transfer receipts were down by 12.6% as the Government's net inflows contracted to US\$ 38 million from US\$ 43.7 million in 1997.

The capital and financial account surplus reached a record US\$ 490.9 million, equivalent to 11.9% of GDP, thanks to robust investments in hotel facilities. Net private direct investment rose to US\$ 234.6 million, while private-sector borrowings more than doubled to 6.7% of GDP.

In **Barbados**, the balance of payments recorded an overall deficit —of US\$ 37.2 million or the equivalent of 1.8% of GDP, the first time since 1991. Declining receipts from exports of sugar and beverage concentrates were the main reasons why the country also recorded its first current account deficit (of US\$ 8.8 million, or 0.4% of GDP) since 1991. The merchandise deficit widened by 5.4% to 76% of GDP. Exports were down by 11.9%, while imports rose by only 2.7% despite robust demand for consumer and capital goods, with imports of these items climbing by 15.8% and 11.1%, respectively. Although there was a slowdown in demand for intermediate goods, purchases of construction materials were up by 12.2% as a consequence of the burgeoning growth of the construction industry.

Net service receipts rose by a negligible 0.4%, following strong growth (12.5%) in 1997. Travel receipts were up by 5.8%, owing to fairly robust activity in the tourism sector. Growth in net transfers slowed to 2.8% after having risen by over 19% in 1997. On the other hand, the capital account surplus contracted substantially (by 58.5%). Net international reserves shrank to US\$ 14.1 million, equivalent to 13.5% of GDP. This decline reduced the import coverage for goods and non-factor services to 12 weeks (versus 14 weeks a year earlier).

The overall balance-of-payments position for **Belize**, which averaged a surplus of US\$ 1.2 million over the last five years, shifted from a surplus of US\$ 1 million in 1997 to a deficit of US\$ 15.4 million in 1998, equal to 2.5% of GDP. This largely reflected errors and omissions of US\$ -13.9 million, which may point to significant statistical discrepancies or to the existence of real flows that have not been accounted for. Official international reserves were down by US\$ 43.9 million (7.1% of GDP) and were equivalent to 1.8 months of import cover, or just over half the three-month benchmark.

Reflecting faster growth in imports and reduced growth in exports, the merchandise trade deficit widened by 17.1% to US\$ 104.8 million, the equivalent of 17% of GDP. Exports were down by 3.8%, largely due to

Table 4  
**CARIBBEAN SUBREGION: BALANCE ON CURRENT ACCOUNT**  
*(Millions of dollars)*

	1993	1994	1995	1996	1997	1998 <sup>a</sup>
Aruba	22	60	-15	-62	-196	-28
Antigua and Barbuda	-1	-18	-1	-40	...	...
Bahamas	49	-42	-144	-263	-468	-589
Barbados	69	135	90	104	0	-9
Belize	-49	-31	-3	-2	-32	-54
Dominica	-23	-38	-50	-40	-33	...
Grenada	-44	-22	-35	-58	-75	...
Guyana	-140	-101	-95	-54	-105	-99
Jamaica	-184	18	-192	-238	-401	-339
Saint Kitts and Nevis	-30	-26	-47	-67	...	...
Saint Lucia	-49	-49	-33	-80	-99	...
Saint Vincent and the Grenadines	-44	-58	-41	-35	-93	...
Suriname	44	59	73	80	...	...
Trinidad and Tobago	113	221	270	68	-579	-949

Source: ECLAC, on the basis of official data.

<sup>a</sup> Preliminary figures.

declines in export volumes of sugar, citrus fruit and bananas, which thus served to highlight the country's dependence on traditional commodity exports. Sugar export earnings were adversely affected by the appreciation of the pound sterling against the ECU, and depressed citrus prices in the first half of the year also drove down export revenues. Imports rose by 2.8% in the presence of higher domestic demand, since activities in the commercial free zone and bonded warehouses remained stable.

Increases of 8.8% and 2% in travel receipts and transfers, respectively, resulted in a 3.7% improvement in the services account. Tourist arrivals were estimated to have increased by 6.4%, providing inflows of US\$ 105.3 million, an increase of US\$ 10.3 million. Current account developments led to a 67.7% rise in the deficit to US\$ 53.5 million, equal to 8.7% of GDP. Meanwhile, the surplus on the capital and financial account contracted by 10.1%, which was less than half the rate of decline registered for 1997.

External sector developments in Guyana led to a balance-of-payments deficit of US\$ 22.17 million, the equivalent of 4.1% of GDP, following a surplus of US\$ 4.0 million the previous year. The current account, which has been a weak aspect of the country's external accounts for many years, improved somewhat, with the

deficit, which had averaged US\$ 59.6 million over the previous five years, falling by 6.3% to 17.9% of GDP.

Export receipts shrank by 7.8% owing to reduced export volumes and lower prices for primary commodities. Imports were also down by 6.3% as a consequence of reduced aggregate demand in a contracting economy. The country's position on the merchandise trade account was partially compensated for by a 22.1% reduction in the deficit in invisibles. A slowdown in capital inflows resulted in a 34.9% decline in the capital account surplus.

Capital and financial inflows fully offset the current account deficit in Jamaica, which thus balanced its external accounts. The current account deficit was down to US\$ 339.2 million, equivalent to 5.5% of GDP, from 6.5% of GDP in 1997. This improved performance reflected a contraction in outflows on the merchandise and income accounts which was only partly offset by the fall in receipts from services and transfers.

The merchandise deficit—a long-standing feature of the country's external accounts which reflects the presence of an economic disequilibrium—was down marginally by 1.7% of 17.8% of GDP. Exports shrank by 6.4% to US\$ 1,590.4 million, following a decline of 1.3% a year earlier. All major export groups registered

decreases, except re-exports and goods acquired in domestic ports by foreign carriers. Earnings from major traditional exports fell, largely due to depressed international prices for alumina exports. In fact, earnings from alumina fell by US\$ 76.4 million despite a 2.4% rise in export volume. Bauxite earnings, however, were up by 11.4% as a result of higher export volumes. Sugar earnings fell by US\$ 7.3 million due to a 5.4% fall in the average price and a 1.8% decline in volume. Sugar prices were hurt by the appreciation of the United States dollar against the pound sterling. Banana exports also fell sharply—by 27.3%—as a consequence of reductions of 21.9% and 6.9% in volume and price, respectively. The decline in banana exports was in part a reflection of the temporary impact of adjustments undertaken in order to rationalize and improve the productivity and efficiency of the industry in light of the WTO ruling against the current European Union regime as it relates to African, Caribbean and Pacific (ACP) countries.

Earnings from non-traditional exports declined by 2.1%. Revenues from apparel exports maintained their downward trend, which is a reflection of rising operational costs, relatively low productivity and weak competitiveness. These problems have led to the relocation of a number of plants to Mexico, where they can benefit from the North American Free Trade Agreement (NAFTA).

Imports contracted by 4.5% to US\$ 2,692,300,000, or 43.4% of GDP. General merchandise imports fell by 4.9%, but the various components of this aggregate displayed differing patterns. Consumer goods imports were up by 3.3% (a manifestation of the population's high propensity to consume imported commodities). Food imports rose by 8.2%, but motor vehicle imports were down by 18% owing to an increase in the common external tariff on motor vehicles and a ban on imports of reconditioned vehicles older than three years for non-commercial purposes. Fuel imports fell sharply (by 28.2%), with the reduction in the fuel bill reflecting the descent of international fuel prices resulting from the production of excess supply by OPEC. Similarly, capital goods imports shrank by 16.1%; this, however, was simply a reflection of the one-time purchase of aircraft the previous year.

Net services inflows contracted by 15.1% in 1998, or almost three times the rate of decline for 1997. Travel receipts fell by 4.2% since 5.9% upswing in gross tourism earnings (attributable to an increase in stopover visitors) was offset by higher spending by Jamaicans travelling abroad.

The surplus in the capital and financial account narrowed by 15.3%, after posting a robust growth rate of 68.5% the previous year. This decline was related to a fall-off in grants to the official sector and net investment outflows. Although gross official investment inflows were up, thanks in part to a US\$ 250 million Eurobond placement, this was counteracted by US\$ 484.7 million in debt repayments. The shortfall in official receipts was offset by growth of US\$ 244.9 million in private-sector investment receipts. The net result was a US\$ 41.6 million increase in net international reserves, compared with a drawdown of US\$ 154.4 million in 1997. By year-end, total gross reserves stood at US\$ 712.3 million, providing cover for 12 weeks of imports.

In the OECS subregion, the balance-of-payments surplus more than doubled to US\$ 50.5 million, the equivalent of 2% of GDP. The trade deficit, which is somewhat structural in nature given the weak competitiveness of OECS commodity exports, almost doubled to US\$ 1,040,300,000, over 40% of GDP. The decline in exports was held to 4%, down from 7.1% in 1997. Banana export receipts were up by 11.9%, after a 26.7% fall in earnings in the previous year. Exporters of bananas benefited from a 6.5% rise in the average green market price (AGMP) for their fruit. St. Vincent and the Grenadines and St. Lucia recorded increases of 49.6% and 6.5% in banana export earnings, respectively. In Dominica, however, receipts decreased by 10.7%, as export volumes were negatively affected by unfavourable weather conditions. Sugar receipts from St. Kitts and Nevis slipped by 26.7% to US\$ 32.7 million, reflecting falling export volumes and prices. In Dominica receipts from soap exports went up by 5.8% to US\$ 50 million.

Imports increased by 9.3%, which was almost three times as much as in 1997, to the equivalent of 52.1% of GDP. Imports of consumer goods posted fairly strong growth in the presence of weak domestic supply, while imports of capital goods were up sharply in response to the demand generated by a number of projects in such areas as hotel construction, road improvement and residential construction.

Net service inflows registered a scant 1.8% growth rate following an increase of 8.2% a year earlier. Proceeds registered on the travel account grew marginally (by 0.9%) since gross spending by visitors to the subregion (excluding Montserrat) was up by only 1.8% to US\$ 2,365,000,000. Capital and financial inflows rose by 19.4% to a level equivalent to 18.7% of GDP.

Table 5  
**CARIBBEAN SUBREGION: EXTERNAL DEBT**  
*(Millions of dollars)*

	1993	1994	1995	1996	1997	1998 <sup>a</sup>
Antigua and Barbuda	232	237	244	236	222	...
Bahamas	453	410	393	358	388	349
Barbados	352	357	359	365	349	343
Belize	168	184	184	220	241	259
Dominica	94	99	103	102	89	...
Grenada	81	88	87	89	86	...
Guyana	2 062	2 004	2 058	1 537	1 514	1 497
Jamaica	3 687	3 652	3 452	3 232	3 278	3 306
Montserrat	10	10	10	10	10	...
Saint Kitts and Nevis	47	52	54	60	102	...
Saint Lucia	100	106	115	127	137	...
Saint Vincent and the Grenadines	77	88	88	88	87	...
Suriname	206	198	185	178	165	...
Trinidad and Tobago	2 102	2 064	1 905	1 876	1 541	1 430

Source: ECLAC, on the basis of official figures.

<sup>a</sup> Preliminary figures.

**Trinidad and Tobago** saw a 56.5% reduction in the balance-of-payments surplus, which thus amounted to US\$ 76.2 million, equivalent to over 1% of GDP in 1998. The country's terms of trade were adversely affected by the fallout from the Asian crisis, which led to sluggish international demand for commodities and flat prices. The current account deficit narrowed marginally, as the merchandise trade deficit, which widened sharply—by 33.9%—to 11.4% of GDP, was compensated for by abundant service inflows.

Exports were down by 6.4%, following growth of 1.5% in 1997. Given the downswing in international crude oil prices of almost 30%, receipts from crude oil and mineral fuels contracted by US\$ 157.8 million. Exports of chemicals declined by US\$ 106.4 million, reflecting lower prices for urea, ammonia and methanol. Prices for the latter two commodities were at their lowest level in five years. Some respite was provided by the 6.8% increase in manufactured goods exports.

Imports rose slightly (by 0.1%) to 9.2% of GDP. The 11% fall in imports of machinery and transport equipment, associated with the slowdown in direct investment, was offset by a 22% increase in imports of manufactured goods.

The combined services and income account registered its first surplus in 20 years. This welcome performance was attributable to strong central government receipts from production-sharing contracts in the energy sector and robust growth in communications and tourism earnings. A record number of travelers visited Trinidad and Tobago in 1998, resulting in a 16.3% increase in travel receipts. Net inflows from insurance services were up, while income accruing to foreigners from investments in Trinidad and Tobago fell by 5.3%. Public-sector interest payments fell marginally in 1998.

The capital account surplus contracted by 32.3% in 1998, but was still large enough to support an overall surplus. Foreign direct investment, which peaked at over \$ 1 billion the previous year, amounted to \$ 719.5 million in 1998 as large investment projects in the energy sector tapered off. Commercial banks accumulated foreign assets of \$ 49.7 million. Meanwhile, the deficit in official flows declined, thanks to a 38.7% decrease in total debt service payments. This drove down the debt service ratio to 9.3% of goods and non-factor services exports, as compared to 15.4% the previous year. At the same time, gross foreign assets provided 4.3 months of import cover, up from 4.1 months in 1997.

## **ECONOMIC SURVEY OF LATIN AMERICA AND THE CARIBBEAN, 1998-1999**

### **STATISTICAL ANNEX** (Electronic version)

#### **INTRODUCTION**

As in the last three editions of the *Survey*, this year's edition includes a statistical appendix on CD-ROM which provides ready access to data for recent years and permits the preparation of spreadsheets covering a longer time period. The same methodology as the year before has been used for the presentation of this statistical information.

This CD-ROM contains the complete set of statistical tables upon which the *Economic Survey for Latin America and the Caribbean, 1998-1999* is based. A number of these tables are also included in the printed version.

In order to facilitate access to the data, a query system has been developed by subject area and by country.

Refinements made after the copy deadline for the *Economic Survey* in the historical series for the public sector in some countries are reflected in this version of the tables. Several errors that were subsequently found in the tables in the printed document have also been corrected.

#### **USING THE TABLE DISPLAY PROGRAM**

This is the first application to be produced jointly by the ECLAC Documents and Publications Division and the Economic Development Division. It is therefore experimental in nature and will be improved upon in later versions. The program allows the user to select tables by country and subject area, view them on-screen, print them in spread sheet format and/or export them to the hard disk or to a specific directory in the same format. Context-sensitive on-line help is also available.

#### **INSTALLATION**

The program will run automatically when the CD-ROM is inserted in the drive.

The program will create a folder, as specified by the user, which will contain the files needed to execute the application.

#### **To install from disk drive A: to hard disk C:**

- Insert disk 1 in disk drive A:
- Type A: and <Return>.
- Type INSTALAR and <Return>.
- Type name of directory to which files and programs are to be copied <Return>.

The specified directory will contain the programs and data files required to execute the application.

*Notes:*

- The application is installed only to hard disk C:
- Reset the computer in order for the modifications to the CONFIG.SYS and AUTOEXEC.BAT files to take effect.
- The application can also be installed from the hard disk using the command D:\Setup.exe<Return>.

## **USE OF THE APPLICATION**

The program begins with a welcome window showing the version number and the author's name. Pressing displays a window indicating the current selection of tables. Specify a selection to open a second window showing the countries and the number of tables that exist for each one. This second window shows only those countries that meet the conditions specified in the first window, and indicates the number of tables that meet those conditions.

## **NAVIGATING THE SCREENS**

Unlike most computer applications, this program is screen-driven rather than menu-driven.

The available alternatives are always displayed on the last line of the screen. In the table window, use arrow keys to locate the required country. Press to display information relating to the tables. Two windows will then open; the first shows the country files available, while the second gives the title of the table, the subject area and the country for the file where the cursor is positioned. Using the arrow keys, select the file to be viewed and press (<Return>).

From the table display screen, the user can export (<F10>) or print the table (<F7>). In addition, the user can select a printer (<Shift> + <F7>) or request help (<F1>).

## **HELP**

- A bar showing valid commands is displayed on each screen. Pressing <F1> will bring up a more detailed help screen relating to the process currently in operation.

## **NOTE**

This edition also includes Programa de Visualización de Textos and separate folders containing figures, Acrobat PDF files and Excel files (original version).



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ECONOMIC COMMISSION FOR LATIN AMERICA AND THE  
CARIBBEAN  
Casilla 179-D Santiago, Chile

### PERIODIC PUBLICATIONS

#### CEPAL Review

*CEPAL Review* first appeared in 1976 as part of the Publications Programme of the Economic Commission for Latin America and the Caribbean, its aim being to make a contribution to the study of the economic and social development problems of the region. The views expressed in signed articles, including those by Secretariat staff members, are those of the authors and therefore do not necessarily reflect the point of view of the Organization.

*CEPAL Review* is published in Spanish and English versions three times a year.

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*Síntesis estudio económico de América Latina y el Caribe, 1998-1999*, 1999, 34 pp.

*Summary Economic Survey of Latin America and the Caribbean 1998-1999*, 1999, 34 pp.

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