

**2005-2006**



# **Economic Survey**

**OF LATIN AMERICA  
AND THE CARIBBEAN**



**UNITED NATIONS**

**ECLAC**

The *Economic Survey of Latin America and the Caribbean* is issued annually by the ECLAC Economic Development Division. The 2005-2006 edition was prepared under the supervision of Osvaldo Kacef, Officer-in-Charge of the Division; Jürgen Weller and Sandra Manuelito were responsible for its overall coordination.

In the preparation of this edition, the Economic Development Division was assisted by the Statistics and Economic Projections Division, the Latin American and Caribbean Institute for Economic and Social Planning (ILPES), the Division of International Trade and Integration, the ECLAC subregional headquarters in Mexico and Port of Spain and the country offices of the Commission in Bogotá, Brasilia, Buenos Aires and Montevideo.

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## Notes

The following symbols have been used in the tables shown in the *Survey*:

Three dots (...) indicate that data are not available or are not separately reported.

A dash (-) indicates that the amount is nil or negligible.

A full stop (.) is used to indicate decimals.

The word "dollars" refers to United States dollars unless otherwise specified.

United Nations Publication

ISBN: 92-1-121593-5

ISSN printed version: 0257-2184 ISSN online version: 1681-0384

LC/G.2314-P

Sales No.: E.06.II.G.2

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Printed in Santiago, Chile - United Nations

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## Foreword



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This year's edition of the *Economic Survey of Latin America and the Caribbean* is the fifty-eighth in the series. It is divided into two parts: the first analyses the main features of the regional economy, while the second examines the situation in the individual countries of Latin America and the Caribbean. A full statistical appendix is included, containing regional and national data.

The introduction of the first part outlines the relatively favourable performance of the region's economy as a whole in recent years and analyses the factors which could jeopardize that performance. It underlines the growing uncertainties in the global economy, which could endanger the prospects for growth in the region. Nonetheless, it draws attention to improvements in a number of economic indicators, reflecting the reduced vulnerability of the region's economies to any adverse developments in the global situation.

The following chapters are devoted to the international situation, macroeconomic (fiscal, exchange-rate and monetary) policy, and the region's performance internally (level of economic activity, inflation, employment and wages) and externally (trade balance, transfers and income, capital flows and

external debt). A statistical appendix illustrates trends in the main indicators at the regional level.

One of the principal challenges facing the region is export diversification, especially the need to offer more knowledge-intensive goods. The special chapter in this edition of the *Economic Survey* provides an analysis from the macroeconomic viewpoint of the ways in which that process is affected by levels of, and trends in, investments and real exchange rates.

The second part of the document provides overviews of macroeconomic policies and trends in the Latin American and Caribbean countries in 2005 and the first half of 2006. The country reports include tables on the main economic indicators. Beginning with this edition of the *Economic Survey*, these reports and the statistical appendix specific to each country are included in the CD-ROM provided with the print version and are available on the ECLAC website ([www.eclac.org](http://www.eclac.org)). The tables contained in the statistical appendix provide ready access to data for recent years and facilitate the creation of spreadsheets. The CD-ROM also contains the electronic version of the regional parts of the text.

The statistical information contained in this publication has been updated to 30 June 2006.



## Executive Summary

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The economy of the Latin American and Caribbean region grew by 4.5% in 2005 and is expected to expand by around 5% in 2006, thereby completing a fourth consecutive year of growth. If these projections are borne out, the average annual increase in the region's GDP for this period will amount to approximately 4.3%, which translates into an average rise in per capita GDP of nearly 2.8% per year. In view of the moderate slowdown projected for the world economy, ECLAC estimates put the region's growth rate for 2007 at about 4.5%.

Although the region is growing more slowly than some other parts of the developing world, its economies' expansion is, in the aggregate, combined with surpluses on the countries' balance-of-payments current accounts and sound public finances. This makes Latin America and the Caribbean considerably less vulnerable to external shocks. Under prevailing international conditions, which include increasing market volatility and the prospects of a gradual decline in world economic growth, the style of growth seen in the region over the past few years is providing a safety margin that will help it cope with any changes in external conditions.

The region's growth has been underpinned by the highly favourable external environment created by the world economy's steady expansion and abundant liquidity

on international capital markets. These factors have enabled it to significantly increase its export volumes and have improved the terms of trade for the South American countries, Mexico, and Trinidad and Tobago. In Mexico, Central America and some Caribbean nations, such as Grenada, Guyana and Jamaica, remittances from emigrant workers have been a major source of revenue.

While the world economy may succeed in dealing with the threat of inflation and in rectifying existing global imbalances without any steep downturn in its growth rate, these factors are still a source of uncertainty. Some indicators appear to be heralding a period of greater global volatility, and the possibility cannot be ruled out that this may dampen growth somewhat and trigger a reversal in the net direction of some capital flows back toward developed countries.

In view of the region's less vulnerable external and fiscal positions, and so long as these changes are moderate and occur gradually, there is no reason to expect the region to make any major departures from the growth path it has been following in recent years.

The world economy's growth rate slowed somewhat in 2005, with the increase in global GDP amounting to 3.5%, compared to 4.0% in 2004. However, China's and India's striking dynamism, with 2005 growth rates of

over 9% and 8%, respectively, has improved the terms of trade for commodity exporters, and many emerging economies have therefore been able to sustain higher rates of expansion. In fact, Latin America's average commodity export prices continued to rise by rates of over 13%, with the increase being led—as in 2004—by energy prices. This was reflected in a commodity price index that was 59.9% higher than its average level for the 1990s.

In 2003-2005, unlike what occurred during some earlier episodes in the region, the countries' governments avoided expansionary fiscal policies and instead opted to use the present growth phase to build up their primary surpluses and pay down their debt.

The fiscal performance of the region's central governments allowed it to amass a primary surplus (measured as a simple average) of 1.4% of GDP in 2005, compared with one of 0.6% in 2004. Calculations of the overall balance (i.e., once interest payments on public debt have been factored into the equation) show a reduction in the deficit from 1.9% to 1.2% of GDP. Taking into account the broader nature of government accounts in the more decentralized countries of the region, the non-financial public sector's primary surplus climbed from 0.9% of GDP, on average, in 2002 to 3.1% in 2005. The improvement seen in 2005 is attributable to the widespread increase in fiscal revenues, which outweighed a smaller increase in expenditure.

At the level of the non-financial public sector, the public debt-to-GDP ratio for 2005, measured as a simple average, came to 48.6%, down from the 2004 figure of 55.9%. The main factors behind this trend have been the region's large primary surpluses, debt restructurings and the appreciation of many of the countries' currencies against the dollar. Sizeable reductions were also made in the total public debts of countries included in the Heavily Indebted Poor Countries (HIPC) Debt Initiative.

Thanks to the improved fiscal situation (which has reduced the countries' borrowing requirements) and the build-up of reserves, there was less of an incentive for countries to enter into stand-by arrangements with the International Monetary Fund (IMF). One of the major events to occur in this connection was the early repayment of IMF loans by two of the Fund's largest borrowers, Argentina and Brazil, in late 2005. As a result of these early repayments, which reduced the Fund's loan portfolio by nearly half, Latin America ceased to be one of the Fund's main borrowers for the first time in many years.

Judging from the budgets drawn up by the countries in late 2005, the fiscal information available during the early months of 2006, and what appears to be an upswing in expenditures during the first quarter, a smaller primary surplus is expected for 2006.

Exchange-rate policy in 2005 was quite heterogeneous and was a very influential factor in the build-up of reserves. One of the main reasons why it varied so much from case to case is that the countries of the region use different types of exchange-rate regimes. Countries that use exchange-rate targets have to intervene in the market in order to keep their nominal parities within their target range, while countries with flexible exchange rates may intervene for a variety of reasons, such as to reduce exchange-rate volatility and avoid a serious currency misalignment or to accumulate reserves in order to replenish stocks and thus be able to better withstand sudden changes in foreign-exchange flows (especially in the case of countries with highly dollarized financial sectors).

Between December 2004 and December 2005, the Latin American and Caribbean region's real effective exchange rate vis-à-vis the rest of the world appreciated by 8.3%. The extraregional effective rate of exchange appreciated throughout 2005, however, so a comparison of the average rates for 2004 and 2005 yields a smaller figure (4.5%). In 2005, the appreciation of the real effective exchange rate relative to the rest of the world was almost twice as high for South America (10.1% between December 2004 and December 2005) as, on average, for Central America, the Caribbean and Mexico (6%). In contrast, the aggregate real effective exchange rate for the region vis-à-vis the rest of the world showed a slight depreciation (0.8%) in the first four months of 2006.

Monetary policy in the region has been adapting quite swiftly when turning points were reached in external conditions, and particularly to developments in financial markets and shifts in the outlook for international economic activity. With some differences in degree depending on the status of the economy, priority has continued to be placed on keeping inflation under control. The central banks of the region are concerned about the need to prevent the surge in oil prices from driving up price indices. The appreciation of almost all the countries' currencies has helped to rein in the pace of price rises, however.

Increases in the monetary policy rate were very slight in the great majority of the countries in 2005, despite the fact that real interest rates are fairly low in historical terms. The few exceptions are significant, however, since they include Brazil and Mexico, the region's largest countries. From a medium-term perspective, in most of the countries real rates at the start of 2006 are only slightly lower or higher than they were three years ago.

A majority of the countries have seen a rise in real lending rates in recent months. This trend reflects the change in direction of the United States Federal Reserve's interest rate adjustments in June 2004. Since that time, many of the region's central banks have followed its lead.

Lending activity has rebounded from the depressed

levels observed before 2003. Nominal growth rates for total credit and private credit both topped 15% in the 12 months prior to the first quarter of 2006. This increase, which is a reflection of the improvement in global economic conditions, is higher than in preceding years and has brought these variables back up to their pre-2001 levels.

The Latin American and Caribbean region's economic growth rate of 4.5% in 2005 (5.9% in 2004) is attributable to the momentum provided by both domestic and external demand. After having fallen steadily between 1999 and 2003, investment began to rebound in 2004 and continued to do so in 2005, thanks to the persistence of favourable external conditions, a high capacity utilization rate in many industries, the appreciation of the countries' exchange rates relative to their 2002-2003 levels, and a larger credit supply. Meanwhile, low interest rates, the greater availability of credit and an increase in total wages fuelled an upswing in private consumption. In fact, total consumption was the only component of demand to rise more sharply in 2005 than in 2004. The growth of the region's export volumes in 2005 (8.4%) continued to outpace GDP, while the expansion of imports (11.4%) attested to the strength of domestic demand (5.1%).

The various sectors of economic activity reflected the behaviour of the corresponding components of expenditure. More robust external demand continued to drive production in the mining and hydrocarbons sector (3.6%), and the expansion of domestic demand buoyed the manufacturing sector's performance (3.2%) both in branches of industry catering to the domestic market and in those that primarily export their products to other countries within the region. Output in the agricultural sector was up by 2.2%. The construction sector's strong growth (6.4% for the region as a whole) in many of the countries was reflected in an increase in gross fixed capital formation.

Generally speaking, services expanded more than goods-producing sectors. The upturn in consumption spurred commerce, which posted an 5.6% increase regionwide, while the expansion of transport and communications (7.7% in regional terms) was in large part a result of the strength of activity in goods-producing sectors and the growth seen in communications, particularly mobile telephony. Tourism-related activities such as hotels and restaurants, as well as the transport sector, exhibited a great deal of dynamism.

One of the most striking aspects of the region's performance in the last two years has been the sharp rise in gross national disposable income, which (measured at constant prices) outstripped GDP growth, surging by 7.1% in 2004 and 5.9% in 2005. This increase can be attributed to the trading gains deriving from change in the terms of

trade, which, measured at 2000 prices, were equivalent to 1.7% of GDP in 2005 (0.4% in 2004). The region's national savings rates continued to climb, reaching a regional average, in current dollars, equivalent to 22.4% of GDP — the highest since 1990.

Inflation in the Latin American and Caribbean countries continued to trend downward in 2005, falling to a weighted average of 6.1% (as compared to 7.4% in 2004). Measured as a simple average of national rates, it amounted to 7.3% (versus 8.6% in 2004).

Even though domestic demand (particularly private consumption) was significantly stronger in 2005, in various cases the rise did not translate into steeper increases in consumer prices; as a result, core inflation was lower than the general inflation rate in almost all of the countries.

The region's relatively high rate of economic growth in recent years has had a noticeable impact on its labour markets. In fact, 2005 was the third year in a row of marked increases in the employment rate. The 2005 rise of 0.5 points takes the rate up to 53.6% of the working-age population. It is important to bear in mind, however, that these recent improvements are simply bringing the region's employment rate back up to where it stood in 1997.

The reactivation of employment since 2003 has been of a markedly different composition than before, as it is increasingly driven by the creation of wage-based jobs. This reflects businesses' growing confidence in the outlook for growth and has led to an expansion of formal-sector employment in many economies of the region.

Against the backdrop of these favourable economic trends, unemployment fell by over one percentage point to 9.1%, its lowest level since the mid-1990s. This was due both to an increase in employment and a slowdown in the growth of the labour supply, as the labour participation rate dipped by 0.3 of a percentage point to 59.2% of the working-age population.

Recent improvements notwithstanding, unemployment remains high, with an estimated 18 million people out of work. Furthermore, a sizeable percentage of new jobs are in low-paying positions, and the number of short-term employment arrangements in the formal sector is on the rise. The labour market's reactivation in 2005 has not yet led to any significant rise in real wages, which were up by just 0.5%.

In the early months of 2006, the region's unemployment rate continued to decline at a fairly moderate pace as the net result of an increase in employment and a modest upturn in the participation rate, while real wages began to climb more quickly.

For the third year in a row, the region's balance-of-payments current account yielded a surplus, with the 2005 average amounting to US\$ 35.325 billion, or the equivalent of 1.5% of its GDP. It also posted a

surplus of US\$ 21.65 billion on the capital and financial accounts (including errors and omissions), or 0.9% of regional GDP. As a result, the global balance totalled US\$ 56.977 billion, or 2.4% of regional GDP. The corresponding counterpart items were a US\$ 35.265 billion (1.5% of the region's GDP) increase in reserve assets, US\$ 26.816 billion in payments on IMF loans (1.1% of GDP), and US\$ 5.105 billion in exceptional financing. The region therefore became a net recipient of capital flows while at the same time running a surplus on its current account. This was the first time that had happened (with the exception of 2003, when both surpluses were much smaller) since the beginning of the data series in 1980.

The current account included a US\$ 80.627 billion merchandise trade surplus and a US\$ 48.7 billion surplus in current transfers, which represented 3.4% and 2.1% of the region's GDP, respectively. Exports and imports were up by 20.0% and 18.2%, respectively. The expansion of external sales was the combined effect of an 8.1% increase in the volume of shipments and an 11.0% rise in prices. In the case of imports, the volume was 12.1% higher and prices were 5.5% above the preceding year's levels. In contrast, the services and income balances ran deficits of US\$ 18.519 billion (0.8% of GDP) and US\$ 75.476 billion (3.2% of GDP), respectively.

Foreign direct investment (FDI) totalled US\$ 47.8 billion (2% of GDP), which was 9.7% more than the year before. At US\$ 26.2 billion (1.1% of GDP), the deficit in short-term capital flows was smaller than in 2004. This figure was the net result of two opposing flows: on the

one hand, debt paydowns and external asset formation and, on the other, sizeable capital inflows in the form of portfolio investments.

The reduction in the region's external debt was coupled with a widespread restructuring of debt profiles aimed at diminishing exposure to shifting external conditions, particularly interest-rate and exchange-rate movements. Liability management operations focused on extending external-debt maturities, retiring the more expensive debts, diversifying exchange-rate risk by issuing debt instruments in currencies other than the United States dollar, and reducing that same form of risk by shifting more debt balances into local currencies. As a result, the Latin American and Caribbean region's external debt-to-GDP ratio shrank from 37% of GDP in 2004 to 27% by late 2005.

In 2006, rising interest rates in the United States have begun to make the market more risk-averse. When the United States posted a higher-than-expected rate of inflation in May, financial markets slumped, particularly in emerging (including Latin American) markets. This was triggered by investors' expectations of a steep increase in interest rates, which could in turn lead to a cooling of the global economy's growth.

The continuation of these trends is uncertain, as are the implications of a possible adjustment of global disequilibria. Be that as it may, macroeconomic conditions in the region, particularly its primary surpluses, build-up of reserves, and improved debt profiles, give reason to believe that the region is in a better financial position to cope with any future deterioration in the external environment.

## Chapter I

# Introduction

The Latin American and Caribbean region grew by 4.5% in 2005 and is expected to expand by around 5% in 2006, thereby completing a fourth consecutive year of growth. If these projections are borne out, the average annual increase in the region's GDP for this period will amount to approximately 17.6% (an annual average of 4.3%), which translates into an average rise in per capita GDP of nearly 12% (2.8% per year). This is only the second time that this has occurred in the region in the last 25 years (the first was in 1991-1994). In view of the moderate slowdown projected for the world economy, ECLAC estimates put the region's growth rate for 2007 at around 4.5%.

Although high in historical terms, the region's present growth rates are lower than those being observed in some other parts of the developing world. It is noteworthy, however, that this economic expansion is, in the aggregate, taking place in combination with surpluses on the countries' balance-of-payments current accounts and sound public finances. This makes the region considerably less vulnerable to external shocks. In this sense, the region's current growth phase is remarkable even when viewed from a comparative international perspective, both because of its reduced reliance on external saving and because of the speed at which it is paying down its debt.

Under prevailing international conditions, which include increasing market volatility and the prospects of a gradual slowing of world economic growth, the style of growth seen in Latin America and the Caribbean over the past few years is providing the region with a safety margin that will help it cope with any changes in external conditions.

Table I.1  
**GROSS DOMESTIC PRODUCT**  
(Projected growth rates)

Country	2006	2007
Argentina	7.6	5.5
Bolivia	4.2	4.0
Brazil	4.0	4.0
Chile	5.6	5.5
Colombia	4.8	4.5
Costa Rica	5.5	5.0
Ecuador	3.5	3.0
El Salvador	3.5	3.0
Guatemala	4.0	3.5
Haiti	2.5	2.5
Honduras	4.8	4.0
Mexico	4.0	3.5
Nicaragua	3.5	3.5
Panama	6.5	6.5
Paraguay	3.5	3.5
Peru	5.8	5.5
Dominican Republic	8.0	6.0
Uruguay	5.0	4.0
Venezuela (Bolivarian Rep. of)	8.0	6.0
Latin America	4.9	4.3
Caribbean	6.3	4.3
Latin America and the Caribbean	5.0	4.3

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

## A. Highlights of recent trends

The region's growth has been underpinned by the highly favourable external environment created by the world economy's steady expansion and abundant liquidity on international capital markets. These conditions have enabled it to significantly increase its export volumes and have improved the terms of trade for the South American countries and Mexico, and both of these factors have helped the region to generate increasingly large trade surpluses.

The region's terms of trade in 2005 were 23.4% higher than the average for the 1990s; if the comparison is made using their average level for 2003-2005, then the increase amounts to 17.7%. As shown in table I.2, most of this improvement was attributable to commodity prices, but in the case of the 2003-2005 average, a portion of it also stems from lower import prices. Towards the end of this period, however, the impact of fuel price increases also began to be felt.

Table I.2  
TERMS OF TRADE: VARIATION RELATIVE TO  
THE AVERAGE FOR THE 1990s  
(Percentages)

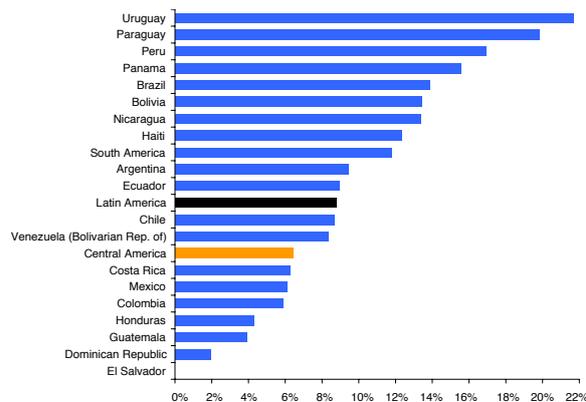
	2005	Average 2003-2005
Export price index	27.8	16.2
Commodities	24.4	16.2
Natural-resource-based, manufactures	1.9	1.1
Other	1.5	-1.1
Import price index	4.4	-1.5
Variation	23.4	17.7

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

The rise in the terms-of-trade index was accompanied, as noted earlier, by an upswing of nearly 9%, on average, in export volumes over the past two years. In the case of South America, the increase amounted to 12% (see figure I.1). Within this subregion, six out of eight countries posted average increases in export volumes of over 10% per year. Although they may expand somewhat less in 2006, the fact that they have risen by an average of 7.3% per year over the past decade attests to the increasing openness of the countries' economies.

Another feature of this growth cycle has been the expanding flow of remittances being sent back, especially to Central America and Mexico, by emigrant workers.

Figure I.1  
EXPORTS OF GOODS: AVERAGE ANNUAL GROWTH RATES,  
2004-2005  
(Dollars at 2000 prices)



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

This combination of trade surpluses and hefty unrequited transfers accounts for the surplus on the balance-of-payments current account, which, for the first time ever, is occurring in conjunction with positive economic growth rates.

As a result of the combined effect of favourable terms of trade and the high level of transfers, the region's aggregate national income rose faster than its GDP (7.1% versus 5.9% in 2004 and 5.9% versus 4.5% in 2005) (see box I.1). Consumption picked up speed, climbing by 4.2% in 2004 and by 5.3% in 2005. It has not, however, kept pace with the growth rates for national income, which means that national saving has been on the rise, especially in South America.

Gross fixed capital formation has been the fastest-growing component of demand (especially in countries where the terms of trade improved), with growth rates of 13% in 2004 and 10.7% in 2005 for the region as a whole. Construction and additional machinery and equipment contributed more or less equally to the expansion of investment in 2004, but in 2005 nearly two thirds of the total increase was accounted for by the growth of investment in equipment.

Box 1.1  
DIFFERENCES BETWEEN GDP AND GROSS NATIONAL DISPOSABLE INCOME

The trend in gross national disposable income in Latin America and the Caribbean has been one of the most notable aspects of the region's economic performance over the past two years. Measured in United States dollars at 2000 prices, it is calculated as the sum of the region's GDP, the trading gain or loss resulting from changes in the terms of trade,<sup>a</sup> net payments to the rest of the world of the profits of foreign corporations operating in the region, interest payments on external debt, and net current transfers received from the rest of the world, including emigrants' remittances and net grants and donations.<sup>b</sup>

Measured in dollars at constant 2000 prices, the regional aggregate of gross national disposable income increased by 5.9% in 2005 (7.1% in 2004), compared with GDP growth of 4.5% (5.9% in 2004). This growth differential is attributable to the considerable trading gain resulting from an improvement in the terms of trade, which amounted to 1.7% of GDP for the region as a whole (0.4% in 2004). The higher increase in income was shared by most of the countries in the region. In 2004-2005, the average annual rate of increase in gross national disposable income exceeded GDP growth in all the countries, except the Dominican Republic, Panama and Uruguay.

The reasons for this greater increase in income vary across countries. In some countries, the main factor was the positive terms-of-trade effect; this was particularly true in those that saw a greater increase in the purchasing power of their exports (exporters of metals, minerals and hydrocarbons). In Argentina's case, it was due to lower factor payments, while in some Central American and Caribbean countries (El Salvador, Haiti, Honduras and Nicaragua) it was accounted for by increased inflows, measured at constant prices, of current transfers (mostly remittances from nationals living abroad).

Table 1  
LATIN AMERICA AND THE CARIBBEAN: GROSS NATIONAL DISPOSABLE INCOME AND ITS COMPONENTS, 2004-2005<sup>c</sup>  
(Millions of dollars at 2000 prices, growth rates in percentages)

	GDP		Gross national disposable income	
	2004	2005	2004	2005
Argentina	9.0	9.2	9.5	10.1
Bolivia	3.9	4.1	5.6	6.5
Brazil	4.9	2.3	5.3	2.5
Chile	6.2	6.3	10.4	9.9
Colombia	4.8	5.1	6.6	6.4
Costa Rica	4.1	5.9	4.4	6.0
Ecuador	7.6	3.9	7.9	8.9
El Salvador	1.8	2.8	3.4	3.0
Guatemala	2.7	3.2	3.6	3.8
Haiti	-3.5	1.8	-2.4	2.3
Honduras	5.0	4.1	5.1	11.0
Mexico	4.2	3.0	5.6	3.8
Nicaragua	5.1	4.0	5.8	5.3
Panama	7.6	6.4	4.6	4.6
Paraguay	4.1	2.9	4.9	1.9
Peru	5.2	6.4	5.3	7.2
Dominican Republic	2.7	9.2	1.8	8.9
Uruguay	11.8	6.6	12.1	5.8
Venezuela (Bolivarian Rep. of)	17.9	9.3	22.8	20.7
Latin America	5.9	4.5	7.1	5.9

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

Table 2  
LATIN AMERICA AND THE CARIBBEAN: COMPONENTS OF GROSS NATIONAL DISPOSABLE INCOME, 2004-2005<sup>c</sup>  
(Millions of dollars at 2000 prices, percentages of GDP)

	Trading gain or loss		Net payment of profit and interest		Current net transfers	
	2004	2005	2004	2005	2004	2005
Argentina	-0.2	-0.5	-3.0	-1.9	0.2	0.2
Bolivia	7.0	8.6	-4.6	-4.0	5.9	6.2
Brazil	-0.3	0.3	-2.9	-3.3	0.5	0.5
Chile	6.5	10.8	-8.8	-10.2	1.2	1.7
Colombia	1.1	3.1	-4.3	-5.0	3.7	3.7
Costa Rica	-3.0	-4.3	-2.3	-1.1	1.1	1.3
Ecuador	-3.5	1.2	-7.0	-6.8	8.9	8.7
El Salvador	-0.3	-0.3	-3.1	-3.6	17.2	18.0
Guatemala	-0.7	-0.7	-1.4	-1.3	13.1	13.6
Haiti	-0.6	-0.8	-0.3	-0.9	25.9	27.3
Honduras	-5.6	-5.1	-5.2	-4.1	20.2	25.9
Mexico	0.2	1.0	-1.5	-1.8	2.6	2.9
Nicaragua	-6.6	-7.0	-3.9	-2.2	13.8	13.6
Panama	-1.0	-2.6	-7.2	-7.1	1.6	1.5
Paraguay	-0.2	-2.7	-0.9	0.5	2.4	2.5
Peru	1.7	3.6	-5.0	-6.4	2.1	2.3
Dominican Republic	-2.6	-2.7	-6.2	-5.9	9.0	8.6
Uruguay	0.1	-0.9	-2.9	-2.5	0.6	0.5
Venezuela (Bolivarian Rep. of)	3.9	12.8	-2.9	-1.3	-0.1	-0.1
Latin America	0.4	1.7	-3.0	-3.0	1.9	2.0

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

<sup>a</sup> See United Nations, Commission of the European Communities, Organisation for Economic Co-operation and Development (OECD), International Monetary Fund and World Bank, System of National Accounts 1993, 1993, New York, 1993, chapter XVI, paragraphs 16.151-16.156. According to the definition used by ECLAC, the trading gain or loss resulting from changes in the terms of trade is determined by multiplying the value of goods and services exports at constant prices by the variation of the terms of trade index. (See ECLAC, Producto interno bruto de los países de América Latina, E/CN.12/L.51/Add.2), Santiago, Chile, 1970, part II. The formula used is as follows:

$$T = Q_x (P_x/P_m - 1)$$

Where:

T = the trading gain or loss resulting from changes in the terms of trade  
P<sub>x</sub> = unit value index for goods and services exports

Q<sub>x</sub> = goods and services exports at constant prices  
P<sub>m</sub> = unit value index for goods and services imports

<sup>b</sup> As an approximation for the last two aggregates, the income balance and the current transfers balance of the balance of payments, in dollars at constant 2000 prices, are used.  
<sup>c</sup> Table 1 measures the annual variations in GDP and national income, both at dollars in 2000 prices. Table 2 measures the ratio in each year between each of the three aggregates and GDP at 2000 prices. The relationship between the two tables is as follows: the difference between the aggregates shown in table 1 in any given year (e.g., for all of Latin America in 2005: 5.9 - 4.5 = 1.4) should be equal to the sum of the differences between the three pairs of the series shown in table 2 (for all of Latin America in 2005: (1.7 - 0.4) + [-3.0 - (-3.0)] + (2.0 - 1.9) = 1.4).

The investment rate for 2005 (21.6%) was still, however, lower than it had been before the series of financial crises that began in 1997. Indeed, present investment coefficients are too low to sustain a fast enough growth rate to fuel job creation in the formal sector at the level needed to help alleviate the delicate social situation existing in Latin America and the Caribbean. Thus, even though a great deal of headway has been made thanks to the rebounding level of economic activity, as discussed in the chapter on the labour market, the region still has a long way to go.

Figure 1.2  
CONTRIBUTION TO GROWTH OF GROSS FIXED CAPITAL FORMATION



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

Box 1.2  
HOW MUCH SHOULD LATIN AMERICA AND THE CARIBBEAN INVEST?

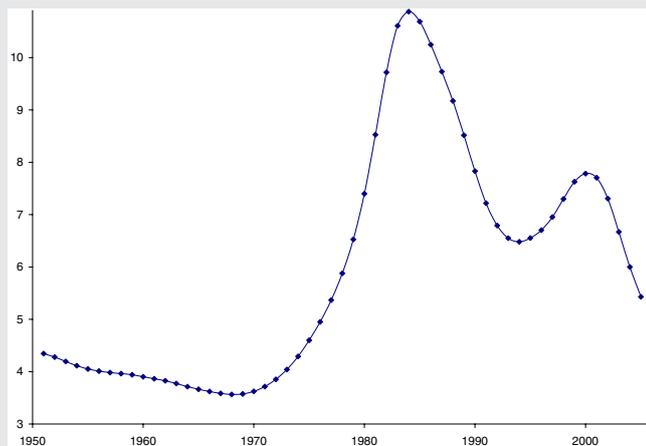
There is no simple way to determine what level of investment is needed in Latin America and the Caribbean. The answer depends, among other factors, on the type of investment, the sectors involved, how it is financed and a variety of factors that determine the effectiveness of any given investment. A shortcut which is often used, although it is not free of criticism,<sup>a</sup> is to assume that the ratio of the investment rate to the GDP growth rate  $[(I/Y)/(\Delta Y/Y)]$ , or the incremental capital/output ratio (ICOR), is fixed, and then to use this as a basis for calculating how much investment is needed to sustain a given economic growth rate.

The following figure shows the trend in this coefficient for Latin America since 1950. As the figure shows, it remained fairly stable up to the 1970s, with values

of around 4, and then climbed higher with the crisis of the 1980s. It then declined slowly until it rose again with the crises of the late 1990s. If, in the absence of further shocks, the value of this coefficient

(which is currently over 5) were to settle back to around 4-4.5, then the region would need to invest between 24 and 27 points of GDP in order to achieve an annual growth rate of 6%.

LATIN AMERICA: INCREMENTAL CAPITAL/OUTPUT RATIO (ICOR)



<sup>a</sup> See, inter alia, William Easterly, "The Ghost of Financing Gap: Testing the Growth Model of the International Financial Institutions", *Journal of Development Economics*, vol. 60, No. 2, 1999, pp. 423-438.

## B. International market trends and their probable impact on Latin America and the Caribbean

### 1. The international situation

The pace of world economic growth remained brisk in the early months of 2006, but most projections point to a slowdown in the second half of the year that will probably carry over into 2007. Lower growth rates are being predicted for the future in response to the rising levels of risks that have been present in the world economy for some time now and the fact that financial markets and commodities have begun to exhibit heightened volatility midway through the year.

The main risks at the global level are associated with the growing deficit on the United States' balance-of-payments current account. This imbalance could conceivably trigger a sudden, disorderly adjustment which could dampen demand in that country and, given its position as an engine of growth for the international economy, have a magnified ripple effect in the rest of the world.

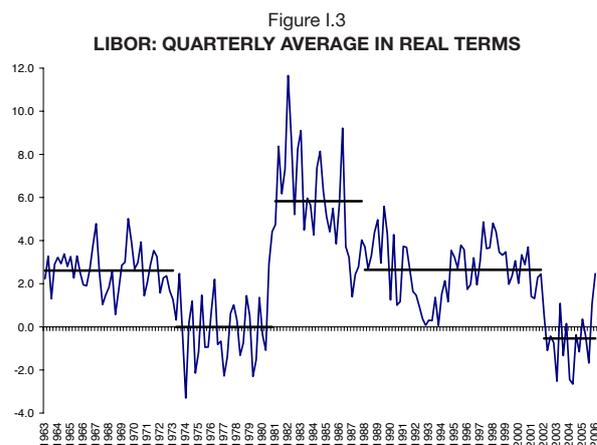
The most immediate concern, however, is what sort of impact rising oil prices may have on inflation and consumer expectations in the United States. Fears of a possible upswing in inflation have prompted interest rate hikes, with the increases being steeper for short-term rates than they have in the case of medium- and long-term rates.

From a global perspective, one of the questions now being asked is to what extent a more energetic pace of activity in Europe and Japan might offset slackening growth in the United States economy. The likelihood of this occurring will be influenced by the position adopted by Europe's and Japan's central banks, since too steep an interest-rate hike could curb a faster rate of expansion in these economies.

If, against the backdrop of the Asian and especially Chinese economies' robust expansion, Europe and Japan continue to grow at the same pace as they have in recent months, it may be possible for the world economy to accomplish an orderly adjustment that would allow it to diminish global disequilibria while continuing to grow at its present rate or only slightly more slowly.

Clearly, the chances of having this positive outcome come to pass will depend a great deal on the extent of the supply shock represented by the continued rise in oil prices and on the implications in terms of a tightening of monetary policy to stifle inflationary pressures. Both of these factors (supply shocks and rising interest rates) are usually present during global recessions.

Either way, the low real interest rates seen for most of the last decade (see figure I.3) are probably coming to an end. As noted earlier, thus far increases in short-term interest rates have not fully carried over into longer-term rates. This fact may be a sign of confidence in the central banks' and, in particular, the United States Federal Reserve's ability to hold inflation in check. In the future, however, these higher rates are likely to dampen demand and spur a flight to quality that would hurt emerging markets. In fact, as the mid-point of 2006 approached, country-risk was rising and some emerging-economy currencies were beginning to depreciate. Just how much of an impact this situation will have on the region's markets will depend primarily on the scale of the slowdown in world economic activity, which will surely have a negative influence on commodity prices and exports.



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

## 2. Effects on Latin America and the Caribbean

Judging from the above factors, the medium-term prospects for the Latin American and Caribbean region will depend, first and foremost, on the types of commercial ties maintained by its countries. If a smooth, orderly adjustment is achieved, then the United States economy's slower rate of growth can be expected to affect Mexico and Central America more than the rest of the region, since their export structure is more concentrated in that market. South America, by contrast, has a more diversified structure in which China and other Asian economies are playing an increasingly important role. In addition, a large percentage of Mexico's and Central America's exports are manufactures that are engineered to meet destination-market specifications and that would therefore be more difficult to divert to other markets in the short run.

Another consideration is how much of an impact the supply shock generated by rising hydrocarbons prices may have on individual countries depending on whether they are net oil exporters or importers. The Central American and Caribbean countries (with the exception of Trinidad and Tobago) would appear to be the most vulnerable in this respect. Some South American nations are also in this position.

The implications of mounting uncertainty and volatility and their effects on financial markets are another element to be considered. In fact, as a result of the growing unease that began to be seen in international financial markets in May, the demand for emerging-economy bonds has slackened. This, in turn, has driven up country-risk and exerted varying degrees of pressure on these countries' currencies.

Nevertheless, as noted earlier, the Latin American and Caribbean region is better prepared to deal with these types of processes than it has been on other occasions. But although this is true for the region as a whole, there are quite significant differences across countries, depending on the following factors: (i) their current account balance and the associated degree of reliance on external saving; (ii) the extent to which their current account balance is determined by commodity price levels; (iii) the levels and, especially, structure of their external assets and liabilities; and (iv) their fiscal position.

### (a) Current account balance and reliance on external saving

As noted earlier, the region as a whole is registering an increasingly large surplus on its balance-of-payments current account, with the final balance for 2005 being estimated at 1.5% of GDP. In 2004, only 8 out of 19 Latin American countries had a surplus on this account, but in 2005 the region's surplus was attributable to the results posted by just 7 countries. In a number of countries that did run deficits, however, those shortfalls were quite small and were more than offset by foreign-exchange inflows in the form of foreign direct investment. An analysis of trends in the basic balance (rather than in the current account balance) shows that the region as a whole had a surplus equivalent to 3.2% of GDP in 2004 and 3.5% in 2005. In addition, out of the 19 countries covered by this study, there were 12 countries with surpluses in 2004 and 15 in 2005.

The Caribbean as a whole registered a small deficit on its current account in 2005 and a surplus on its basic balance equivalent to 5.2% of GDP. This result is due entirely to the results posted by Trinidad and Tobago (an oil exporter), however; the rest of the countries in the subregion ran deficits on both of these accounts.

In summary, then, with the exception of some Central American and most Caribbean countries, the region can be described as exhibiting a lower degree of external vulnerability than in the past.<sup>1</sup>

### (b) External accounts and terms of trade

It is also clear that the surpluses recorded by some countries were heavily influenced by changes in their terms of trade. If, for example, the value of the region's merchandise trade flows were calculated on the basis of its terms of trade during the 1990s, then its current account surplus would turn into a deficit equal to 2.7% of GDP and its basic surplus would turn into a deficit amounting to 0.7% of GDP.

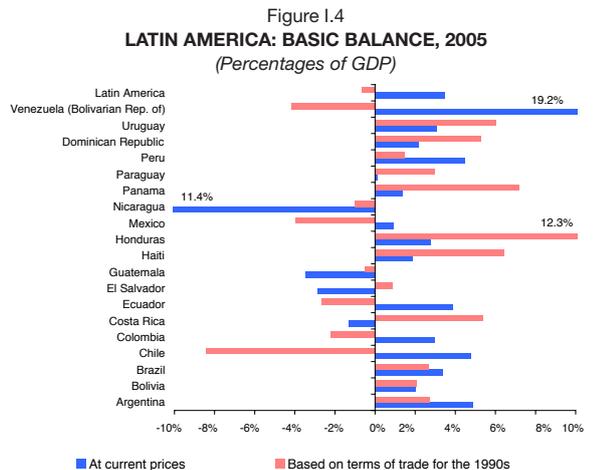
A return to the region's terms of trade in the 1990s would, however, make almost no change at all in the

<sup>1</sup> One factor that has helped to lessen vulnerability to external shocks in some cases is the reduction of the degree of dollarization in some of the region's economies, especially in South America. This continues to be a risk factor in a number of the economies, however.

number of countries having a basic surplus in 2005, since some oil importers (especially Central American countries) would, all other things being equal, then have a surplus instead of a deficit. Something quite similar would surely happen if such calculations were done for the Caribbean countries (with the exception of Trinidad and Tobago), but some of the information needed to prepare such an estimate is not available.

Some countries that are highly specialized in raw material exports, such as Chile and, to a lesser extent, the Bolivarian Republic of Venezuela and Mexico, would then run sizeable deficits, however, although the Chilean economy is, on the other hand, the least vulnerable to external shocks thanks to its countercyclical policy, lower degree of dollarization and low public debt levels. The MERCOSUR economies (which are large exporters of agricultural commodities) either do not exhibit any major impact from the terms-of-trade effect (Argentina, Brazil) or this type of price correction would result in a larger surplus (Paraguay and Uruguay). In this case, the comparison based on 1990 price levels does not show up such a marked different in the terms of trade because price rises have not been as sharp in recent years. Another reason for this result is that agricultural prices were relatively higher in the 1990s than metal and oil prices were.

In this case it should also be noted that, with few exceptions, the macroeconomic equilibria associated with the external sector are not as sensitive to the level of the countries' terms of trade.



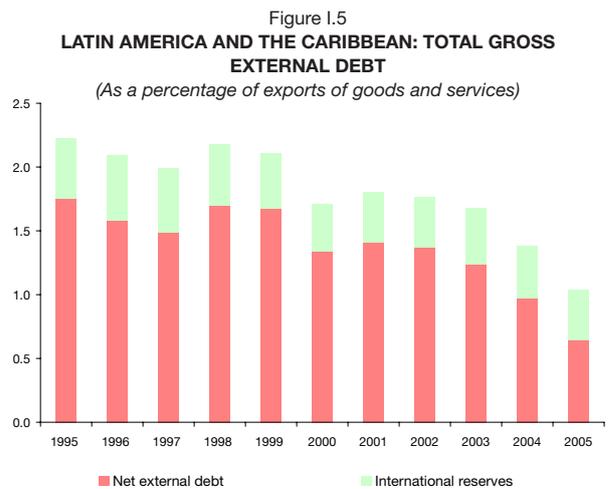
Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.

**(c) Level and structure of external assets and liabilities**

In recent years, the countries of the region have sharply reduced the size of their debt burdens, both relative to GDP and as a ratio of the region's exports. As may be

seen from figure I.5, the ratio of the total debt to exports of goods and services is less than half of what it was 10 years ago, and if the debt net of international reserves is substituted for the total debt, then the ratio falls to around one third of its former level.

Although some countries' external debt ratios are still high (6 out of 19 Latin American countries and 6 out of 13 Caribbean countries have ratios of over 100%), the situation is significantly better now than it has been since the 1980s. This is not only because the external debt-to-exports ratio is lower, but also because of the change in the ratio between short-term debt and international reserves. As figure I.6 shows, improvements in the debt structure and increases in international reserves have altered the trend of this coefficient, which is now only one third as high as it was 10 years ago.



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

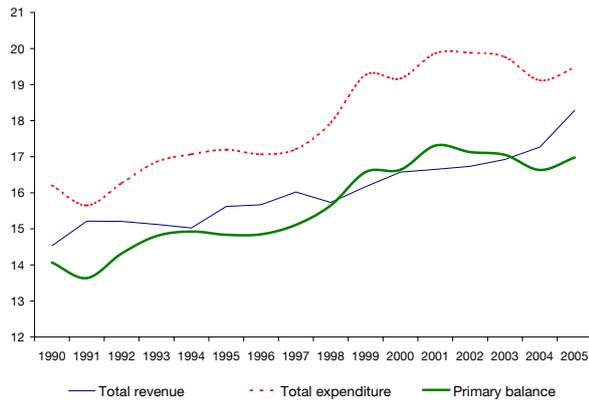


Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.

#### d) Fiscal position

The countries of the region have also been consolidating their fiscal positions in recent years. On the one hand, the macroeconomic situation has boosted fiscal revenues thanks both to the upswing in economic activity and to the improvement in the countries' terms of trade. On the other, unlike what has occurred during other growth phases, public expenditure has been kept under control. The combination of these two factors has resulted in hefty primary surpluses which the countries have used to pay down their debts (see figure I.7).

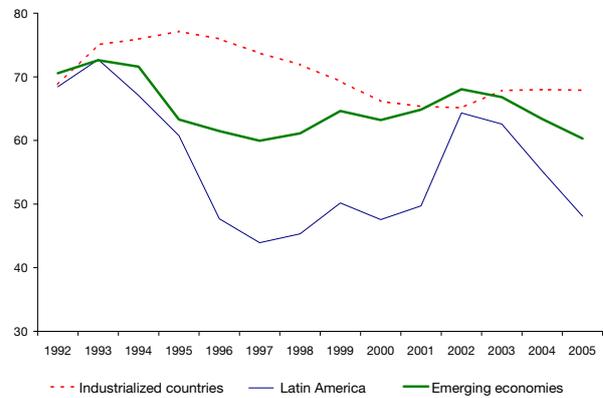
Figure I.7  
LATIN AMERICA AND THE CARIBBEAN: REVENUE, EXPENDITURE AND PRIMARY FISCAL BALANCE  
(Central government, as a percentage of GDP)



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

The reduction in the public debt relative to GDP has been sharper in the region than in developed countries and in developing countries as a group (see figure I.8). Not only has the debt been cut in size, but its composition has changed in ways that help make the region less vulnerable. One of these improvements has been the increase in the share of the debt that carries a fixed interest rate. Fixed-rate obligations have risen from 45% of the total in the late 1990s to nearly 70% in Argentina, from 7% at the start of 2002 to 28% in early 2006 in Brazil, from 38% in 2001 to 60% in 2006 in Peru and from 43% in 2000 to 70% at present in Uruguay. Another important improvement has to do with the shift in the currency mix of the debt towards a larger proportion of debt denominated in local

Figure I.8  
LATIN AMERICA, EMERGING ECONOMIES AND INDUSTRIALIZED COUNTRIES:  
PUBLIC DEBT AS A PERCENTAGE OF GDP



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

currencies. For example, just 10% of Argentina's debt was denominated in pesos in the late 1990s, but that share has risen to 52% now, while Brazil has increased the share of its net obligations that are denominated in reais from 54% to 95% between 2002 and early 2006.

The widespread improvement in public accounts is the net result of differing situations, however. For example, only a fifth of the Latin American countries (Argentina, Bolivarian Republic of Venezuela, Chile and Paraguay) have overall fiscal surpluses and half of them have debts amounting to over 50% of GDP. In addition, the need to maintain balanced fiscal accounts poses formidable challenges for economic policymakers. For countries specializing in non-renewable resources, the sharp rise in revenues has prompted a debate about how these windfall profits can be used to best advantage. Given the existence of a justified need to raise the level of social spending and to invest more in infrastructure, the region as a whole must now strive to determine the most appropriate direction for fiscal policy.

Above and beyond these issues, and although much remains to be done in order to ensure the sustainability of internal and external macroeconomic equilibria, it is clear that the Latin American and Caribbean region is better placed now than it was in the past to contend with any change for the worse in the external environment, provided that it takes place in a gradual, controlled manner.

## C. The outlook for the economies of Latin America and the Caribbean

Although it is certainly possible that the world economy may be able to cope with the risks represented by inflation and the correction of global disequilibria without experiencing a hard landing, these phenomena constitute a source of uncertainty. The escalation of the conflict in the Middle East and other international disputes are also a cause of concern. Even if everything works out well, a period of greater global volatility appears to be in the offing, and the possibility cannot be ruled out that this could cause growth rates to decline and capital flows to reverse direction and begin moving towards developed countries, where the level of risk is perceived as being lower.

Against this backdrop, the prices of the region's commodity exports are not expected to display a great deal of forward momentum, and this could have an impact on the size or sign of the countries' current account balances. Smaller trade surpluses and a tighter supply of external funds could have an impact on exchange markets that would either halt or partially reverse the currency appreciations witnessed over the past two years.

So long as these changes are moderate and occur gradually, and given the region's less vulnerable external

and fiscal positions, it is unlikely to depart in any major way from the growth path that it has recently embarked upon. In an international environment such as this, the economies having a more diversified export structure in terms of the countries of destination and a comparatively small share of sales to the United States market (and especially of products that cannot easily be diverted to other markets) will be the ones that enjoy the greatest amount of manoeuvring room. Furthermore, although somewhat lower commodity prices and slightly higher real exchange rates may pose a greater challenge for public finances, they may also spur the search for a more diversified and knowledge-intensive pattern of specialization. In this sense, the process of defining the region's style of growth in the coming years should provide some scope for the application of productive policies. As ECLAC has noted on repeated occasions, it is also essential for the region to boost its rate of investment, since, although investment has made a considerably recovery, it is still too low to ensure sustained growth at the pace needed to alleviate the social situation in Latin America and the Caribbean.

## D. Latin America and the Caribbean: growth and inflation in 2006 and 2007

The Latin American and Caribbean countries' GDP will grow by 5% in 2006 and by slightly less (nearly 4.5%) in 2007.<sup>2</sup> In general, as shown in table I.3, the various subregions will grow at fairly similar rates in 2006, with most falling into the range of 3.5%-6.5%. The exceptions will be Argentina, the Bolivarian Republic of Venezuela and the Dominican Republic, whose economies will expand

by over 7.5%, and Haiti, with a projected growth rate of 2.5%. As in past years, the Southern Cone and the Andean countries will be the two fastest-growing subregions, with rates of 7% and 6.2%, respectively.

The outlook for Latin America and the Caribbean in 2007 continues to be quite promising, with growth projected at 4.3%. The predicted rate is somewhat lower

<sup>2</sup> Economic Projections Centre, "Latin America and the Caribbean. Projections 2006-2007", *Estudios estadísticos y prospectivos series*, No. 42 (LC/L.2528-P/I), Santiago, Chile, Economic Commission for Latin America and the Caribbean (ECLAC), April 2006; and Economic Commission for Latin America and the Caribbean (ECLAC), "Atlas del crecimiento, 2006-2007" [online] [www.eclac.cl/deype/atlas\\_crecimiento/index.htm](http://www.eclac.cl/deype/atlas_crecimiento/index.htm).

Table I.3  
**LATIN AMERICA AND THE CARIBBEAN: GDP GROWTH, 2004-2007**  
*(Annual growth rates, in percentages)*

	2004	2005	2006	2007
Latin America and the Caribbean	5.9	4.5	5.0	4.3
South America	6.9	5.1	5.4	4.7
Brazil	4.9	2.3	4.0	4.0
Southern Cone	8.4	8.3	7.0	5.4
Andean countries	9.5	6.9	6.2	5.2
Mexico and Central America	4.2	3.2	4.1	3.6
Central America	4.0	4.4	4.5	4.1
Mexico	4.2	3.0	4.0	3.5
Caribbean	3.7	4.0	6.3	4.3

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

than the figure for 2006 chiefly because domestic demand is expected to be more sluggish in most of the countries of the region and the world economy's expansion is likely to slow its pace slightly.

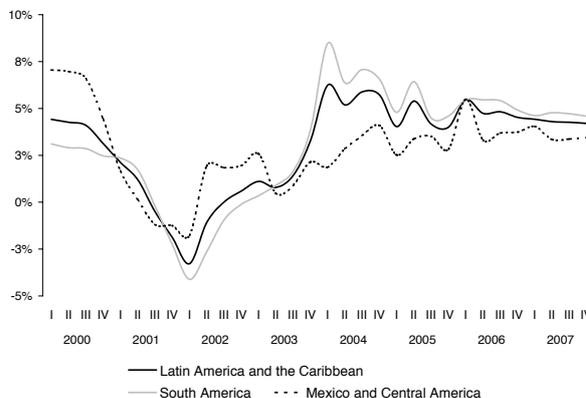
The Southern Cone's growth rate for 2006 is projected at nearly 7%, mainly because the Argentine economy is expected to expand by 7.6% thanks to the strength of domestic demand, particularly for investment. In 2007, Argentina's growth rate is expected to slip to around 5.5%. The Andean countries are likely to post a rate of 6.2%, primarily owing to the Bolivarian Republic of Venezuela's continued rapid pace of growth. A slower rate, within the range of 5%-5.5%, is expected for the Andean countries and the Southern Cone in 2007.

In Brazil, the statistics published for the first quarter of 2006 provide confirmation of a positive economic outlook for the year, during which domestic demand will continue to respond to the expansionary monetary and fiscal policies, marking up a growth rate of 4%.

As in the past few years, Mexico and Central America are expected to grow more slowly than South America in 2006 (see figure I.9), but the gap between them will narrow as the former subregion expands by about 4.1%. Primarily as a consequence of the United States' robust growth pattern, the Mexican economy will expand by 4% in 2006. Its projected rate for 2007 will be around 3.5%.

The projection that Central America will post a rate for 2006 of around 4.5% is based on the strengthening of demand being seen in most of that subregion's countries. This figure also represents a slight improvement over its 2005 performance. Private consumption will continue to be spurred by increased consumer credit and remittances. In addition, implementation of the Dominican Republic - Central America - United States Free Trade Agreement (CAFTA-DR) is expected to boost investment in the second half of the year. Some countries' non-traditional exports will continue to rise quite sharply, and the Central

Figure I.9  
**ECONOMIC GROWTH IN LATIN AMERICA AND THE CARIBBEAN, 2000-2007**  
*(Annual growth rates)*



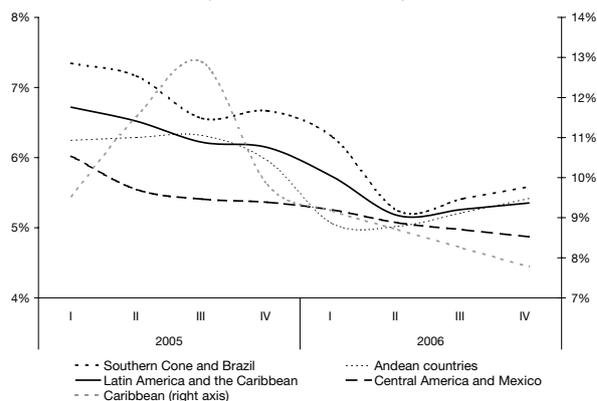
Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.

American countries are expected to continue growing at a rate slightly above 4.0% in 2007.

The Caribbean subregion's economy is likely to grow at over 6.0% in 2006, with Trinidad and Tobago leading the field with a rate of around 10%. The 2006 hurricane season represents the biggest risk in terms of the Caribbean's economic performance; there is also some concern about some countries' public finances.

Consumer prices in the region are expected to rise by 5.4% in 2006, as compared to the 6.1% rate of inflation recorded in 2005. This reduction is associated with the fairly favourable price indices registered early in the year (see figure I.10) and will enable the region to continue to hold inflation to historical lows (see table I.4).

Figure I.10  
**LATIN AMERICA: INFLATION, 2005-2006<sup>a</sup>**  
*(Annual rate of variation)*



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

<sup>a</sup> Average inflation rates are calculated using population figures as the basis for weightings.

Table I.4  
**LATIN AMERICA AND THE CARIBBEAN: INFLATION, 2004-2006<sup>a</sup>**  
*(Annual growth rates, in percentages)*

	2004	2005	2006		
			Low	Projected	High
Latin America and the Caribbean	7.4	6.1	4.6	5.4	5.9
South America	7.1	6.4	4.8	5.5	6.2
Southern Cone and Brazil	6.9	6.7	4.8	5.6	6.1
Andean countries	7.5	6.0	4.9	5.4	6.5
Mexico and Central America	8.0	5.4	4.1	4.9	5.2
Caribbean	9.1	9.5	7.2	7.6	7.9

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

<sup>a</sup> Average inflation rates are calculated using population figures as the basis for weightings.

Trends in inflation at the regional and subregional levels are depicted in figure I.10. A slight reduction is shown for the Southern Cone and Brazil, while the

projection for 2006 of 5.5% is mainly a reflection of trends in Argentina, since the other countries' inflation rates are expected to be quite moderate.

The Andean countries are also showing a reduction relative to 2005, and their 2006 inflation rate is expected to come in at an estimated 5.5% as well. This is partly attributable to the positive results achieved by a number of countries in this subregion through the use of inflation targets. There continues to be some uncertainty as to future trends in the Bolivarian Republic of Venezuela, however, where inflation remains at double-digit levels.

Projections put the rate for Central America and Mexico at nearly 5% for 2006, which is slightly lower than the 2005 figure, even though domestic prices in Central America continue to reflect the trend in oil prices. The Caribbean subregion's inflation rate is expected to fall to 7.6%, mainly thanks to price trends in Jamaica.



## Chapter II

# International economy

## A. World growth

World economic growth slowed in 2005, with global output increasing by 3.5% compared to 4.0% in 2004. This was partly due to the fact that many economies have finished making a recovery from the recession that took place at the beginning of the decade; the slower expansion of the United States economy at year's end was another factor.<sup>1</sup>

As shown in table II.1, growth slowed throughout the world in 2005. Both the United States' economy and that of the euro area posted lower growth rates than those of 2004; the former grew by 3.5% in 2005, compared to 4.2% in 2004, while the euro area grew by 1.3%, down from 2.1% in 2004.

While the rate of expansion in developing countries also slackened somewhat, dropping from an aggregate rate of 6.8% in 2004 to 6.2% in 2005, it should be noted that growth in these countries over the last three years has exceeded 5% — something which had not occurred since the late 1960s and early 1970s. Moreover, when the distribution of growth in developed countries is compared to the average for the first five years of the last few decades, it becomes clear that not only were growth rates higher in 2000-2005, but variations across countries also declined (see figure II.1). In fact, the remarkable buoyancy of the Chinese and Indian economies — which grew at rates exceeding 9% and 8%, respectively, in 2005 — has helped

Table II.1  
**WORLD GDP GROWTH RATES, 2002-2005**  
*(Percentages)*

	2002	2003	2004	2005
World	1.8	2.7	4.0	3.5
Developed countries	1.2	1.9	3.1	2.6
United States	1.6	2.7	4.2	3.5
Euro area	0.9	0.8	2.1	1.3
Japan	0.1	1.8	2.3	2.7
Developing countries	3.7	5.2	6.8	6.2
Latin America and the Caribbean	-0.8	2.0	5.9	4.5
China	9.1	10.0	10.1	9.6
Newly industrialized economies	5.0	3.0	5.4	4.4
Transition economies	5.3	6.8	7.9	7.6

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

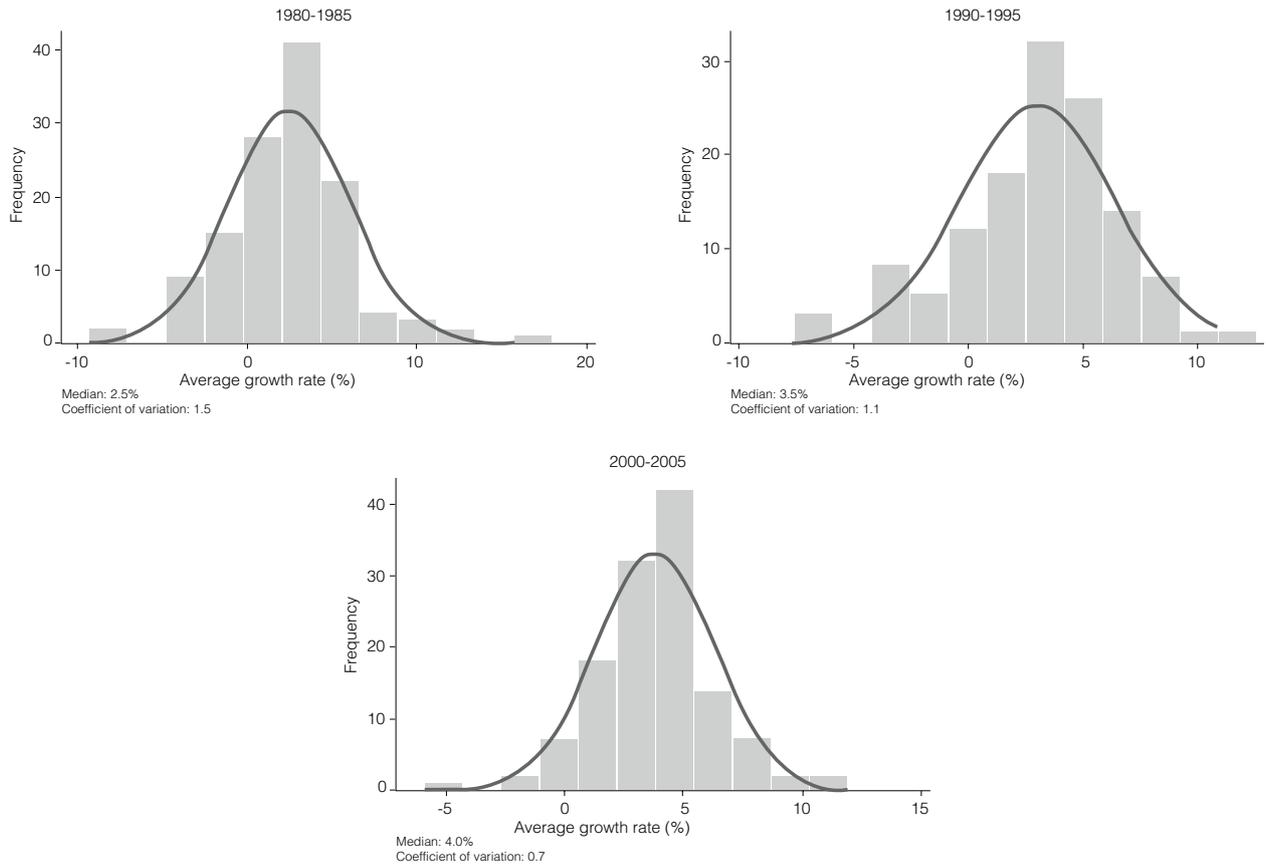
<sup>1</sup> The reduced growth of the United States during the last quarter of 2005 was mainly the one-off result of Hurricane Katrina.

to improve the terms of trade for commodity-exporting countries, thereby enabling emerging economies to sustain higher rates of expansion.

Consequently, the price of petroleum continues to rise, driven by an upsurge in global demand. In 2005, the price per barrel of West Texas Intermediate (WTI) showed a year-on-year increase of 32% measured in constant May 2006 dollars. Uncertainty regarding the possible impact of high petroleum prices on inflation is one of the main concerns facing developed and emerging

economies that import crude oil. The world growth rate in 2006 may therefore be close to that of 2005, with a 0.2% range of variation, depending on the reaction of developed economies to stricter monetary policies aimed at curbing inflation. While the growth rate of the United States is expected to slow slightly, the greater buoyancy displayed this year by the euro area and the Japanese economy, coupled with continuing high growth rates in China, may offset this slowdown and preserve the favourable international environment.

Figure II.1  
DISTRIBUTION OF GROWTH IN DEVELOPING COUNTRIES <sup>a</sup>



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

<sup>a</sup> Does not include transition economies.

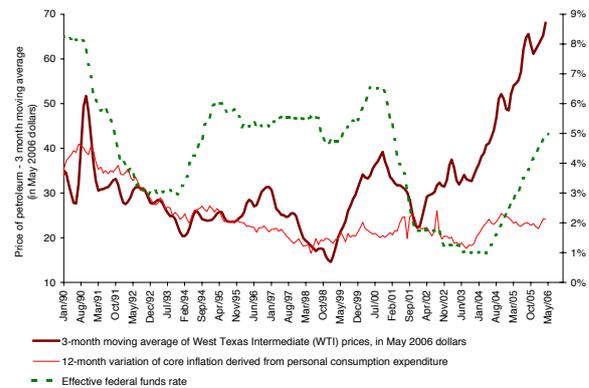
## B. Inflation and economic slowdown in the United States: A global concern

In the United States, the inflationary effect of high crude oil prices is a cause of concern for the Federal Reserve. In mid-2004, the Federal Reserve began implementing a restrictive monetary policy, as high real estate prices buoyed the economy. As shown in figure II.2, monthly core inflation in the United States, measured on the basis of personal consumption, grew at an average year-on-year rate of 2% between January 2004 and May 2006. The monetary authorities set this rate as the upper limit of the permissible range (1%-2%). It is therefore reasonable to assume that, in the short term, the Federal Reserve is likely to continue raising interest rates.

The monetary authorities of the United States are facing a year of mixed economic indicators. After growing at a rate of 4.2% in 2004, the economy slowed in 2005, growing at a rate of 3.5%. GDP appears to have expanded by over 2% during the first half of 2006, thanks to a strong rally during the first quarter of the year following a weak performance during the last quarter of 2005.<sup>2</sup> Certain indicators are unsettling, however. These signs include a slowdown in private consumption expenditure in May 2006 due to rising gasoline prices and the apparent end of the real estate boom, which may erode consumer confidence in the short term. The impact of interest rate hikes on consumer credit should also be considered, given the high household indebtedness ratio and heavy reliance on private consumption characteristic of the United States economy. In short, the growth rate of the United States may decline during the second half of 2006, with GDP for the year as a whole rising by approximately 3.4%.

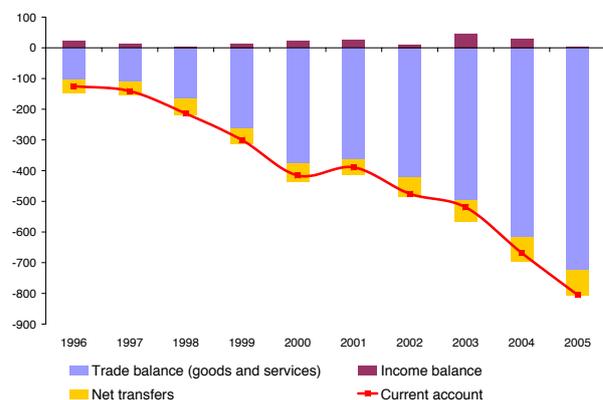
The persistence and expansion of the United States economy's external imbalances remain the most pressing concern from a global perspective. The country posted a current account deficit of over US\$ 800 billion in 2005, which was approximately US\$ 137 billion more than in 2004 (see figure II.3). As a percentage of GDP, the deficit rose from 5.7% in 2004 to 6.4% last year. This persistent imbalance is a reflection of the growing deficit on the balance of trade in goods and services. While interest payments to non-residents have risen as a result of increased debt issues, the profitability of United States assets abroad has more than offset this increase, thereby evening out

Figure II.2  
UNITED STATES: PETROLEUM PRICES, CORE INFLATION AND THE EFFECTIVE FEDERAL FUNDS RATE



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of International Monetary Fund, International Financial Statistics [online], Bureau of Economic Analysis of the United States Department of Commerce, and Federal Reserve Statistical Release database.

Figure II.3  
UNITED STATES: CURRENT ACCOUNT IMBALANCES, BY COMPONENT, 1996-2005 (Millions of dollars)



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

<sup>2</sup> In seasonally adjusted terms, during the first quarter of 2006 the GDP of the United States rose at an annual rate of 5.6% with respect to the last quarter of the preceding year.

the result on the income account. Debate on this issue focuses on the medium- and long-term sustainability of the imbalance. While some experts have called for an adjustment in the form of a strong depreciation of the dollar and fiscal discipline, others acknowledge that the imbalance is a problem shared with the economies that are financing this continuing deficit. In fact, many Asian nations (particularly China and Japan) and petroleum-exporting countries possess large current account surpluses thanks to the competitiveness of their products and high commodity prices. The abundant global liquidity which this generates is channelled mainly into dollar-denominated assets, thereby financing the current account imbalances of the United States economy.

In real effective terms, while the United States dollar depreciated slightly more than 6% during the first five months of 2006, its cumulative depreciation since 2002 is equivalent to over 21%. This is the result of a gradual process. The euro continues to gain strength, posting a real effective exchange rate increase of 2.4% during the first five months of 2006. Since its revaluation in mid-2005, the Chinese yuan has undergone a real appreciation of slightly more than 5%, which has not been enough to reduce its trade surplus. The dollar may be expected to continue depreciating slowly in the future, as pressure for a further revaluation of the yuan continues.

In 2005, the euro area, which includes 12 of the 25 countries that make up the European Union, was unable to sustain the rate of economic growth it had achieved the preceding year. After an aggregate GDP increase of 2.1% in 2004, conditions deteriorated during the last quarter of 2005; at year's end, growth stood at 1.3%. This slowdown was a result of lower growth in Germany (1.0%), France (1.2%) and Italy (0%), which together account for over 70% of the subregion's GDP. In Germany, private and public consumption both contracted during the last quarter of 2005, in seasonally adjusted terms, compared to the previous quarter. The growth rate of overall consumption in France declined during the same period, while the level of the country's net exports fell. This was also the case in Italy, where the growth of consumption also declined and investment contracted between the third and fourth quarters of last year.

In 2005, the Harmonised Consumer Price Index (HCPI) of the European Economic and Monetary Union rose by 2.2%. Since 2000, inflation in the euro area has grown at an annual rate exceeding 2%. The response of the European Central Bank (ECB) has been to raise its benchmark rate by 25 basis points, beginning in late 2005,

in order to reduce inflation without unduly interfering with the region's growth.

In fact, during the first quarter of 2006, private consumption in Germany and France surpassed levels reached during the last quarter of 2005 (0.6% and 0.9%, respectively). Renewed optimism early in the year has been reinforced by recent improvements in the European Union's employment indicators, which may bolster overall consumer confidence. Households in Germany may even begin buying certain types of consumer goods in advance, thereby increasing their overall spending levels, in response to the country's announced 2007 VAT hike. Private consumption expenditure in Europe's major economies is likely to become robust once again in 2006, with the monetary union's aggregate GDP growth hovering around 2% at year's end. The future is less certain from 2007 onward, as the sustainability of these rates will depend on the pass-through of fuel prices to the rest of the economy, as well as the measures adopted by the European Central Bank within a framework of more restrictive fiscal policies and a stronger euro.<sup>3</sup>

Japan continued to recover, buoyed mainly by an improvement in domestic demand. The country's GDP expanded by 2.3% in 2004 and 2.7% in 2005. These rates exceeded those posted between 2001 and 2003, consolidating the revitalization of an economy that accounts for approximately 14% of global GDP. Thus far in 2006, private consumption and investment have continued to rise, accompanied by low unemployment and higher wages, and improved corporate profits have offset rising fuel prices. Prices have begun responding to this increased growth, with cumulative inflation reaching 0.8% during the first quarter of 2006 as a result. This departure from eight years of deflation may soon reverse the Bank of Japan's expansionary monetary policy. More robust domestic demand also generated a 15.7% increase in imports of goods and services in 2005, surpassing the upsurge in the country's exports (7.3%) and reducing its trade and current account surpluses, which amounted to 3.6% of GDP. Economic expansion is expected to continue in 2006, with GDP growth approaching 2.8%. In the future, the Japanese economy's hefty fiscal deficit (5.5% of GDP in 2005) may lead the government to make adjustments in an effort to increase revenues or cut spending. Depending on their intensity, these adjustments may dampen private consumption and corporate profits.

The Chinese economy remains vibrant. GDP in China expanded by 9.6% last year, after marking up a 10% rate for 2004.<sup>4</sup> The country has experienced two

<sup>3</sup> In addition to a VAT hike in Germany, the restrictive policies planned for 2007 include a 1% cut in government spending in France.

<sup>4</sup> The National Bureau of Statistics of China has revised its GDP figures, increasing its estimates for recent years to reflect the good performance of the service sector.

decades of high, sustained growth, at an average annual rate of 10% between 1987 and 1996 and 8.4% between 1995 and 2005. This forceful economic performance is founded upon three main pillars: a considerable increase in net exports, investment (mainly in infrastructure) and the energizing effect of domestic consumption. In 2005, exports increased by 28.4% over the preceding year, totalling US\$ 762 billion —more than the combined total of all exports from Latin America and the Caribbean (US\$ 576 billion). Spurred by domestic demand, imports climbed by 17.6% following a 36% increase in 2004.

This resulted in a US\$ 90 billion increase in the country’s current account surplus in 2005 —from 3.6% of GDP in 2004 to over 7% only one year later.

Investment in China is estimated to have exceeded 42% of GDP in 2005 —down slightly from 45.3% in 2004. This decline is a result of stronger administrative restrictions on the real estate sector that are intended to regulate its growth. In 2006, the Chinese economy is expected to grow at much the same rate as in 2005, although questions remain regarding its sustainability and possible inflationary pressures.

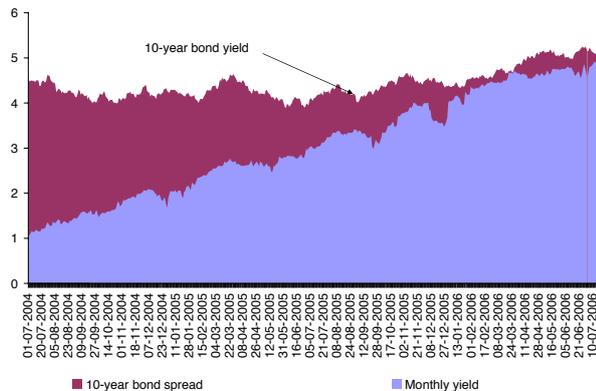
### C. Investment in production declines amid increasing uncertainty

The last few years have been characterized by high levels of international liquidity owing to improved corporate profits and the foreign trade surpluses generated by high commodity prices —particularly for petroleum. Institutional investors, such as the central banks of surplus countries (mainly Asian nations and some petroleum-producing countries), have placed a significant portion of their reserves in dollar-denominated assets. Higher earnings in the production sector have not been used to increase installed capacity, but rather to purchase financial assets, most of them in dollars. This has kept investment demand below the levels that would generally be expected, given the abundance of liquidity in the

economy. One explanation for this phenomenon may be that transnational corporations have already undergone a restructuring process in early 2000 and have therefore ruled out the idea of expanding their installed capacity in the short term at a time when productivity is on the rise. Stronger demand for dollar-denominated term assets has put an end to the trend in long-term interest rates, which had been rising more slowly than short-term rates (which were being hiked by the major economies’ central banks), thereby flattening the asset yield curve (see figures II.4 and II.5).

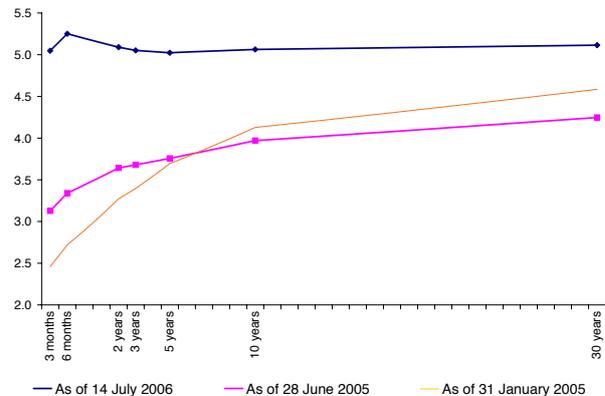
The heightened uncertainty sparked by the increased pass-through of fuel prices in developed economies associated

Figure II.4  
SHORT- AND LONG-TERM YIELDS OF UNITED STATES TREASURY BONDS, JULY 2004 – JULY 2006



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

Figure II.5  
YIELD CURVE OF UNITED STATES TREASURY BONDS, 2005 AND 2006



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

with higher production and shipment costs, as well as further increases in short-term interest rates, may begin to affect long-term interest rates, since markets remain alert and sensitive to inflation and the monetary policies adopted to address it, particularly in the United States. The behaviour of investors in May 2006 offers one example of this phenomenon: faced with a risk of higher inflation in the United States, they withdrew their investments in emerging economies, taking refuge in developed-country assets instead. This suggests a more uncertain global environment and a latent risk of flight to quality.

There are two quite different scenarios as to how events may unfold in this regard. Some experts espouse the de-coupling view, which holds that the slowdown of the United States economy will not have significant repercussions in the rest of the world because of the strength of Asian economies (particularly China, India, the Republic of Korea and Japan) and a higher rate of growth in Europe. Others believe that persistently high petroleum prices and slower economic expansion in the United States will drag the rest of the world down as a

result of reduced trade, higher global interest rates and a greater aversion to risk that could lead to a marked decline in worldwide growth over the next few years.

Despite these competing views, the world economy has retained the upward momentum observed in 2005, although uncertainty has increased. Incipient signs of a slowdown in the United States economy, as well as the possible adoption of stricter monetary policies by the United States Federal Reserve and the European Central Bank, may affect the expansion of the world's major economies in early 2007 (with the usual lag). It is too early, however, to draw conclusions regarding the depth, speed and consequences of the cooling of the United States economy, or the possibility that higher growth in the euro area and Japan may continue to offset that slowdown. What is clear is that emerging economies must be prepared to face an environment of greater global uncertainty characterized by increased geopolitical instability in the Middle East, which would in turn affect future oil prices and give rise to more doubts concerning the performance of the global economy.

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## 1. Commodity prices

During the present decade, unlike the 1980s and 1990s, increases have been recorded both in the overall commodity export price index and in the price index for energy, metals and agricultural products.<sup>5</sup> Energy sources registered the steepest increase (183.3%), followed by metals and minerals (98.8%), while the price index for agricultural exports rose by 25.9%. During the first six years of the 1970s, energy and agricultural prices posted smaller increases, rising by 386.9% and 89.7%, respectively. Metal and mineral prices climbed by only 46.5% during the same period — a smaller increase than has been recorded during the present decade.<sup>6</sup>

In 2005, the average prices for commodities exported by Latin America continued to rise, in keeping with a trend that first appeared in 2002, reaching rates above 13% for the third year in a row. As in 2004, energy products turned in the strongest performance. The 2005 price index was 59.9% higher than the average for the 1990s: 175.4% for energy products, 58.4% for metals

and minerals, and only 1.2% for agricultural products. As shown in figure II.6, both the overall price index for commodity exports and the index for energy, metals and agricultural prices are in the expansionary phase of the business cycle, and their values are above the trend values for the corresponding series. The magnitude and duration of the current cycle's upswing sets it apart from the two preceding ones. A positive correlation, reinforced since the 1990s, can also be observed among the three product cycles. The simultaneous across-the-board recovery of commodity prices is associated with the favourable impact of the increase in external demand for raw materials.

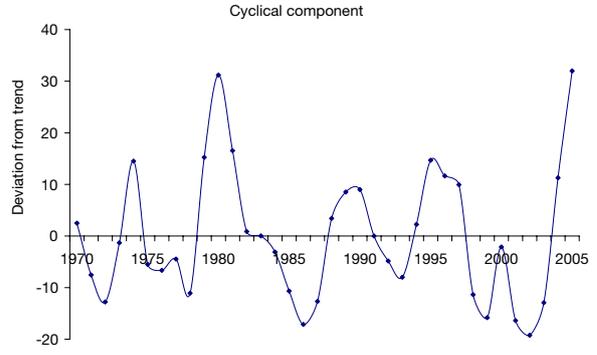
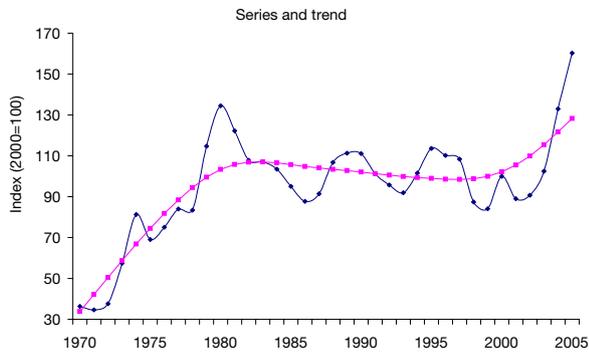
In 2005, the overall price index for commodities exported by Latin America rose by 21.1%, which falls short of the 29.4% increase recorded in 2004. Moreover, in 2005, unlike the preceding year, the upturn in price indices for energy products (21.1%) far exceeded that of other commodities (15.3%).

<sup>5</sup> None of these indices increased during the 1990s; during the 1980s, only the metals and minerals index rose. For a detailed analysis, see Alejandra Ovalle, "América Latina: evolución del índice de precios de los principales productos de exportación 1980-2005", Santiago, Chile, Economic Commission for Latin America and the Caribbean (ECLAC), 2005, unpublished.

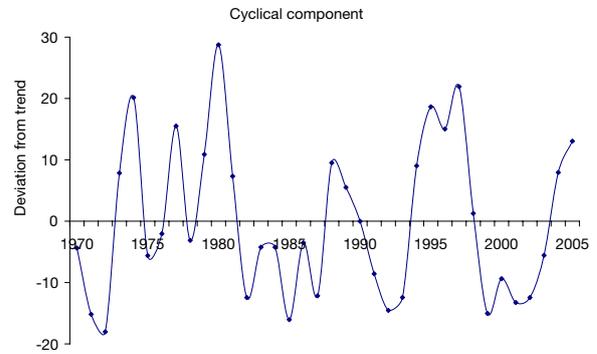
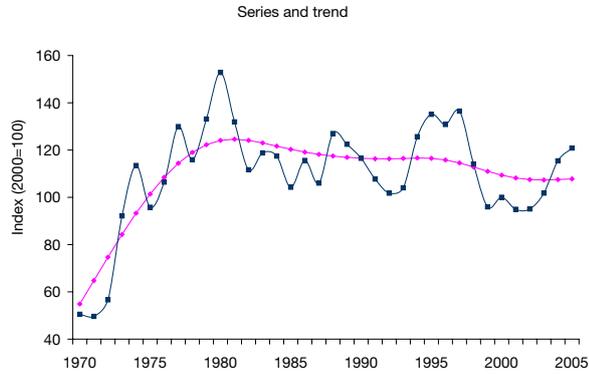
<sup>6</sup> Between 1970 and 1979, the overall price index rose by 215.9% for commodity exports, 163.6% for agricultural products, 1,187.9% for energy products and 123.3% for metals and minerals. The upswing in the price index for energy products reflected the higher petroleum prices brought on by the embargo enforced by Arab countries in 1973.

Figure II.6  
**PRICE INDICES, SERIES, TRENDS AND CYCLICAL COMPONENTS**

**Commodity price index**



**Price index for agricultural products**



**Price index for energy products**

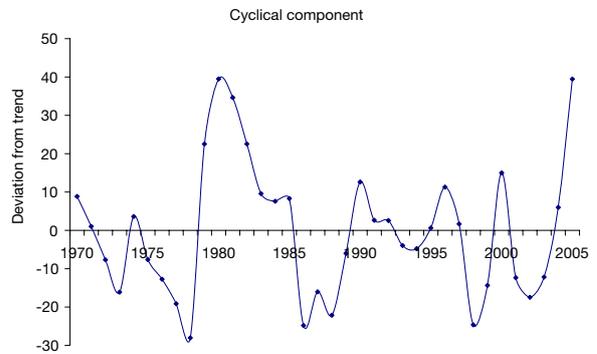
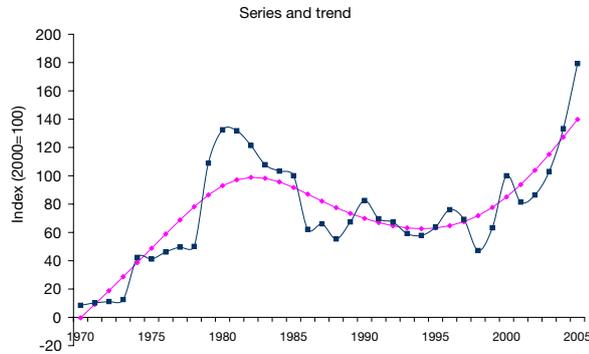
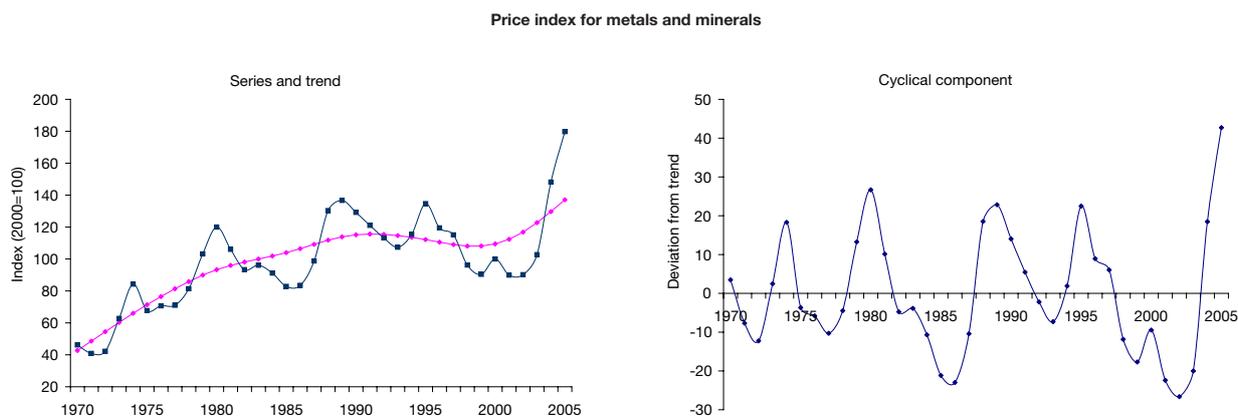


Figure II.6 (concluded)



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

In the first group of products, there have been increases worth noting in the prices of crude oil (36.7%), petroleum products (33.4%) and natural gas (51.4%). The increase in oil prices is a reflection of the unstable balance between supply and demand associated with the expansion of demand for crude oil, which is being driven mainly by China and India. It should be noted that, as a result of this upsurge in demand, the amount by which maximum short-term production capacity currently exceeds actual output is only enough to cover 2% of world demand. The strategies devised to address this issue are reflected in the changes made in the United States' strategic reserves, as well as the replacement of crude oil with other sources of energy. The combination of these factors has heightened the reaction of petroleum prices to any news that might point to an impending imbalance between supply and demand, such as an important supplier's possible exit from the market.<sup>7</sup> The active hurricane season of 2005 — especially the temporary impact of Hurricane Katrina on the refining capacity of the United States — also played a considerable role in the price rises registered by petroleum products.

Among non-energy products, beverages turned in the strongest performance. The increases recorded in the price of coffee — both Type I (39.1%) and Type II (48.7%) — have been quite notable.<sup>8</sup> Metal and mineral prices climbed by 22.5%, with this general upward trend

being led by iron, zinc and copper, which rose by 71.5%, 31.9% and 28.4%, respectively. Among foods, the price of sugar increased by 37.9%. In contrast, prices for soybeans, soymeal and soy oil, which are important products for the region, fell by 10.4%, 9.5% and 11.5%.<sup>9</sup> This trend is attributable to the increase in supply resulting from good harvests in Brazil and Argentina.

As of April 2006, the overall price index for commodity exports was up by 23.1%.<sup>10</sup> The price index for energy products rose by 36.6%, and that of non-energy products increased by 17.1%. While energy products displayed the strongest momentum, the largest increases were posted for sugar, zinc, iron, copper and other metals. The rise in sugar prices can be explained by demand-related factors, namely an upsurge in purchases for use in the production of ethanol, a substitute for petroleum-based fuels. In Latin America, Brazil and Colombia, among other countries, are partially modifying their energy structure, especially with regard to motor vehicle fuels.<sup>11</sup> Moreover, a seasonal supply factor — the drought in India and the resulting contraction of worldwide sugar production — has influenced its international price. In the case of metals, the expansion of demand in China and India has driven up prices. Buoyant demand, low stocks and the fact that any additional increase in production capacity can only be made at a higher marginal cost suggest that metal prices will remain high in the immediate future.

<sup>7</sup> The market has, for example, closely tracked the royal succession in Jordan, election results in the Islamic Republic of Iran, and the acts of sabotage carried out against the petroleum industry in Nigeria.

<sup>8</sup> Type I coffee corresponds to Colombian Mild Arabicas, while Type II is composed of Brazilian and other natural Arabicas.

<sup>9</sup> The weight of soybeans and soybean products in the overall price index is 7%.

<sup>10</sup> This figure refers to the percentage variation in the average index over the last 12 months.

<sup>11</sup> In cities such as Cali and Bogota, gasoline is legally required to be 10% ethanol.

## Chapter III

# Macroeconomic policy

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## A. Fiscal policy

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### 1. Introduction

As indicated in the *Preliminary Overview of the Economies of Latin America and the Caribbean, 2005*,<sup>1</sup> improvements in the countries' public accounts have lessened their external vulnerability. This trend, which has been reflected in fiscal and public-debt indicators, is attributable to a range of factors, including the characteristics of the current macroeconomic situation and decisions taken by national authorities.

Since 2002, fiscal policy has been implemented against a generally favourable macroeconomic backdrop, although the specific situation has varied somewhat from one subregion to another. In light of the international situation and the development of the region's economies, the expansionary phase that began three years ago is expected to continue in 2006.

Since 2003, the region's overall fiscal deficit has narrowed, many countries have been posting primary surpluses, and the region's degree of external vulnerability has declined as its public debt has shrunk. The question arises, however, as to how sustainable this situation may prove to be.

These developments have raised new concerns among the fiscal authorities of some of the countries that are benefiting the most from external factors and rising commodity prices, and there has been some debate as to how fiscal surpluses should be used and as to their impact in terms of stability and equity (see box III.1).

Given the institutional diversity of the way in which the countries' public sectors are structured, it is difficult to find an indicator capable of reflecting their various fiscal positions. As a first approximation of fiscal performance (and, in some cases, as a lowest common denominator), data on central government accounts will be used, although

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<sup>1</sup> LC/G.2292-P/E, Santiago, Chile, December 2005. United Nations publication, Sales No: E.05.II.G.188.

Box III.1  
**RISING PRICES FOR NON-RENEWABLE RESOURCES AND FISCAL POLICY IN COUNTRIES  
 SPECIALIZING IN SUCH RESOURCES**

Traditionally, Latin America has been a major supplier of energy and mineral resources to the rest of the world. It contributes almost 14% of world oil production and possesses about 10% of the world's reserves. Chile is the world's biggest producer and exporter of copper, making up an average 30% of total output. Soaring prices for oil and copper in recent years have therefore had a strong impact on the economies which specialize in producing these goods.

This situation has created a number of dilemmas for fiscal policymakers, who must now answer two fundamental questions which often arise during economic booms: How can the countries take advantage of rising prices for such commodities to boost fiscal revenues? and, How should fiscal surpluses be allocated in order to avoid the macroeconomic problems that often arise during price spikes?

In response to the first question, the countries of the region have designed a number of mechanisms to take advantage of the additional resources. The most direct way to transform the income from these commodity exports into fiscal resources has been for governments to participate in their production. Also, the countries generally use the following tax instruments to collect funds derived from the production and sale of the commodities by public- or private-sector corporations: (i) royalties, usually based on production, which provide the government with at least a minimum payment for mineral resources; (ii) traditional forms of income tax (often with differential rates); and (iii) profits taxes levied on corporations involved in the development of such resources. In recent years, some countries have implemented reforms in this area which have coincided with the strong upswing in commodity prices. In 2005, Chile introduced a specific tax on operating revenues in the mining industry, and Bolivia adopted a direct tax on oil and petroleum products.

These instruments have enabled

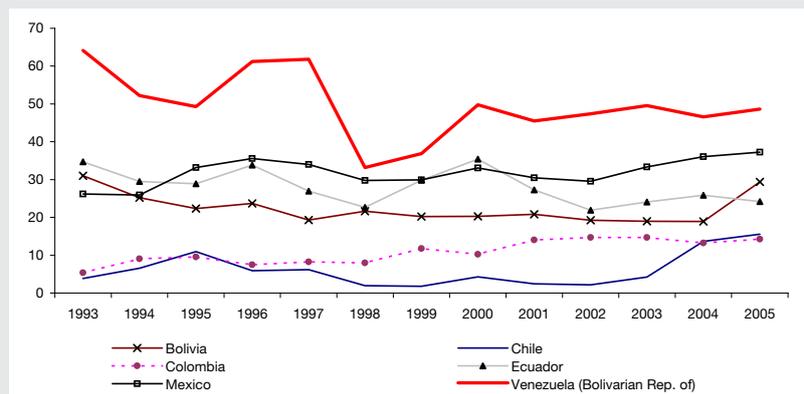
Bolivia and Chile to considerably boost the level of fiscal resources they derive from such commodities, thanks, in particular, to the strong upswing in the prices they bring, as can be seen in the following figure.

The second issue has to do with the role of fiscal policy in stabilizing the economy. The basic recommendation

usually made in this regard is that, when an economy is booming, fiscal authorities should be able to temper the pace of economic activity by restricting public spending while, during recessions, they should use fiscal policy to help spur the economy.

During boom periods, export

**FISCAL REVENUES FROM NON-RENEWABLE RESOURCES  
 AS A PERCENTAGE OF TOTAL FISCAL REVENUES**  
 (Percentage of total fiscal revenues)



Source: Juan Pablo Jiménez and Varinia Tromben, "La política fiscal en países especializados en productos no renovables", *Macroeconomía del desarrollo series*, No. 46 (LC/L.2521-P), Santiago, Chile, Economic Commission for Latin America and the Caribbean (ECLAC), 2006. United Nations publication, Sales No: S.06.II.G.48.

windfalls can trigger what the specialized literature refers to as "Dutch disease." In such cases, the economic upturn results in an immediate improvement in the terms of trade, but can have harmful consequences for the economy. These may include the highly paradoxical effect of encouraging a cut in production and external trade in tradable-goods sectors which have not benefited from the boom. This effect can result from variations in relative prices and the impact of exchange-rate appreciations.

It is therefore usually recommended that fiscal policy should provide for the creation of a stabilizing mechanism. Mechanisms of this kind can be classified according to the variable to be stabilized. On the one hand, there are mechanisms

that target the source of the fluctuations, including the price of the commodity in question. This category includes financial instruments (such as futures contracts and bonds tied to non-renewable resource futures), diversification of exports and international price stabilization agreements. On the other hand, there are mechanisms which, based on the assumption that international prices are unstable, are designed to minimize their main impacts on the domestic economy by stabilizing one of the variables directly affected by the volatility. This category includes rules aimed at reducing the effects of fluctuating revenue upon spending and stabilization funds financed with export earnings.

Countries in the region have set up a variety of mechanisms, although their

## Box III.1 (concluded)

existence continues to be a matter of debate. In 2001 Chile adopted a fiscal rule requiring the government to maintain a cyclically-adjusted structural surplus equivalent to 1% of GDP. The cyclical component of this rule is defined not only on the basis of GDP but also by the prices of copper and, more recently, of molybdenum as well. This has softened the impact of income volatility on public spending.

Although the region has some long-established stabilization funds (Colombia's National Coffee Fund dates back to 1940), in recent years there has been a revival of such funds, whose objective is to reduce the impact of income volatility on public accounts. To date, the following funds have been created: in Chile, the Copper Compensation Fund (founded in 1985 and activated in 1987); in Colombia, the Petroleum Saving and Stabilization Fund

(created in 1995); in Ecuador, the Fund for Stabilization, Social Investment and Public Debt Reduction (created in 2002 and deactivated in 2005); in Mexico, the Oil Stabilization Fund (created in 2000), and in the Bolivarian Republic of Venezuela, the Macroeconomic Stabilization Fund, created in 2004 to replace the Macroeconomic

Stabilization Investment Fund (created in 1998). Although it would be difficult to make a conclusive assessment regarding these funds, it should be noted that frequent rule changes and the high percentage of precommitments have restricted their capacity to accumulate balances, even during periods of rising prices.

YEAR-END STABILIZATION FUND BALANCES, 1996-2004  
(Percentages of GDP)

	1996	1997	1998	1999	2000	2001	2002	2003	2004
Chile	2.3	2.3	2.0	1.5	1.0	0.9	0.4	0.1	0.2
Colombia				0.6	1.4	1.5	1.6	1.4	1.3
Ecuador								0.3	0.4
Mexico					0.2	0.1	0.0	0.1	0.1
Venezuela (Bol. Rep. of)				0.2	3.9	5.2	3.6	0.8	0.7

Source: Juan Pablo Jiménez and Varinia Tromben. "La política fiscal en países especializados en productos no renovables". Macroeconomía del desarrollo series. No. 46 (LC/L.2521-P). Santiago, Chile. Economic Commission for Latin America and the Caribbean (ECLAC). 2006. United Nations publication. Sales No: S.06.II.G.48.

other aggregates, such as indicators for the countries' non-financial public sectors (NFPS), will be also be brought into the discussion.

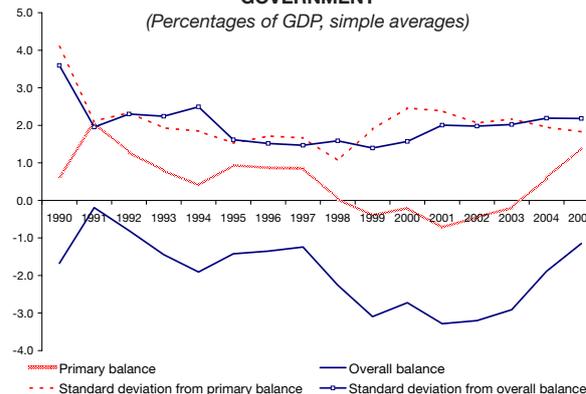
At the central government level, the region's fiscal performance produced a simple average primary surplus of 1.4% of GDP at the close of 2005, compared with 0.6% a year earlier.<sup>2</sup> If the overall deficit is taken into account (in other words, if interest payments on public debt are included), then the deficit ranged between the equivalent of 1.9% and 1.1% of GDP.

This average reflects a widespread improvement in the countries' fiscal accounts. In 2005, 15 out of the 19 countries listed in table III.1 recorded a primary surplus. This contrasts sharply with the outcome in 2002, when only seven countries achieved a primary surplus.

An examination of figure III.1 indicates that, assuming that the aforementioned average is the result of varying performances, then measuring the standard deviation can facilitate the analysis of that diversity. In general terms, it can be said that unevenness in performance as measured by primary balances tended to increase during the crisis (beginning in 1998) and to lessen when the situation improved, beginning in 2001-2002. As for the overall

balance, variation in the standard deviation is related to the influence of debt interest payments, which differ according to the level of indebtedness and the interest rates charged to each country.

Figure III.1  
LATIN AMERICA AND THE CARIBBEAN: PRIMARY BALANCE,  
OVERALL BALANCE AND STANDARD DEVIATION FOR CENTRAL  
GOVERNMENT



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

<sup>2</sup> As a weighted average, the primary surplus rose from 2.0% of GDP in 2004 to 2.2% of GDP in 2005.

Table III.1  
**LATIN AMERICA AND THE CARIBBEAN: CENTRAL GOVERNMENT FISCAL INDICATORS<sup>a</sup>**  
*(Percentages of GDP at current prices)*

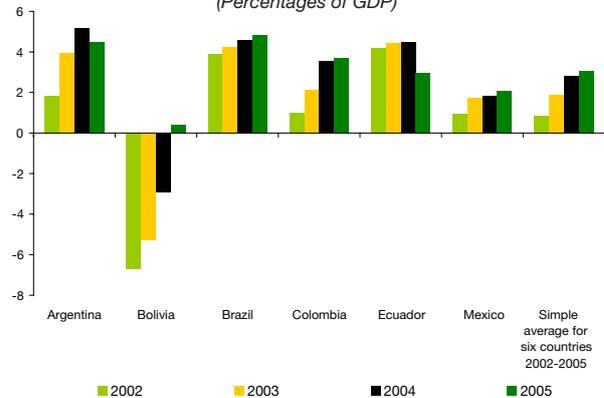
	Primary balance					Overall balance					Public debt <sup>b</sup>					
	2002		2003		2004		2005 <sup>c</sup>		2002		2003		2004		2005	
	2002	2003	2004	2005 <sup>c</sup>	2002	2003	2004	2005 <sup>c</sup>	2002	2003	2004	2005	2002	2003	2004	2005
Latin America and the Caribbean	-0.4	-0.2	0.6	1.4	-3.2	-2.9	-1.9	-1.1	60.6	59.3	53.0	45.6	65.3	63.4	55.9	48.6
Simple average	1.1	1.4	2.0	2.2	-3.5	-1.9	-0.9	-1.3	46.9	45.5	42.1	34.2	63.2	57.0	52.5	43.1
Weighted average	0.3	1.6	2.8	2.5	-3.8	-1.8	-0.1	-1.0	86.3	78.5	68.3	51.2	104.7	87.7	76.8	58.6
MERCOSUR <sup>d</sup>	0.3	1.5	2.9	3.1	-3.3	-1.5	0.4	0.2	72.2	65.4	56.8	42.5	88.2	74.1	64.8	49.5
MERCOSUR + Chile <sup>d</sup>	-0.7	-0.4	0.2	1.1	-3.9	-3.7	-2.8	-1.6	55.9	57.0	52.4	49.4	61.4	63.4	57.4	49.5
Andean Community <sup>d</sup>	1.6	1.4	1.7	3.3	-2.4	-2.4	-1.5	0.6	49.9	45.4	40.0	36.8	48.1	47.5	41.0	36.7
Petroleum exporting countries <sup>d</sup>	-2.2	-1.6	-0.8	-0.3	-5.0	-4.5	-3.7	-3.0	57.8	60.8	56.5	53.6	74.8	79.2	73.8	69.4
Other <sup>d</sup>	0.7	1.3	1.2	1.3	-1.8	-1.1	-1.0	-0.8	24.0	24.2	23.0	22.3	27.5	27.6	25.8	24.1
Mexico	-0.5	-0.7	-0.1	0.5	-2.9	-3.3	-2.6	-2.1	60.2	62.0	56.3	50.4	61.8	63.7	58.1	52.2
Central America <sup>d</sup>	1.5	2.1	3.2	2.4	-0.6	0.2	2.0	0.4	145.9	138.2	126.4	72.8	184.4	144.8	132.5	78.4
Argentina <sup>e</sup>	-5.5	-4.6	-2.6	-0.6	-8.0	-7.1	-5.4	-3.5	76.3	84.5	79.2	74.1	78.0	90.7	85.0	78.5
Bolivia	2.4	2.5	3.0	2.9	-6.4	-2.5	-1.3	-3.5	41.7	37.2	34.0	34.3	65.5	58.7	54.2	51.7
Brazil <sup>f</sup>	-0.1	0.7	3.1	5.6	-1.2	-0.4	2.1	4.7	15.7	13.1	10.8	7.5	22.2	19.6	16.9	13.3
Chile	-1.0	-0.5	-0.3	-1.4	-4.9	-4.7	-4.3	-4.8	50.3	50.7	47.0	46.9	71.5	67.7	62.6	60.2
Colombia <sup>g</sup>	0.0	1.4	1.4	2.0	-4.3	-2.9	-2.7	-2.1	40.8	40.0	41.1	37.3	45.4	46.3	48.3	42.7
Costa Rica	2.6	2.5	1.5	1.9	-0.7	-0.4	-1.0	-0.5	49.9	45.4	40.0	36.8	54.3	49.1	43.3	39.6
Ecuador	-1.6	-0.8	0.9	1.1	-3.1	-2.7	-1.1	-1.0	35.2	37.2	38.0	37.8	38.3	40.6	40.8	40.9
El Salvador	0.3	-1.1	0.2	-0.3	-1.0	-2.3	-1.0	-1.5	16.4	18.4	18.8	17.6	17.5	19.4	19.6	18.3
Guatemala <sup>h</sup>	-2.6	-2.7	-2.7	0.4	-2.7	-2.9	-3.3	-3.3	60.2	57.5	46.7	40.8	66.5	63.5	51.1	50.4
Haiti	-3.7	-4.6	-2.0	-1.4	-4.8	-5.6	-3.1	-2.4	66.3	72.0	70.1	53.1	65.8	71.0	70.0	53.3
Honduras	0.7	1.3	1.2	1.3	-1.8	-1.1	-1.0	-0.8	24.0	24.2	23.0	22.3	27.5	27.6	25.8	24.1
Mexico <sup>i</sup>	-0.2	0.3	-0.1	0.1	-2.5	-2.8	-2.2	-1.8	133.7	137.7	99.9	91.9	134.1	136.0	100.0	92.1
Nicaragua	2.2	0.5	-1.2	1.2	-1.9	-3.8	-5.4	-3.9	69.0	66.6	70.0	64.8	69.4	67.0	70.2	65.8
Panama	-1.7	0.9	2.7	2.0	-3.2	-0.4	1.6	0.8	59.2	44.4	38.0	31.4	63.0	46.9	41.7	34.7
Paraguay <sup>h</sup>	-0.2	0.2	0.6	1.1	-2.1	-1.8	-1.3	-0.7	46.8	47.3	43.3	39.8	...	...	...	...
Peru	-1.4	-3.3	-1.9	0.8	-2.7	-5.2	-4.0	-0.7	98.7	94.3	74.6	66.3	23.9	44.2	25.5	26.6
Dominican Republic	-0.8	1.1	2.4	2.7	-4.9	-4.6	-2.5	-1.6	...	...	...	...	106.0	100.4	78.9	69.6
Uruguay	0.6	0.3	1.8	4.7	-4.0	-4.4	-1.9	1.7	...	...	...	...	42.0	45.9	38.8	33.7
Venezuela (Bolivarian Rep. of)	0.6	0.3	1.8	4.7	-4.0	-4.4	-1.9	1.7	...	...	...	...	42.0	45.9	38.8	33.7

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.  
<sup>a</sup> Includes social security. <sup>b</sup> At 31 December each year, using the average exchange rate in the case of external debt. The figures for Mexico in the central government column relate only to the federal government and, in the NFPS column, to the public sector. For the Dominican Republic, the public debt includes only external debt. <sup>c</sup> Preliminary estimate. <sup>d</sup> Simple average. <sup>e</sup> National administration. <sup>f</sup> Federal government and central bank. Nominal balances. <sup>g</sup> National central administration. Results do not include net loans, adjustments for accruals, floating debt or the cost of financial restructuring. <sup>h</sup> Central administration. <sup>i</sup> Federal government and social security.

According to the national budgets prepared at the end of 2005 and fiscal data for the first few months of 2006, a smaller primary surplus is expected for 2006.

As mentioned above, however, central government figures are not entirely representative of the situations of a number of the countries in the region whose public sectors are more decentralized. When the broader coverage of government accounts in the region's most decentralized countries (Argentina, Bolivia, Brazil, Colombia, Ecuador and Mexico) is taken into account, then the calculations indicate that the non-financial public sector's primary surplus rose, on average, from 0.9% of GDP in 2002 to 3.1% in 2005.

Figure III.2  
LATIN AMERICA AND THE CARIBBEAN: PRIMARY BALANCE FOR THE NON-FINANCIAL PUBLIC SECTOR (Percentages of GDP)



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

## 2. 2003-2005 in comparative terms

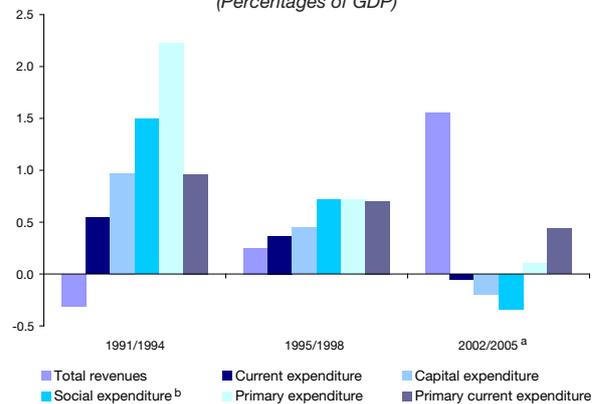
The fiscal outturn in 2003-2005 has differed from the situation in other boom periods in the past 15 years because the region's governments took advantage of the favourable economic conditions to strengthen their fiscal positions.

In 2002-2005, average annual GDP increased by about 4%, fiscal revenues expanded by 1.6% of GDP and primary spending rose by an average of 0.1% of GDP. As shown in figure III.3, trends in public spending during that period contrast with those seen in two other periods with equivalent annual growth rates (average increases of 4%). Whereas in 2003-2005 spending diminished by 0.4% of GDP, primary expenditure rose in all the other cases (by 0.7% of GDP in 1995-1998 and by 2.2% in 1991-1994). From the standpoint of resources, this cycle also stands apart in that revenues climbed by 1.6% of GDP, whereas for the two earlier periods it rose only slightly (1995-1998) or fell (1991-1994).

The variation of spending can be broken down into its various components in either economic or functional terms. On the basis of an economic classification, capital spending for 2002-2005 fell by 0.2% of GDP, whereas it increased in the previous two periods. If a functional classification of expenditure is used, social spending in

2002-2005 fell by 0.3% of GDP, whereas it rose significantly in the other two periods, by 0.7% in 1995-1998 and 1.5% in 1991-1994.<sup>3</sup>

Figure III.3  
LATIN AMERICA AND THE CARIBBEAN: VARIATION OF THE MAIN CENTRAL GOVERNMENT FISCAL INDICATORS (Percentages of GDP)



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

<sup>a</sup> Social expenditure figures are for 2002-2004.

<sup>b</sup> Growth rate of simple yearly averages for Latin America, 18 countries.

<sup>3</sup> This classification of spending is based on data from the Social Development Division and includes the following public-sector functions: education, health care, social security and welfare, housing and other.

### 3. The year 2005 in aggregate terms

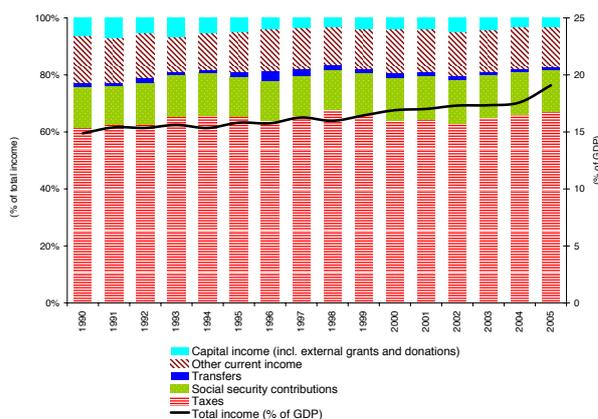
The improved balance recorded in 2005 was due to a general increase of fiscal revenue across the region (only Guatemala and Paraguay saw a fall in their fiscal resources). Spending also rose, but less than revenue.

The increase in revenues was due to the continuing upward trend in commodity prices. The countries in which revenues climbed the most were the Bolivarian Republic of Venezuela (4% of GDP), Bolivia (3.5%) and Chile (2.3%), all of which specialize in extractive industries producing commodities whose prices have been rising sharply (oil, natural gas and copper). Another factor in the case of Bolivia is the direct tax on hydrocarbons (IDH) that it introduced in 2005, which yielded receipts equivalent to 3.1% of GDP.

From a longer-term perspective, fiscal revenue in 1990-2005 grew by 3.8% of GDP, but that growth was concentrated in 1998-2005; fiscal revenue rose continuously from 1998 onward (3% of GDP), peaking in 2005. As for the composition of those revenues, the share of tax receipts has grown (over 60%), while the contribution of capital income and of grants donations has fallen.

Box III.2 provides a more detailed analysis of the various causes of these changes in the tax revenue structure. In most cases, there are a series of considerations that are useful in analysing tax issues and defining ways of strengthening the tax structure. First, Latin American and Caribbean tax systems are based mainly on indirect

Figure III.4  
LATIN AMERICA AND THE CARIBBEAN: BREAKDOWN OF FISCAL REVENUE  
(Percentages, simple averages)



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

taxes, with lower direct tax receipts than in other regions. In recent years there has been a downturn in the share of revenue provided by taxes on external trade, greater VAT receipts, a lack of significant progress on income taxes, a tendency for revenue systems to become concentrated in a smaller number of different taxes, and the development of extraordinary or emergency tax schemes.

#### Box III.2 TAX REVENUE TRENDS IN LATIN AMERICA

Tax policy and its role in Latin America have been ongoing subjects of analysis in recent years.<sup>a</sup> The changing economic and social conditions in the region in relation to trade and financial liberalization efforts at the worldwide level, the abandonment of the State's entrepreneurial role, increasing labour-market informality and the growing concentration of income in general have all left their mark in the area of taxation.

Over the past two decades there have been major structural changes in the tax situation in Latin America. These changes have not led to a suitable balance in the distribution of the tax burden among

the various socio-economic strata. As a result, no social consensus has been reached concerning that distribution, nor has there been any success in ensuring that these changes result in lasting distributional patterns for the different levels of government in the tax burden in those countries where there are competing taxing powers. Despite repeated reforms, the countries of the region have not yet achieved a satisfactory degree of stability regarding the appropriate level of the tax burden or the socially accepted tax structure; there is often debate as to the direction to be followed. For instance,

ongoing reform efforts are being undertaken in an attempt to broaden the tax base for VAT on goods and services in line with the belief that the majority of the tax burden should be borne by consumption in order to make sure that incentives for saving and capital formation are not undermined; on the other hand, however, efforts are being made to avoid taxing the basic basket of goods, and there is a prevailing belief that direct taxes should play a more important role and that the contribution of personal income taxes should be increased by raising the rates charged to the most dynamic sectors of

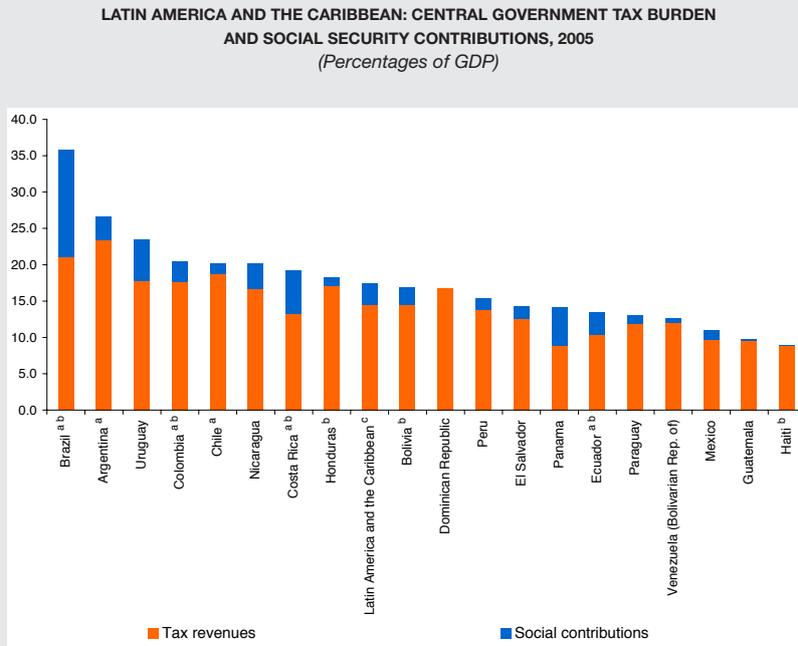
## Box III.2 (concluded)

the economy, such as the financial and export sectors.

The relevant data indicate that the tax burden in countries such as Argentina, Brazil, Chile, Colombia and Uruguay differs considerably from its size in countries whose tax intake is lower, such as the Bolivarian Republic of Venezuela, Ecuador, Guatemala, Haiti, Mexico and Paraguay. In any case, regardless of the size of the tax burden, most of the countries still have not achieved a sufficient degree of fiscal solvency, and there are a number of unmet social needs that cannot be satisfied without increased public resources.

It is also clear that, despite all the economic changes which have affected the region's development in recent decades, the tax burden has grown. Comparing the receipts for 2005 with those for 1980, the rise in the tax burden is between 2.5% and 3% of GDP, depending on whether or not social security contributions are taken into account. This shows that, in one way or another, the countries' numerous tax reforms and improvements have borne fruit.

Nonetheless, as mentioned in the section on fiscal policy in this chapter, countries in some parts of the region – particularly Central America – have not yet realized their tax potential.<sup>b</sup> A number of developments in terms of the tax structure can also be identified: on the one hand, there has been a significant decline in taxes on external trade, a clear increase in general taxation on consumption, excise taxes have decreased and, at the same time, the share of income tax revenues has remained constant over the years. According to this analysis, wealth



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

<sup>a</sup> General government coverage.

<sup>b</sup> Data for 2004.

<sup>c</sup> Simple average.

and asset taxes have accounted for an extremely small fraction of total receipts, but since this study has focused on central governments, further investigation of this last point at the subnational level is called for. Lastly, tax structures have been oriented towards deriving receipts from a reduced range of taxes, thanks to the elimination of a substantial number of minor taxes.

These trends have been seen in all the countries to a greater or lesser degree, regardless of the level of their tax burdens in absolute terms. International experience has shown that the movement away from a reliance on taxes on foreign trade has

been counterbalanced by an increased use of taxes on consumption, although in many cases this has also been coupled with increases in income taxation. This process has not been as widespread in Latin America, however.

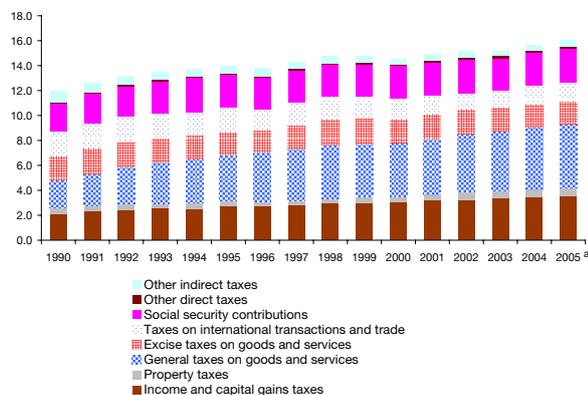
There is also a growing problem with informality in labour and goods markets and increasing unregistered economic activities. These factors' effects on the countries' tax structures is substantial in relation both to the level of available tax resources and to the equity and neutrality of the system, since the fact that some taxpayers do not actually pay any taxes introduces vertical and horizontal inequities.

**Source:** Juan C. Gómez Sabaini, "Evolución y situación tributaria actual en América Latina: una serie de temas para la discusión", Santiago, Chile, Economic Commission for Latin America and the Caribbean (ECLAC), September 2005.

<sup>a</sup> See R. Bird, "Taxation in Latin America: Reflections on sustainability and the balance between equity and efficiency", *IPT Paper*, No. 0306, Rotman, University of Toronto, June 2003; R. Martner and V. Tromben, "Tax reform and fiscal stabilization in Latin American countries", *Gestión pública series*, No. 45 (LC/L.2145-P), Santiago, Chile, Economic Commission for Latin America and the Caribbean (ECLAC), June 2004; P. Bird, "Taxation in Latin America: Structural trends and impact of administration", *Working Paper*, No. 99/19, Washington, D.C., International Monetary Fund, 1999; V. Tanzi, "Taxation in Latin America in the last decade", working paper, No. 76, Center for Research on Economic Development and Policy Reform, Stanford University, December 2000.

<sup>b</sup> See J.C. Gómez Sabaini, "La tributación a la renta en el Istmo Centroamericano: una serie de temas para la discusión", Santiago, Chile, Economic Commission for Latin America and the Caribbean (ECLAC), July 2005. *Macroeconomía del desarrollo series*, No. 37 (LC/L.2359-P); Agosin, A. Barreix and R. Machado, *Recaudar para crecer: bases para la reforma tributaria en Centroamérica*, Washington, D.C., Inter-American Development Bank (IDB), 2005.

Figure III.5  
LATIN AMERICA AND THE CARIBBEAN: TAX BURDEN AND COMPOSITION OF TAX REVENUES  
(Simple averages, percentages of GDP)



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

<sup>a</sup> Data shown for 2005 include the author's estimates.

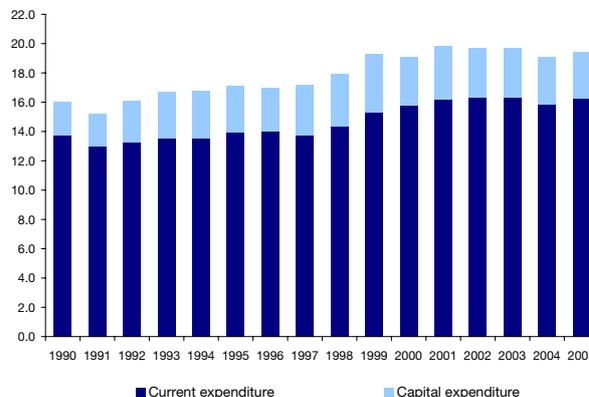
As for disbursements, as mentioned above, the trend in public spending has been a distinctive characteristic of this period, inasmuch as central government spending rose in 2005, regaining its 2001-2002 levels after having diminished in 2004.

Compared with 2004, there was an increase of 0.4% of GDP in 2005 (from 19.1% to 19.5%). On average, the whole of this expansion was concentrated in current spending, while capital outlays remained very close to their low 2004 levels.

Changes in social expenditure patterns must also be considered. The document presented during the thirty-first session of ECLAC<sup>4</sup> and the *Social Panorama of Latin America, 2005* both noted that social spending rose considerably from 1990 to 2002. Nonetheless, as mentioned above, this category of expenditure saw an average decline of about 0.4% of GDP between 2002 and 2004. In the countries eligible for the Heavily Indebted Poor Countries (HIPC) Debt Initiative, the most significant increases took place in 1995-2004, whereas in other countries the upturn in social spending occurred mostly in the first half of the 1990s (see figure III.8).<sup>5</sup>

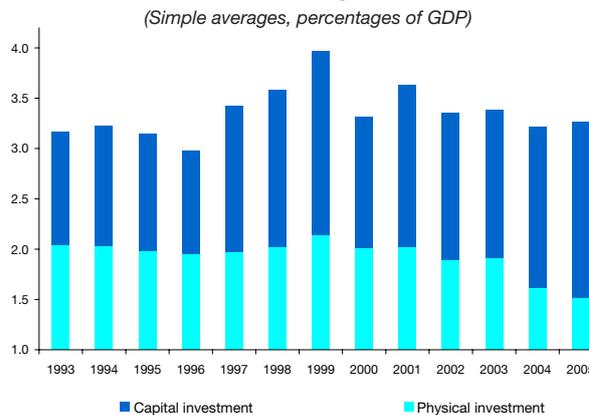
As discussed in detail in the *Economic Survey of Latin America and the Caribbean, 2004-2005* and in the *Preliminary Overview of the Economies of Latin America and the Caribbean, 2005*, this primary balance represents only a partial explanation of the decline in public debt as a percentage of GDP. As a simple average, the debt of the non-financial public sector

Figure III.6  
LATIN AMERICA AND THE CARIBBEAN: COMPOSITION OF CENTRAL GOVERNMENT EXPENDITURE  
(Simple averages, percentages of GDP)



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

Figure III.7  
LATIN AMERICA AND THE CARIBBEAN: CENTRAL GOVERNMENT CAPITAL EXPENDITURE AND PHYSICAL INVESTMENT EXPENDITURE  
(Simple averages, percentages of GDP)



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

was equivalent to 48.6% of GDP in 2005, compared with 55.9% in 2004.

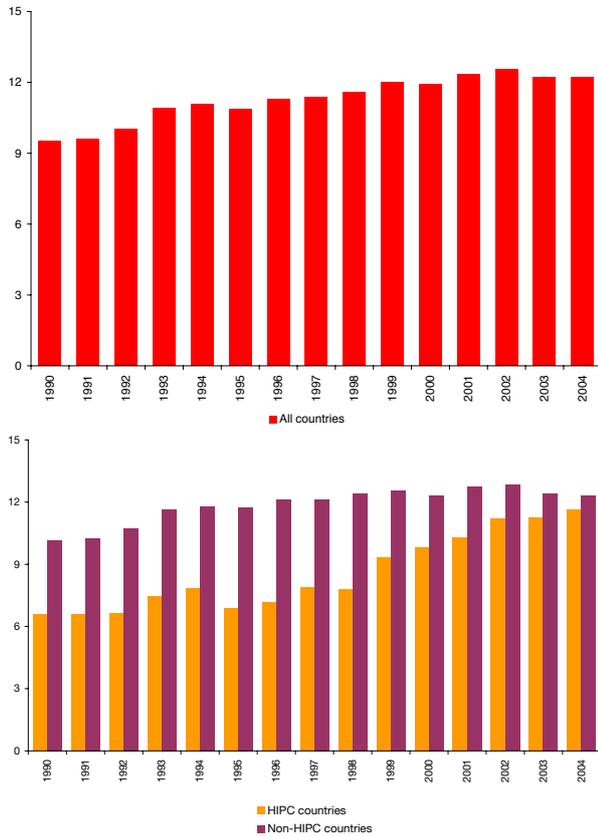
As noted in the introduction to this study, this decrease coincided with declines in other emerging economies, although the percentage for Latin America fell more sharply than it did in other regions. Nonetheless, among the 19 countries analysed, there are still nine countries where the level exceeds 50% of GDP.

In addition to these striking primary surpluses, the most important contributing factors in this trend within the

<sup>4</sup> *Shaping the Future of Social Protection: Access, Financing and Solidarity* (LC/G.2294(SES.31/3)), Santiago, Chile, March 2006.

<sup>5</sup> Bolivia, Guyana, Honduras and Nicaragua are the countries in the region that are eligible for the Heavily Indebted Poor Countries (HIPC) Debt Initiative. Their eligibility is conditional upon the adoption of certain economic policies (macroeconomic adjustments, structural reforms and social policies oriented towards the education and health sectors) which led to considerable spending increases in those areas.

Figure III.8  
**LATIN AMERICA AND THE CARIBBEAN: SOCIAL EXPENDITURE**  
 (Simple averages, percentages of GDP)



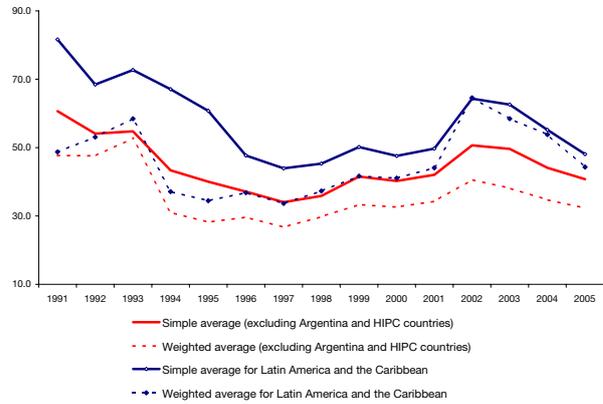
Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.

region have been debt restructurings and the revaluation of local currencies against the United States dollar. In addition, the HIPC Initiative has brought about a steep reduction in the total public debt stocks of Bolivia, Guyana, Honduras and Nicaragua.

The countries of the region are also taking advantage of favourable macroeconomic conditions to implement active debt management policies which have helped to reduce their financial vulnerability. As was underlined in the *Preliminary Overview of the Economies of Latin America and the Caribbean, 2005*, as well as in other sections of this document, that policy has been strengthened by a number of initiatives, such as the retirement of external bonds (Argentina, Brazil, Mexico, Panama and Peru); swaps of external for domestic debt (Argentina, Colombia and Peru); buybacks of Brady bonds (the Bolivarian Republic of Venezuela and Brazil) and the issuance of external debt paper denominated in local currency (Brazil and Colombia).

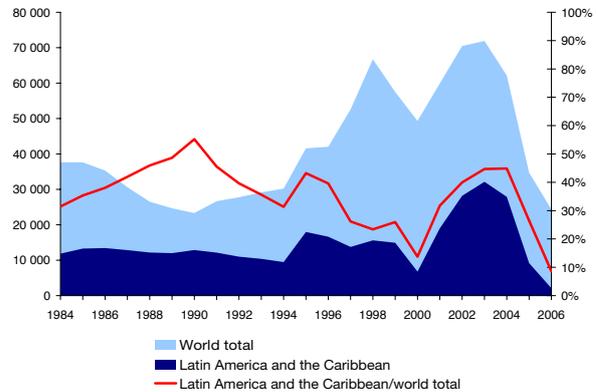
As mentioned in the *Preliminary Overview*, the

Figure III.9  
**LATIN AMERICA AND THE CARIBBEAN: PUBLIC DEBT OF THE NON-FINANCIAL PUBLIC SECTOR**  
 (Percentages of GDP)



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

Figure III.10  
**LATIN AMERICA AND THE CARIBBEAN: LOANS PROVIDED BY THE INTERNATIONAL MONETARY FUND**  
 (Millions of special drawing rights (SDRs))



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of figures from the International Monetary Fund (IMF).

improving fiscal position (which translates into lower borrowing requirements), together with growing reserves, reduced the incentive for arranging for the use of special drawing rights agreements with the International Monetary Fund (IMF). Noteworthy events in this connection included the early repayment, in late 2005, of IMF loans by its two largest debtors, Argentina and Brazil, amounting to US\$ 9.9 billion and US\$ 15.5 billion, respectively.<sup>6</sup> These payments, which reduced the Fund's loan portfolio by almost half, meant that for the first time in many years, Latin America was no longer one of the main recipients of IMF funds. The region now accounts for 8.6% of the Fund's total loan portfolio, which is far below the average -35%- for 1984-2006 (see figure III.10).

<sup>6</sup> In March 2006, Uruguay made an advance payment of US\$ 625 million on amounts that were to fall due during that year.

#### 4. 2005 in disaggregated terms

In disaggregated terms, the improved average for the region in 2005 conceals a number of differing patterns. Although the great majority of the countries expanded their primary surpluses, primary balances were down in Argentina, Brazil, Colombia, Guatemala and Paraguay relative to the figures for 2004.

In the cases of Argentina, Brazil and Colombia, this downturn in the primary balance was attributable to increased primary spending (despite an increase in fiscal revenue of about 0.5% to 1% of GDP). In the case of Guatemala, it was caused by a sharp slump in fiscal revenue.

Further information is contained in table III.2. The four countries where capital spending fell the most were Haiti, Honduras, Nicaragua and Panama (1.4%, 0.9%, 0.6% and 0.7% of GDP). Honduras is among the countries benefiting from the HIPC Initiative.

The ratio between the primary surplus and debt interest payments offers an additional measurement of vulnerability. If the primary surplus covers less than 100% of such payments (meaning that the country has an overall deficit), then it means that the fiscal authorities must borrow further in order to cover their interest obligations. Countries can be categorized into various groups according to the level of this ratio:

- Countries whose primary surplus exceeds 100% of interest payments: Argentina, the Bolivarian Republic of Venezuela, Chile and Paraguay;
- Countries whose primary surplus is equivalent to between 50% and 80% of their interest payments: Brazil, Ecuador, El Salvador, Mexico, Peru and Uruguay;
- Countries whose surplus covers less than 50%: Costa Rica, Nicaragua and Panama.

This list is based on data for the past year. Figure III.11 gives some historical perspective to the fiscal policy picture, combining information on the primary balance for 2005 with an indicator of past fiscal situations. In this case, the indicator is the ratio of public debt to GDP. If the regional averages of these indicators are included, then the countries of the region can each be placed in one of the four quadrants of this graph according to whether their present (the ratio of the primary balance to GDP) and past (public debt as a percentage of GDP) fiscal positions have improved or worsened. The reader should bear in mind that public debt reflects the cumulative impact of past deficits.

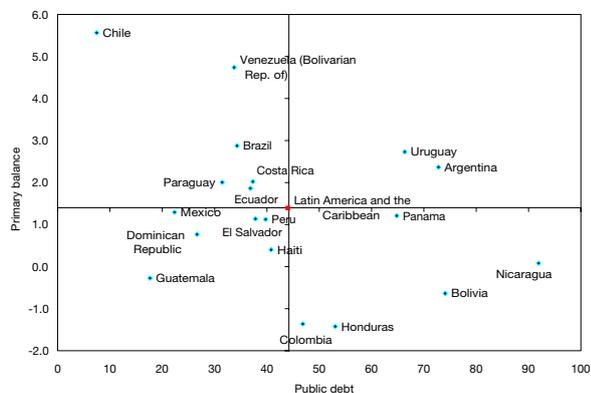
By combining the 2005 central government primary balance figures with the level of public debt as a percentage of GDP, the countries' public finances can be classified

Table III.2  
LATIN AMERICA AND THE CARIBBEAN: VARIATION OF FISCAL AGGREGATES, 2004-2005  
(Percentages of GDP)

	Primary balance	Overall balance	Revenue	Total spending	Current spending	Capital spending	Interest	Primary spending
Argentina	-0.9	-1.5	0.7	2.2	1.7	0.6	0.7	1.6
Bolivia	1.9	1.9	3.5	1.6	1.7	0.0	0.0	1.6
Brazil	-0.1	-2.2	0.9	3.1	2.6	0.6	2.1	1.0
Chile	2.5	2.6	2.3	-0.3	-0.4	0.1	-0.1	-0.2
Colombia	-1.1	-0.5	0.5	1.0	0.6	0.3	-0.6	1.5
Costa Rica	0.7	0.6	0.2	-0.5	-0.4	-0.1	0.0	-0.5
Ecuador	0.4	0.5	1.0	0.5	0.6	-0.1	-0.1	0.6
El Salvador	0.2	0.1	0.3	0.3	0.0	0.2	0.2	0.1
Guatemala	-0.5	-0.5	-0.6	-0.1	-0.3	0.2	0.0	-0.1
Haiti	3.1	2.8	2.0	-0.8	0.6	-1.4	0.3	-1.1
Honduras	0.6	0.6	0.2	-0.4	0.5	-0.9	0.0	-0.4
Mexico	0.1	0.3	0.5	0.2	-0.1	0.3	-0.2	0.4
Nicaragua	0.2	0.4	0.8	0.4	1.0	-0.6	-0.2	0.6
Panama	2.4	1.5	0.7	-0.8	-0.1	-0.7	0.9	-1.7
Paraguay	-0.7	-0.8	-0.1	0.7	0.6	0.1	0.0	0.6
Peru	0.5	0.5	0.8	0.3	0.2	0.1	0.0	0.3
Dominican Republic	2.6	3.3	1.5	-0.3	-0.1	-0.2	-0.6	0.3
Uruguay	0.3	0.8	0.0	-0.9	-0.7	-0.1	-0.6	-0.3
Venezuela (Bolivarian Rep. of)	2.9	3.6	4.0	0.3	-0.4	0.8	-0.7	1.0
Latin America and the Caribbean, simple average	0.8	0.7	1.0	0.4	0.4	0.0	0.1	0.3

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

Figure III.11  
**LATIN AMERICA AND THE CARIBBEAN: PUBLIC DEBT AND  
 CENTRAL GOVERNMENT PRIMARY BALANCE, 2005**  
 (Percentages of GDP)



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

into four groups corresponding to the four quadrants shown in figure III.11.

- Countries where the public debt-to-GDP ratio is below average and the primary surplus is

above average: the Bolivarian Republic of Venezuela, Brazil, Chile, Costa Rica, Ecuador and Paraguay;<sup>7</sup>

- Countries where the public debt-to-GDP ratio is below average and the primary surplus is below average: the Dominican Republic, El Salvador,<sup>8</sup> Guatemala, Haiti, Mexico and Peru;
- Countries where the public debt-to-GDP ratio and the primary surplus are above average: Argentina and Uruguay; and
- Countries where the public debt-to-GDP ratio is above average and the primary surplus is below average: Bolivia, Colombia,<sup>9</sup> Honduras, Nicaragua and Panama.

If these country groupings are compared with the results of the primary surplus/interest ratio, a more dynamic version of this classification emerges: countries with a primary balance/interest ratio above 100% (or those having an overall fiscal surplus) are reducing their indebtedness, whereas for those with an overall fiscal deficit, total public debt is rising.

## 5. Subregional overview

The fiscal positions of the countries in different subregions reflect their varying performances.

The MERCOSUR countries continued the trend towards the generation of primary surpluses observed over the past three years (although Argentina and Paraguay fell short of the record levels seen in 2004). This had the effect of helping to lower their debt-to-GDP ratio, which had peaked in 2002 but has fallen by 25% of GDP over the past year. This sharp reduction can be attributed to the level of these primary surpluses, combined with Argentina's and Uruguay's debt restructurings and Argentina's and Brazil's prepayments of IMF debt.

In the Andean subregion, a distinction must be drawn between the oil-producing and non-oil-producing countries. The petroleum-producing countries are continuing to generate hefty primary surpluses, thanks to

their steeply rising fiscal receipts from the hydrocarbons sector. Elsewhere, Bolivia significantly narrowed its fiscal deficit. Colombia's central government deficit increased in 2005, but decentralized bodies returned a surplus that led to an improvement in the consolidated accounts. Peru also witnessed a marked improvement in its public accounts.

The Central American countries' primary accounts were balanced in 2004-2005, but there is still a large overall deficit of more than 2% of GDP. The improved debt-to-GDP picture is basically due to Nicaragua's entry to the HIPC Initiative, which led to the forgiveness of a large part of its debt.

The Caribbean economies showed a mixed fiscal performance in 2005. Bahamas, Dominica, Jamaica, and Saint Kitts and Nevis narrowed their fiscal gaps, but

<sup>7</sup> Brazil would change quadrants, moving into the category of countries with above-average debt, if data for the non-financial public sector were used instead of central government data.

<sup>8</sup> Both Colombia and El Salvador would change quadrants, moving into the category of countries with an above-average primary surplus, if data for the non-financial public sector were used instead of data on central government primary balances.

<sup>9</sup> Ibid.

Antigua and Barbuda, Belize, Barbados, Guyana, Saint Lucia, Saint Vincent and the Grenadines, and Trinidad and Tobago adopted expansionary fiscal policies. In the first group, these fiscal changes were attributable to short-term economic factors (as in Bahamas), once-off reforms (closing down the sugar industry in Saint Kitts and Nevis), or more permanent changes (Dominica and

Jamaica). The second group of countries opted for fiscal expansion, mostly in order to stimulate aggregate demand (Antigua and Barbuda, Guyana, Saint Lucia, Saint Vincent and the Grenadines, and Trinidad and Tobago). Antigua and Barbuda, Guyana and Saint Lucia boosted capital spending, and the Government of Saint Vincent and the Grenadines expanded its payroll.

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## 6. Conclusions

As noted in the *Preliminary Overview of the Economies of Latin America and the Caribbean, 2005*, the region's governments refrained from adopting expansionary fiscal policies during the 2003-2005 growth cycle, opting instead for debt repayments and accumulation of reserves. This marked a departure from earlier episodes in the region.

This policy reduced external vulnerability and, to some degree, gave fiscal policymakers more room to manoeuvre. The region's authorities should seize this opportunity to move forward with a wide range of tasks in the area of fiscal policy.

As for fiscal revenue, since half the region's countries have tax burdens below 15% of GDP at the central government level, priority should be given to strengthening the tax structure.

Countries specializing in the extraction of non-

renewable resources have seen a sharp increase in their fiscal revenues thanks to upswings in the prices of their exports. The present combination of circumstances thus provides them with a chance to make strides in designing stabilization mechanisms and diversifying their revenue structures and tax systems away from a reliance on the non-renewables sector.

Countries in the region that have weak tax structures and low levels of investment in physical and human capital should look for ways to improve their social spending patterns, while also investing in public infrastructure, an area where expenditure remains at the lowest levels seen in recent decades.

Aside from the improvements observed in recent years, it should be noted that only a fifth of the countries of the region show overall fiscal surpluses, and half of the countries have debts exceeding 50% of GDP.

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## B. Exchange-rate policy

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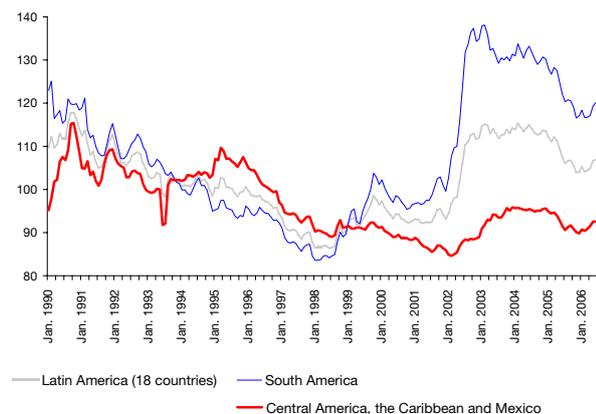
### 1. Exchange-rate movements in 2005

Between December 2004 and December 2005, the Latin American and Caribbean region's real effective exchange rate vis-à-vis the rest of the world diminished by 8.3% (signifying a currency appreciation), although the annual average rate of appreciation for 2005 (5.1%) was lower than it was for 2004. This situation is depicted in figure III.12. The rate of appreciation was almost twice as high in South America (10.1% from December 2004 to December

2005) as in Central America, the Caribbean and Mexico (6%). Interestingly, these figures are not the net result of widely differing situations; in fact, 17 of the countries in the region (all those considered except for Peru) showed declines (currency appreciation) in their extraregional effective exchange rate over this period. As indicated in the section on the external sector, this upward pressure can be accounted for by significant improvements in the

current account balances of a number of South American countries. Elsewhere, in Central America, the real rate of appreciation was linked to the high level of current transfers, mainly consisting of emigrant remittances.

Figure III.12  
**LATIN AMERICA AND THE CARIBBEAN: REAL EFFECTIVE EXCHANGE RATE IN RELATION TO THE REST OF THE WORLD**  
*(Index: simple average for January 1990–December 1999=100)*



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

The total effective exchange rate (which takes into account trade with all partners, including the countries of Latin America and the Caribbean) declined less, as the currencies of trading partners in the region appreciated in real terms relative to the rest of the world. Fourteen countries, however, posted real effective appreciations in relation to all of their trading partners between December 2004 and December 2005. Eight countries recorded significant appreciations (over 5%), with four South American countries posting the highest figures: Brazil (20.1%), Chile (12.4%), Uruguay (9.8%) and Colombia (8.3%). They were followed by two Central American countries (Guatemala, with 6.7%, and Nicaragua, with 5.5%), Jamaica (6.3%) and Mexico (6.2%). Some of the most striking cases in South America, Central America and the Caribbean are analysed below.

Brazil ran a current account surplus in 2005 (1.8% of GDP) and early 2006, as well as having a high level of foreign direct investment (FDI), equivalent to 1.6% of GDP, and high interest rates, which nevertheless showed a downward trend as of December 2005. Probably as a result of their effect in adding to the level of the country's debt obligations had an impact on the balance-of-payments capital and financial account balance (excluding FDI) in

2004 and 2005. This balance moved from a net outflow of foreign currency equivalent to about 2.2% of GDP in 2004 to a net inflow of 0.1% of GDP in 2005. In 2005, the country received capital inflows amounting to US\$ 6.451 billion, which were used to purchase equities, and there were no large private debt payments on the scale seen in 2004.<sup>10</sup> These factors contributed to the 15.9% nominal appreciation of the real against the dollar between December 2004 and December 2005.

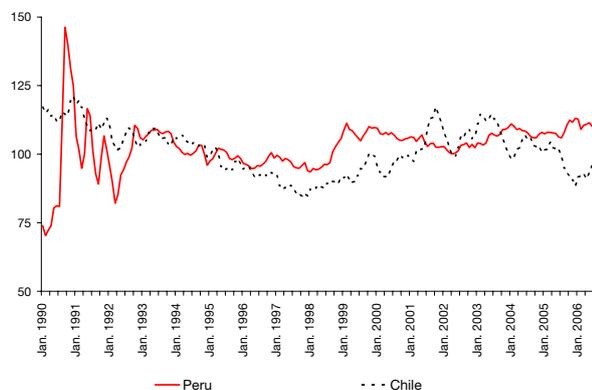
In Chile there were two main factors behind the peso's nominal appreciation of 10.8% against the dollar in 2005, which in turn largely accounted for its real effective appreciation. First, FDI remained high (4.1% of GDP). Chile also benefited from a substantial improvement in its terms of trade, thanks mostly to steeply rising copper prices during the year, but its strong trade performance was partially countered by an increase in net payments of investment income, which amounted to 9.2% of GDP. Second, there was a large reduction in capital outflows compared to 2004.

In Guatemala, when analysing the real effective appreciation in 2005, a distinction should be made between domestic inflation (a cumulative rate of 8.4%) and the nominal appreciation of 2% against the dollar. The latter was primarily attributable to capital inflows (excluding FDI), which were equivalent to 4.2% of GDP despite a substantial reduction in purchases of Guatemalan portfolio assets, and current transfers (mainly emigrant remittances) amounting to 10.9% of GDP. The increase in current transfers in 2005 almost offset the striking upturn in imports and freight expenses. Even so, the build-up of reserves in 2005 was less than half of what it had been in 2004.

The real effective appreciation of the Jamaican dollar in 2005 reflected a nominal depreciation (4.5% between December 2004 and December 2005) that was rather less than the inflation rate for the period (12.9%). The nominal exchange rate remained stable until July, when it began to rise (depreciation). In the second half of the year there was an increase in the demand for foreign currency and dollar-denominated assets. Factors affecting the availability of foreign currency in 2005 included the continuing high levels of remittances and of FDI and capital inflows, although the trade deficit widened. In any case, the government's aversion to a depreciation in the exchange rate, by reason of its fiscal impact (in view of the high levels of public debt, half of which is linked to the price of the dollar), has led the central bank to draw upon its reserves in order to sell United States dollars on the open market.

<sup>10</sup> In the course of 2005, however, the government paid off its debt with the International Monetary Fund.

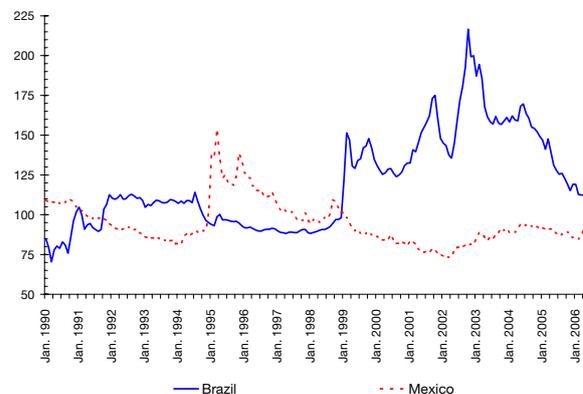
Figure III.13  
**PERU AND CHILE: TOTAL REAL EFFECTIVE EXCHANGE RATE**  
 (Index: simple average for January 1990–December 1999=100)



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

Of the four countries in the region that registered effective depreciations in 2005, the rate was significant only in the case of Peru, with 4.7%. This was largely attributable to the uncertainty about upcoming elections that began to make itself felt in the third quarter of 2005, despite very positive trends in metals prices and the subsequent improvement in the trade balance, which in 2005 posted an 84.9% improvement relative to 2004. Nevertheless, the current account result was negatively

Figure III.14  
**BRAZIL AND MEXICO: TOTAL REAL EFFECTIVE EXCHANGE RATE**  
 (Index: simple average for January 1990–December 1999=100)



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

affected by increased payments of investment income, especially profits and dividends, which rose by 2.1% of GDP. The net result was a current account surplus of 1.3% of GDP. Meanwhile, the balance-of-payments capital and financial account (without including FDI) recorded a net capital outflow of 2.5% of GDP. Foreign-exchange outflows from the public sector amounting to US\$ 1.44 billion also helped to ease the upward pressure on the exchange rate.

## 2. Exchange-rate movements in early 2006

The Latin American and Caribbean aggregate extraregional real effective exchange rate increased (depreciated) by 2.8% between December 2005 and June 2006. Three countries in South America (Paraguay, Bolivarian Republic of Venezuela and Peru) recorded appreciations, while the other seven saw depreciations, the most notable being Colombia (13.5%) and Chile (9.5%). Consequently, the extraregional real effective exchange rate for South America rose, on average, by 2.6% over the period. In Central America, Mexico and the Caribbean, it was up by 3%, with all the countries of the subregion showing depreciations, led by Mexico (10.5%). Although the prices of the region's export commodities remain high, uncertainty in relation to the future course of United States interest rates and slacker demand for emerging-market assets in general may help to dampen demand for assets denominated in Latin American and Caribbean currencies.

Only five countries posted an effective appreciation of their currencies over the first six months of 2006 relative to their December 2005 levels. Paraguay had the largest appreciation, with a rate of 8%, while the figures for Peru, Bolivarian Republic of Venezuela, Guatemala and El Salvador did not exceed 3%. The other countries registered effective depreciations. The scale of these declines in value was generally small, except in the cases of Colombia (12.7%), Mexico (10.3%) and Chile (8.2%).

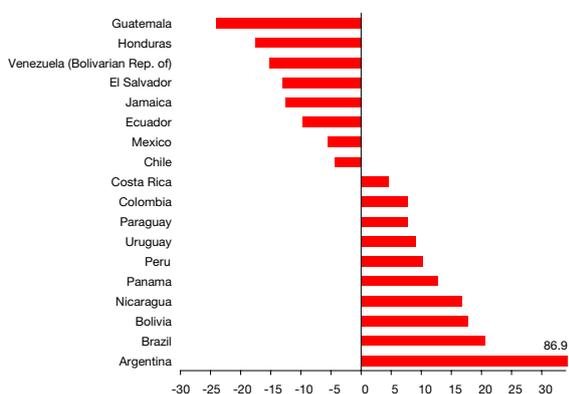
In Colombia, the increase in United States interest rates, weakening demand for peso-denominated assets and a widening current account deficit led to a 12% nominal depreciation of the Colombian peso between December 2005 and June 2006, even though the Banco de la República sold US\$ 944 million in foreign exchange on the market between April and June 2006. In the case of Mexico, monetary policy became more flexible in the second half of 2005, and in May 2006 policymakers struck a neutral

stance. The reduction in interest rate spreads relative to industrial countries and, more recently, the proximity of the elections and sagging investor demand for emerging-market assets were probably the cause of the real effective depreciation recorded by Mexico in 2006.

Figure III.15 compares the total effective exchange rates of the countries in the region in June 2006 with those of the 1990s. Guatemala's and Honduras' real effective exchange rates were 24.1% and 17.5% lower

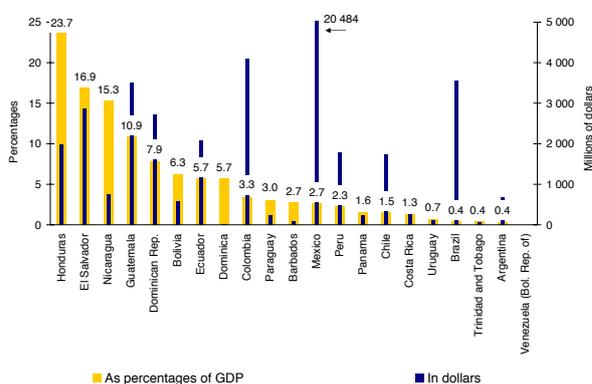
(appreciation), respectively, than the values recorded in the 1990s. To a large extent, this was the result of the high levels of remittances received by both countries in the past few years (see figure III.16) and, more recently and in the case of Guatemala, of capital inflows. Argentina's real effective exchange rate has held at a much higher level than in the 1990s, which tends to corroborate the theory that there was a significant misalignment in the effective exchange rate for at least part of that decade.

Figure III.15  
**LATIN AMERICA: TOTAL REAL EFFECTIVE EXCHANGE RATE, JUNE 2006**  
*(Percentage change in relation to the historical average for January 1990-December 1999)*



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

Figure III.16  
**LATIN AMERICA AND THE CARIBBEAN: NET CURRENT TRANSFERS TO THE REGION, 2005**  
*(Percentages of GDP and millions of dollars)*



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

### 3. Equilibrium exchange rates and emigrant remittances

Although a comparison between the current effective exchange rate and a historical average is not the same as calculating the degree of divergence of an effective exchange rate from its long-term equilibrium rate, the latter is a very difficult calculation to perform in the case of the Central American countries. This is because the long-term component of emigrant remittances and its probable future trajectory would have to be determined in order to compute that divergence, and, unfortunately, there are no reliable or comparable cross-country data on such trends in the region. This is a significant fact, since, if these flows continue to produce income levels

similar to or higher than the figures for 2005 (see figure III.16)<sup>11</sup> over an extended period of time, then the exchange rate's low values (appreciation) would come to represent an "equilibrium" situation. In contrast, if the trend in remittances is reversed, and this type of inflow declines in the not-too-distant future, then these low exchange rates will not constitute an equilibrium level and economic theory would provide stronger support for the authorities' attempts to avoid a very substantial appreciation.

It is important to head off an exchange-rate misalignment because of the cost involved when production sectors have to adapt to changes in the relative prices of

<sup>11</sup> Figure III.16 shows data on current transfers rather than remittances. This is because data on current transfers is available in all the countries (which is not the case of data on emigrant remittances), and current transfers are often a good indicator of the scale of remittances in most countries, as they make up the bulk of such transfers (except in countries where official development aid is more significant, such as Haiti).

tradable and non-tradable goods,<sup>12</sup> as well as the spillover effects on the rest of the economy of changes in higher value-added sectors. For example, if time is needed to acquire specific human capital and enterprise capacity in high-value-added tradable-goods sectors (for example, owing to the need for learning by doing), then situations in which relative prices remain distorted over an extended period of time can lead to deindustrialization, and the ensuing adjustment costs entailed by the eventual correction of these distortions may be quite high. Continuous, large-scale emigration flows, which are unlikely to be

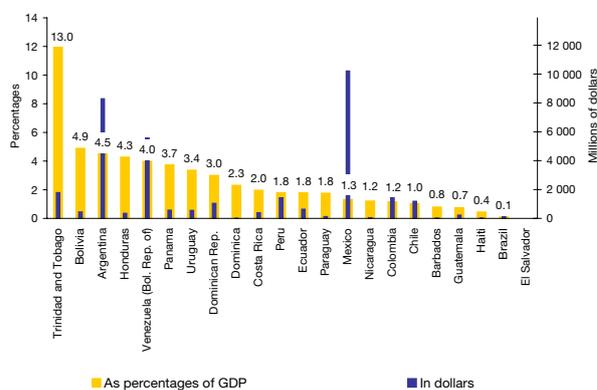
sustainable in the long term, are essential if remittances are to remain at a high level as a percentage of GDP. Even so, empirical evidence indicates that remittances may remain high for quite some time. In fact, between 1990 and 2005, current transfers in El Salvador reached an average of 14.2% of GDP and were never less than 12.2% of GDP. Meanwhile, and despite the fact that the migration policies of the main Latin American receiving countries have become stricter in recent years, it is still too early to conclude that the region's emigration flows have slowed down.

#### 4. Intervention in the exchange market

In 2005 exchange-market intervention policies varied a great deal and significantly influenced the accumulation of reserves, as reflected in figure III. 17. One reason for this diversity was the variety of exchange-rate regimes existing in the region. Countries with a defined exchange-rate target have to intervene in order to maintain nominal parity within the desired range. Countries with crawling pegs, such as Costa Rica and Honduras, or those with fixed rates, such as the Bolivarian Republic of Venezuela (which also has strict exchange controls), are in a similar position. Situations vary in the case of countries that have flexible exchange rates.<sup>13</sup> The reasons for intervening in the market may range from the reduction of exchange-rate volatility, when the market is not highly developed and is subject to a high degree of asymmetry and heterogeneity, to the avoidance of significant exchange-rate misalignments. Nevertheless, the most frequently cited reason is the need to replenish reserves so that the country will be better able to withstand sudden changes in capital movements (especially in countries with highly dollarized financial sectors), which is clearly a very valid objective. Nations that apply monetary policy systems based on inflation targets include, on the one hand, countries such as Chile, where there has been no intervention in the foreign-exchange market since 2001 (although the central bank has publicly expressed its willingness to do so if there are signs of an exchange-rate distortion) and, on the other hand, countries such as Peru and Colombia. The central banks of Peru and Colombia intervened extensively in the exchange market

in 2005, and in the case of Peru, these operations have involved both purchases and sales. In Argentina, where there is no formal system of inflation targets, the trend in terms of intervention in the foreign-exchange market would seem to indicate a clear interest in preventing the nominal parity of the dollar from falling below three pesos. The country accumulated reserves amounting to 4.5% of GDP in 2005, and the central bank purchased US\$ 6.13 billion in the first six months of 2006.

Figure III.17  
LATIN AMERICA: VARIATION IN NET RESERVES OTHER THAN GOLD OR IMF RESERVES, 2004-2005  
(Percentages of GDP and millions of dollars)



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

<sup>12</sup> This by no means entails maintaining an artificially depreciated exchange rate, however.

<sup>13</sup> In Latin America, the expression "floating exchange rate", which is often used in the literature, actually has a number of different meanings, as countries that allow their nominal currencies to float tend to engage in various forms of intervention in the foreign-exchange market.

## C. Monetary policy

Monetary policy in the region has been rapidly adapting to changes in the external environment, especially slumps in financial markets and in international economic activity.

In most countries, policies in this area in 2005 included slight increases in monetary policy rates,

although real interest rates remained relatively low in historical terms. There are some important exceptions, however, including the largest countries in the region: Brazil and Mexico.

### 1. Monetary policy in the region

Monetary policy in the region continues to give priority to controlling inflation, although the emphasis placed on this objective varies somewhat depending on the state of the economy. The hike in oil prices has been a cause of concern to Latin American central banks as they seek to avoid further impacts on price indices, but the widespread trend of appreciating local currencies has helped rein in the pace of price increases. This appreciation has unwanted effects, however, and a number of central banks have therefore decided to intervene in the foreign-exchange market in order to slow the rate of appreciation.

A variety of monetary policy schemes have been adopted by the countries of the region, which currently fall into three broad categories. First, Brazil, Chile, Colombia, Mexico and Peru have adopted a regime of inflation targets in tandem with a flexible exchange rate. In these regimes, the central bank's control of interest rates is the main instrument of monetary policy. Second, countries whose financial systems are dollarized, albeit unofficially, are not easily placed to conduct an independent monetary policy. Bolivia and Uruguay have a high proportion of their deposits in dollars, as does Peru, although the latter has adopted a system of inflation targets. The majority of these countries use a monetary aggregate as a policy tool, as well as intervening in foreign-exchange markets.

Third, Panama (since 1904), Ecuador and El Salvador have currency systems that are linked to the United States dollar and thus use the dollar as their currency. These countries have decided to forego the use of monetary policy instruments, and their interest rates follow movements very similar to those of international interest rates, and their country risk remains constant. In Panama, which has a highly developed and efficient banking system, interest rates are practically the same as international rates.

The increase in monetary policy rates initiated by the United States Federal Reserve has been followed

with caution and moderation by various central banks in the region. Their rates are therefore still at relatively low levels from a historical perspective. For most countries, real interest rates have basically held steady or have even moved downward over the last three years (see figure III.18). Nevertheless there are some important exceptions, including Brazil and Mexico, the largest countries in the region.

After successfully bringing down consumer inflation from an annual 8.1% in April 2005 to 5.1% at the end of that year, the Brazilian central bank reduced the nominal Special System of Clearance and Custody (SELIC) rate on three successive occasions, lowering it from its August 2005 level of 19.75% to an annual 18% by the end of that year. The SELIC rate was revised downward eight times and reached an annual 15.25% in May 2006. It is expected to reach 14% by the end of the year. The central bank also injected more liquidity into the market after a bout of financial turbulence in May.

Despite these expansionary monetary policy measures, Brazil's real rates are still the highest of any of the larger economies (over 11% in annual terms), taking into account the expected 12-month inflation rate of 4.3%. This is almost double the real rates of China and Mexico, which have the second and third highest real rates, respectively, among the larger economies. If the SELIC rate reaches 14% at the end of 2006, the real rate will amount to over 9%.

In Mexico, the authorities reacted to the rise in prices between the second half of 2004 and the second half of 2005 with the largest rate hike in the region. Only the sudden drop in the 12-month inflation rate to 3.5% in August 2005 made a less restrictive monetary policy possible, with a cut in the funds rate (interbank interest rate) from 9.75% to 7% at the end of April 2006. As core inflation has been curbed so far, it seems likely that cautious rate reductions and a gradual yet larger decrease

Figure III.18  
**LATIN AMERICA AND THE CARIBBEAN: REAL INTEREST RATES**  
*(Annualized percentages)*

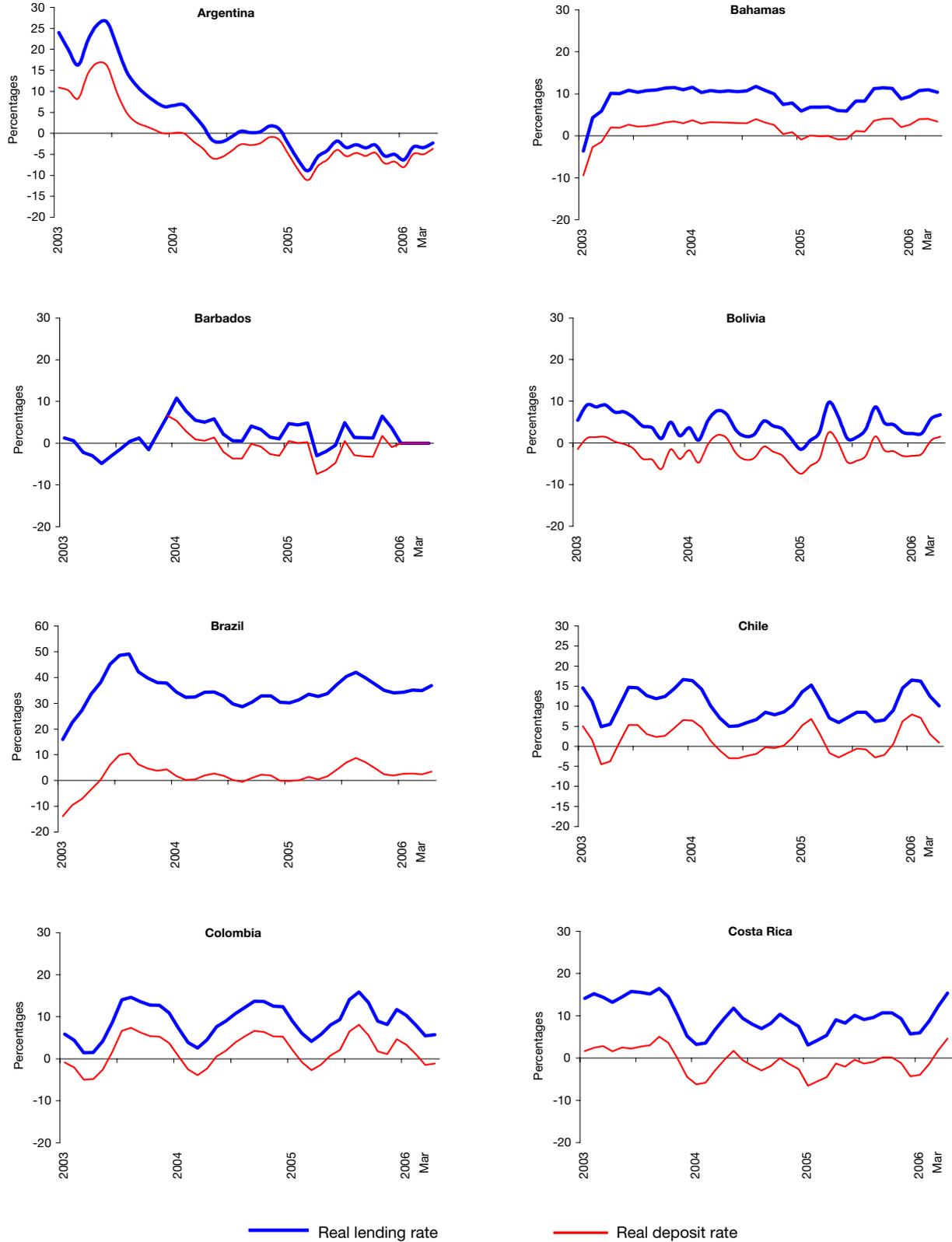


Figure III.18 (continued)

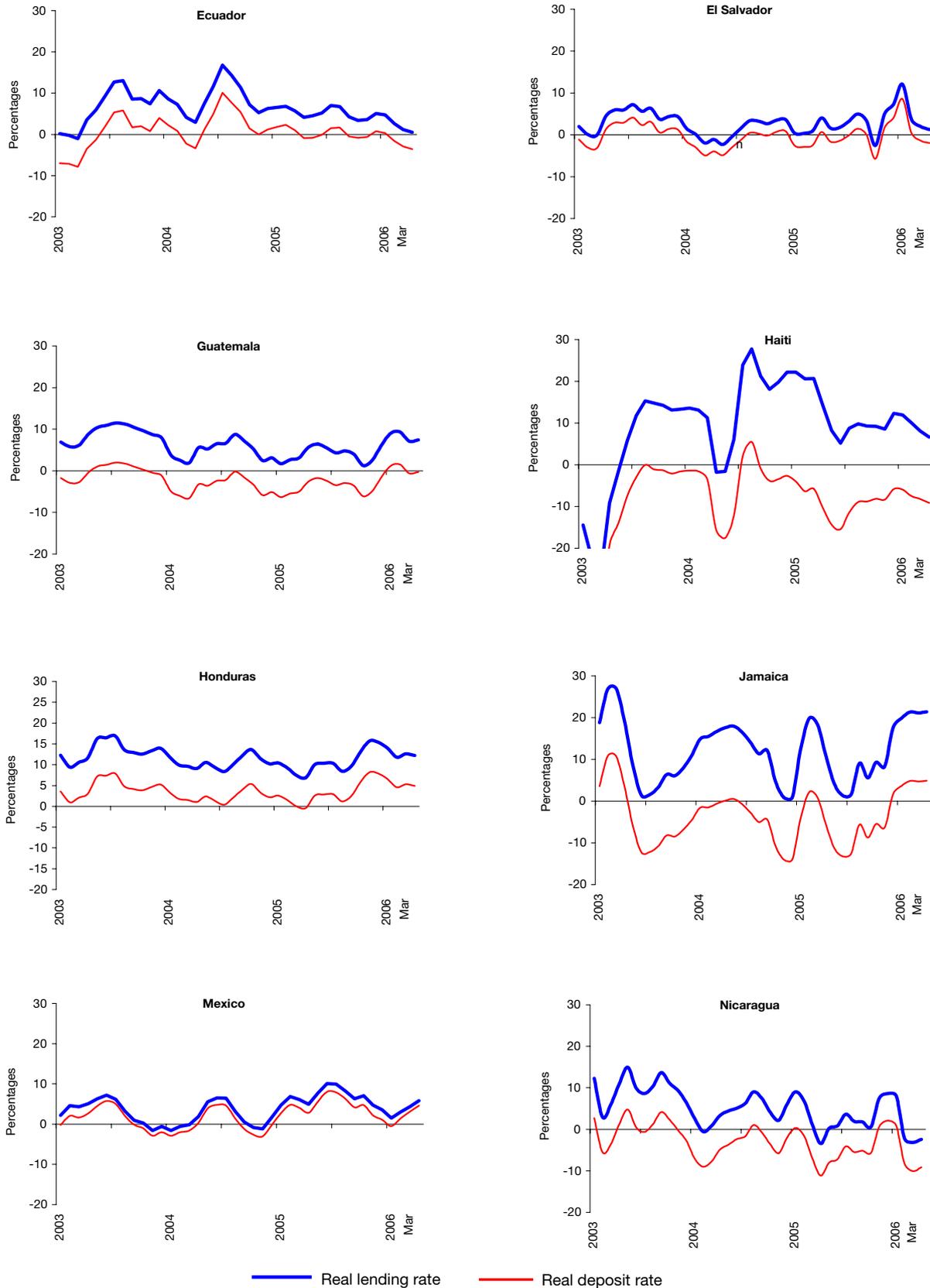
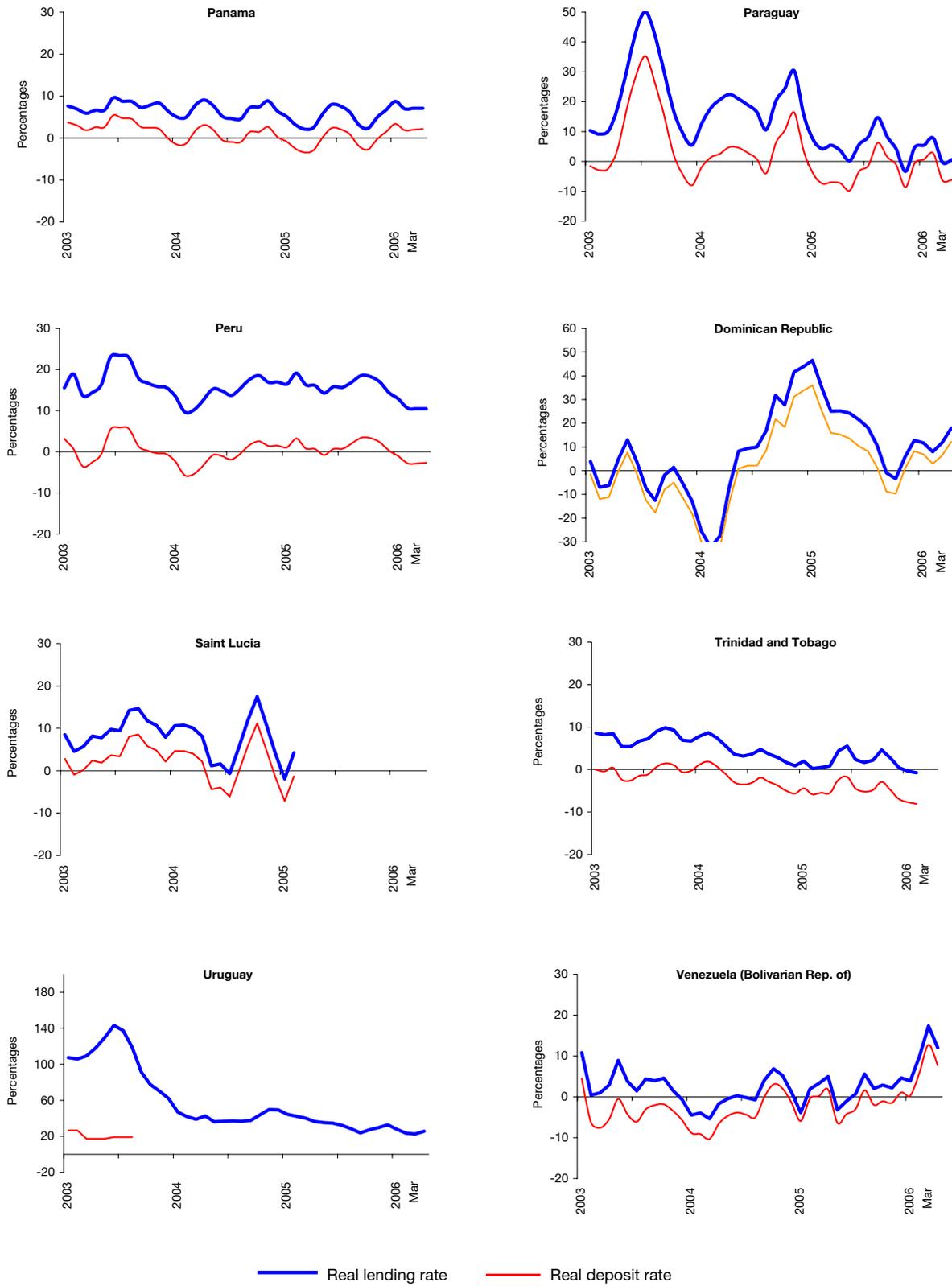


Figure III.18 (concluded)



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

in the spread between short-term rates in Mexico and the United States will probably continue for the rest of the year. This spread narrowed from seven percentage points in May 2005 to less than three in May 2006.

For the first time, the rate reduction was not accompanied by an increase in the *corto* (the funds Mexico's central bank makes available to the market at twice the market rate), which until a few months earlier had been the main instrument of monetary policy. The use of the interest rate alone seems to indicate that the monetary authority was taking the first step towards making the benchmark interest rate, rather than the *corto*, its main monetary tool.

The Mexican central bank's decision to hold its interest rate steady in May interrupted the successive rate cuts that had taken place over the preceding nine months and led to a rethinking of the outlook for additional reductions in the future. In view of the upcoming presidential elections and the weaker peso, which had depreciated by 8.3% between the end of January and mid-June 2005, financial markets had been expecting this.

The Dominican Republic, Haiti and Jamaica are the remaining exceptions. These countries were hit by serious bouts of high inflation, and, in their wake, interest rates have remained above their 2003 levels.

In short, real rates in most countries remained moderate from a historical point of view and have risen only slightly in 2006. In contrast, real interest rates in Brazil and Mexico are still higher than they were two or three years ago and have only recently gone down very slightly.

Argentina and Chile offer more interesting examples as they represent opposite extremes in terms of exchange-rate regimes.

Argentina faces the challenge of gradually lowering its inflation rate, which amounted to over 12% in 2005 and thus overshoot its 8% target figure. Its main objective is to prevent the exchange rate from appreciating at a pace that would undermine the competitiveness of the country's exports.

Since the government managed to stabilize the exchange rate at around three pesos per dollar in August 2003, M1 had expanded by 90.1% by April 2006 and M2 by 59% over the same period. This expansion of the money supply has been accompanied by a shift in money demand towards more liquid assets, which seems to be a response to unresolved problems in the financial system. Nevertheless, money demand is unlikely to increase as rapidly in the future as it has over the past three years.

One positive aspect is that the monetary programme's M2 target was easily met in the first quarter of 2006, after

a failure to meet the target in the last quarter of 2005.

Meanwhile, real interest rates are less negative, as the interbank rate rose from 6.7% at the end of 2005 to 8.2% at the end of March 2006; the inflation rate is expected to be higher than 10% by the end of 2006.

The government has emphasized not only monetary policy but also the success of recent price agreements, although they have not eliminated monetary pressures on prices.

Chile's central bank continued to raise its monetary policy interest rate in 2005, quickening the pace of the adjustment as consumer prices neared and then edged slightly above the target band ceiling of 4%. They ended the year close to the upper limit (3.7%).

Under Chile's currency flotation system, the peso appreciated substantially until May 2006 in line with the financial dictates of the market, reaching a rate of almost 500 pesos to the dollar. This sparked a debate in Congress regarding the suitability of the existing exchange-rate system under current circumstances. This became an issue, in particular, because of the scale of the appreciation, as the exchange rate fell from 741 pesos to the dollar in February 2003 to 514 pesos in December 2005 and in the following months.

The widespread decline in stock markets and a higher level of country risk in the region translated into an exchange rate of 550 pesos to the dollar in June. The change in the global scenario in the wake of a weakening of economic activity and the uncertainty generated by the contraction of world stock markets, in addition to a sharp reduction in Chile's domestic growth rate, have led the central bank to put off making any further increases in the monetary policy rate, which reached 5% in April and remained at that level for the following two months. Before this change in the situation, the rate had been expected to reach around 5.75% by the end of 2006, but now, given this turn in events, there is no longer any clear-cut projection as to its year-end level.

The greatest challenge facing the authorities is not consumer prices, as their 12-month increase of 3.7% as of end-May 2006 is below the 4% ceiling of the target band, but rather wholesale prices, which have climbed by 8.9% over the past five months, as well as the greater impact of mining-sector imports, which shot up by 27.1% between January and May 2006. As this increase feeds into price levels, the system of inflation targets will be put to the test, since the pressure on prices is not coming from demand but rather from the cost of imports, against which an increase in rates is not only ineffective, but could trigger an economic contraction.

## 2. Nominal interest rates

Synchronized movements in the monetary-policy, interbank, deposit and lending rates are a sign that the relevant monetary authorities have the situation well in hand, whereas diverging movements point to a loss of control.

In 2005 most of the countries in the region witnessed a change of the trend of these rates relative to 2004, as they exhibited a slow but steady increase (see figure III.19).

Monetary authorities have had interest rates well

under control for some time now in Brazil, Chile, Colombia and Peru. The interbank and deposit rates have been highly synchronized in these countries and, in fact, have been at practically identical levels for the past few years. Argentina and Paraguay have regained a similar degree of synchronization and similarity since mid-2004. Other countries, such as Mexico and Costa Rica, have maintained a stable margin between the two rates, with the two moving in tandem with one another.

Figure III.19  
**LATIN AMERICA AND THE CARIBBEAN: NOMINAL INTEREST RATES**  
*(Annualized percentages)*

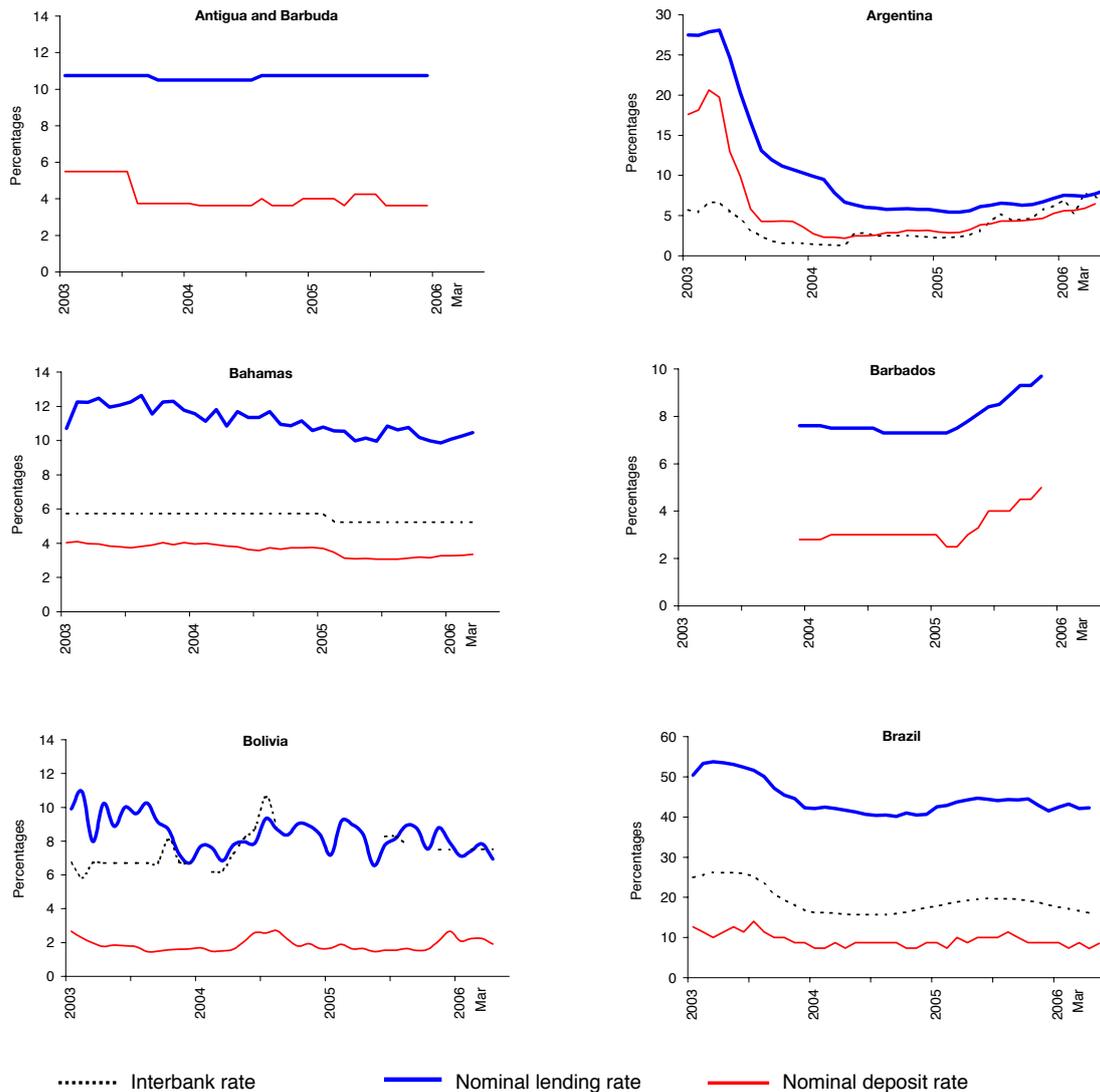


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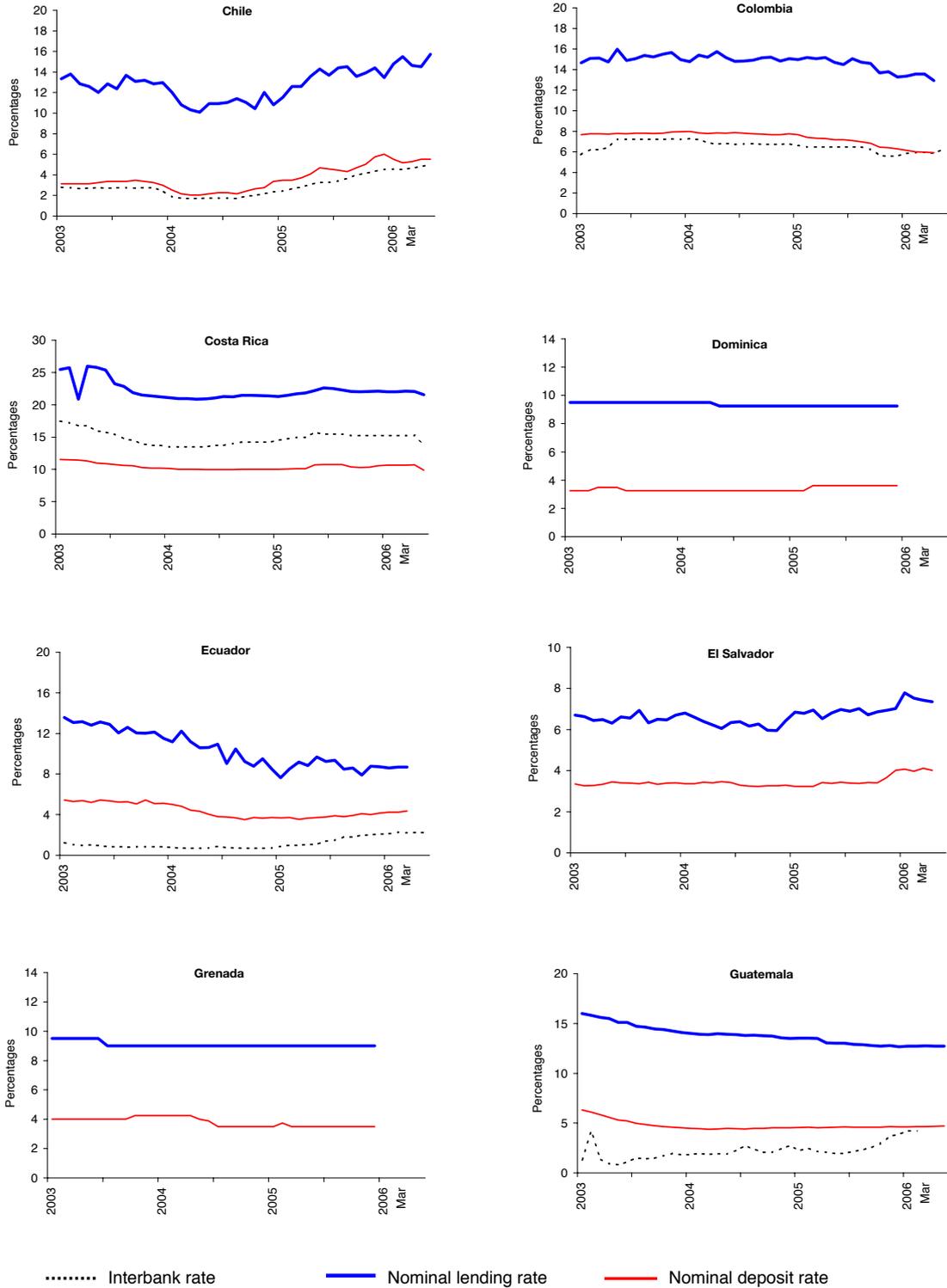


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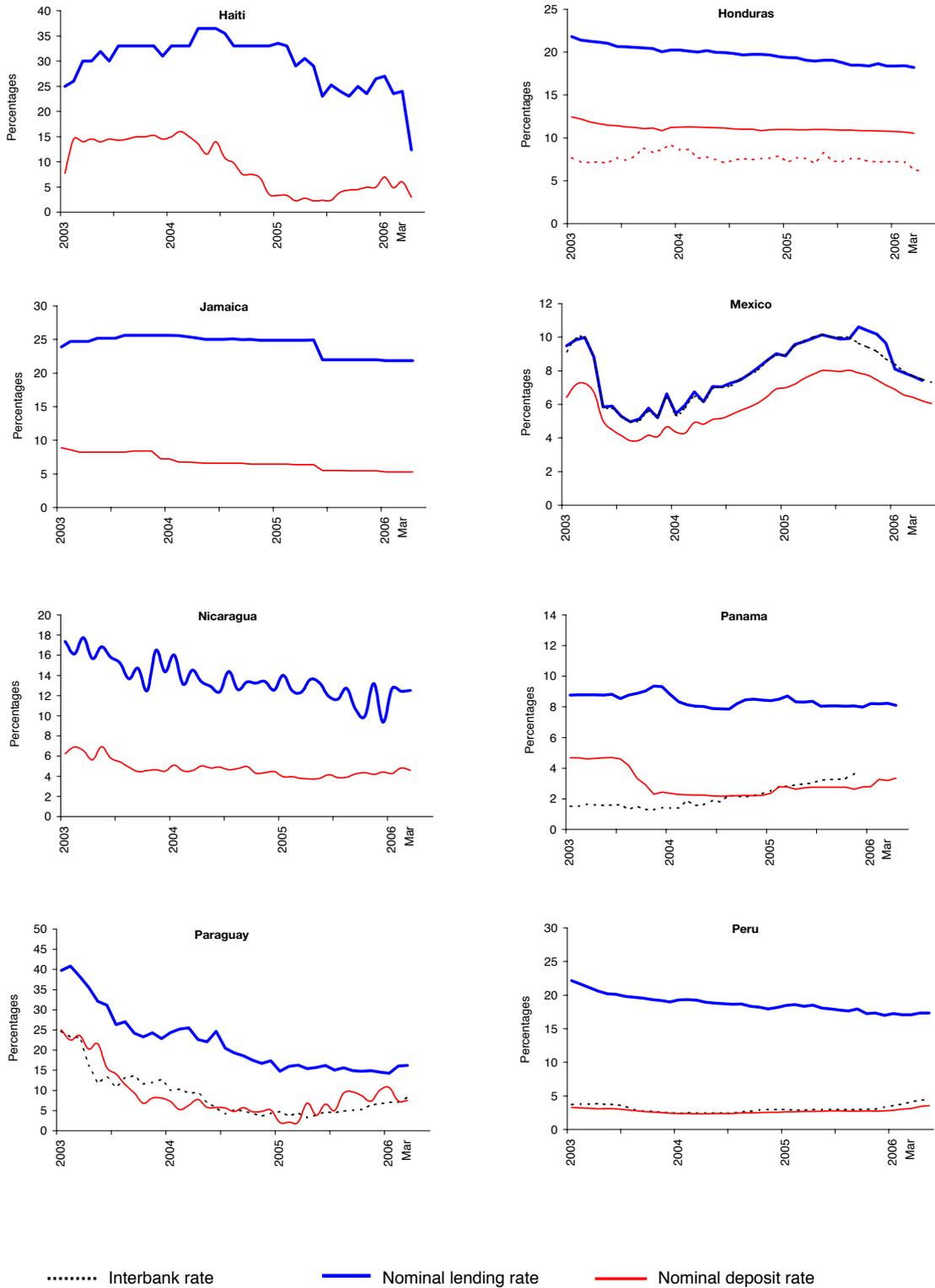
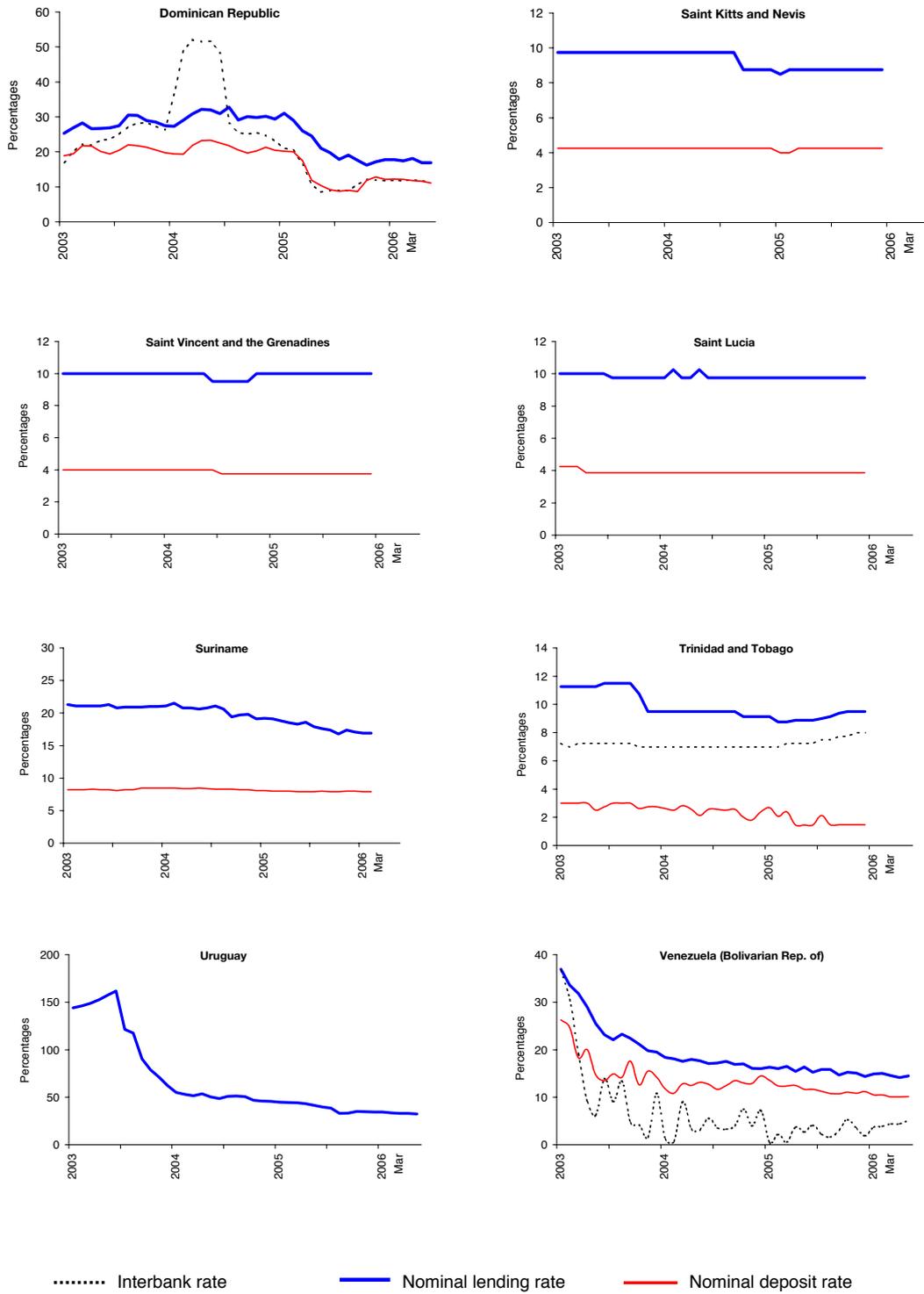


Figure III.19 (concluded)



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

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### 3. Monetary policy of the Caribbean countries

In most of the Caribbean countries, monetary policy ceased to be expansionary in 2005. In a majority of the countries the money supply grew more slowly in 2005 than in 2004, while Barbados and Belize applied clearly restrictive monetary policies.

In November 2004 circulation of the United States dollar was prohibited in Cuba, and the convertible peso came into general use, with a 10% charge being levied on the exchange of dollars for convertible pesos. As a result, bank balances in dollars have shrunk by

57%, and accounts in convertible pesos have tripled.

The monetary union of the Organization of Eastern Caribbean States (OECS) uses the Eastern Caribbean dollar (EC\$), which has a fixed exchange rate against the United States dollar. The union uses the operating rules of a currency board, making adjustments when money demand increases by issuing EC\$ dollars with 60% of their value backed by United States dollars. There was no change in the discount rate or interest rates of commercial banks in 2005.

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### 4. Countries whose currency is tied to the dollar

Countries with a dollarized monetary regime or whose currency is tied to the dollar cannot deploy monetary policy as such, since their monetary aggregates are endogenous and their interest rates tend to align themselves with

international interest rates. Interest rates rose slightly in 2005 in Ecuador, Panama and El Salvador and continued to do so in 2006 in line with the rises in international interest rates.

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### 5. Real interest rates

Nominal rates are a suitable indicator when they are used as an instrument of monetary policy. Generally speaking, however, interest rates adjusted for inflation — real rates — are the relevant variables for the authorities and often are used as intermediate policy objectives.

A majority of the countries have seen a rise in real lending rates in recent months. This trend reflects the change in direction of the Federal Reserve's interest-rate policy in June 2004, since many of the region's central banks have followed its lead.

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### 6. Bank credit

Lending activity has rebounded from its depressed pre-2003 levels. Nominal growth rates for total credit and private credit have both topped 15% (and have reached over 35% in Argentina and Costa Rica) in the 12 months prior to the first quarter of 2006. This constitutes an upward trend in comparison to the preceding years and

has brought these variables back up to their pre-2001 levels, which is a reflection of the improvement in global economic conditions. Only Bolivia and Paraguay show increases in total credit of less than 6% over this 12-month period.

Table III.3  
**LATIN AMERICA (SELECTED COUNTRIES): BANK CREDIT**  
*(Percentage increase in 12 months)*

Country	Period	Industrial and commercial loans		Mortgage loans		Consumer loans		Total credit	
		2005	2006	2005	2006	2005	2006	2005	2006
Argentina	April - April	...	..	-3.2	1.8	67.6 <sup>a</sup>	68.7 <sup>a</sup>	30.0	35.7
Bolivia	March - March	-7.8	-4.1	9.1	18.9	4.6	23.0	-4.7	1.2
Brazil	March - March	16.0	-47.3	5.0	17.3	41.8 <sup>b</sup>	33.9 <sup>b</sup>	22.6	20.1
Chile	March - March	24.0 <sup>c</sup>	17.3 <sup>c</sup>	24.5	21.3	22.6	26.1	15.4	18.4
Colombia	April - April	18.5	14.8	-25.3	-0.9	31.7	44.1	13.3	19.5
Costa Rica	April - April	8.7	37.9	-11.5	42.5	29.2	0.3	18.0	39.0
Mexico	December - December	8.9 <sup>c</sup>	...	39.6	...	52.9	...	7.1	...
Paraguay	April - April	17.6	-6.4	...	...	-13.5	18.3	30.9	5.7
Peru	April - April	-0.4	17.8	11.4	22.7	18.0	30.2	3.4	20.2

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

- <sup>a</sup> Includes credit cards.  
<sup>b</sup> Personal loans.  
<sup>c</sup> Commercial loans only.

## 7. Monetary aggregates

The money supply grew faster in 2005 than in previous years in most of the countries of the region. Argentina (29.6%), Bolivia (40.6%), the Bolivarian Republic of Venezuela (54.6%), Dominica (28.6%), Dominican Republic (26.9%), Trinidad and Tobago (47%) and

Uruguay (33.4%) posted the largest increases in their M1 growth rates. Thus, the reduction in interest rates has been accompanied by a fairly widespread expansion of the money and credit supplies.

Table III.4  
**LATIN AMERICA AND THE CARIBBEAN: VARIATION IN M1**  
*(Percentages)*

	2004 variation (December - December)	2005 variation (December - December)	2006: 12-month variation, last available month	2005: 12-month variation, same month as 2006 column	Last month of 2006 for which information is available
Antigua and Barbuda	20.3	18.2			
Argentina	25.1	29.1	27.1	20.1	
Bahamas	26.6	10.0	1.7	25.2	April
Barbados	18.5	11.3			
Belize	12.6	4.0	2.7	14.9	April
Bolivia	16.0	40.6	43.8	26.0	April
Brazil	16.7	13.2	12.0	16.1	April
Chile	24.1	11.2	9.4	17.3	May
Colombia	16.8	17.8	20.8	18.8	May
Costa Rica	0.5	23.9	23.6	1.5	May
Dominica	3.1	28.6			
Ecuador	26.6	22.0	21.1	27.4	April
El Salvador	12.6	7.4	15.5	13.3	April
Grenada	41.1	-7.3			
Guatemala	7.0	17.7	17.7	13.5	April
Guyana	12.4	9.3	7.0	17.9	March
Haiti	8.8	18.0	12.2	9.9	March
Honduras	10.7	20.0	21.6	19.1	March
Jamaica	22.3	17.6	11.4	17.1	March
Mexico	8.4	15.6	17.7	11.5	April
Nicaragua	23.3	20.7	28.0	20.3	May
Panama	10.8	18.4	22.0	3.8	March
Paraguay	24.2	20.6	15.0	18.9	April
Peru	30.9	25.7	15.9	28.5	April
Dominican Republic	5.8	26.9	14.2	6.0	May
Saint Kitts and Nevis	25.0	-1.6			
Saint Vincent and the Grenadines	13.1	14.2			
Saint Lucia	40.2	13.7			
Suriname	27.9	10.5	24.3	8.3	January
Trinidad and Tobago	14.6	47.0	19.0	24.4	April
Uruguay	13.0	33.4	37.0	16.0	April
Venezuela (Bol. Rep. of)	46.3	54.6	69.6	46.8	April

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

## Box III.3

**FOUNDATIONS OF MACROECONOMIC POLICY COORDINATION:  
FOSTERING DIALOGUE AS A POLICY TOOL IN LATIN AMERICA**

The document entitled *“Foundations of macroeconomic policy coordination: fostering dialogue as a policy tool in Latin America”* is a contribution to the theoretical analysis of macroeconomic policy coordination in Latin America. This analysis uses game theory to suggest that the problems inherent in such coordination can be resolved with the help of a mechanism for macroeconomic dialogue. On the basis of this theory, it explains how macroeconomic dialogue can be used as a very effective tool for achieving coordination in this area in Latin America.

It starts out by looking at the reasons why policy coordination is needed in the region. In general, macroeconomic policy decisions in one country have spillover effects in others, and policymakers often fail to take these spillovers into account. This has been the basis for the analysis of policy coordination in the literature. If national policymakers could coordinate the types of measures that have spillover effects, they could achieve a Pareto-superior outcome. The volatility that the lack of policy coordination can generate in trading partners (independently of the scale of the impact) is also a reason for coordinating macroeconomic policies. A third reason has to do with the pressure brought to bear by certain domestic groups in response to sudden changes in relative prices, which can lead to demands for sectoral protection measures. In Latin America, where intraregional trade increased during the 1990s, efforts to promote integration,

which strengthens the transmission channels of macroeconomic policy from one country to another, lend practical support to the theoretical arguments in favour of macroeconomic policy coordination.

Before considering ways of going about encouraging policy coordination between countries, however, it is important to have a logical framework for the analysis of their interactions. The document therefore reviews the literature on non-cooperative game theory, which indicates the forms that this interaction can take and how to analyse it. The document limits itself to analysing those situations in which countries are not capable of making “credible commitments” to pursue a particular pre-determined policy, which seems to be the most relevant situation when analysing the potential for coordination between sovereign countries in the absence of supranational institutions, as in the case of Latin America. The document begins with a description of the simplest games (static games, without uncertainty), and then adds complexity by incorporating multiple periods and imperfect information. There is a review of basic concepts, such as the Nash equilibrium in cooperative games, and other more complex ones involving uncertainty in a dynamic context.

In particular, this examination shows that countries often participate in dynamic games with imperfect information and that the multiplicity of possible results can often be ranked in terms of their contribution to countries’ welfare. In this case, mechanisms are needed to facilitate coordination of

macroeconomic measures in order to achieve a Pareto-superior outcome. After a review of the underlying concepts of some of the most important “equilibrium selection” mechanisms, macroeconomic dialogue is presented as a fundamental coordination tool which can avert situations where a lack of coordination results in low levels of well-being. A demonstration of this macroeconomic dialogue in action is provided by the Macroeconomic Dialogue Network (REDIMA) project, which is currently being implemented by ECLAC with technical and financial support from the European Union.

Lastly, the document points out that macroeconomic dialogue is a suitable coordination tool not only because it facilitates coordination through the sharing of information but also because of the learning experience involved and because it strengthens the very concept of “collaboration” between countries when there is uncertainty as to the will and capacity of the authorities to coordinate policies with their partners. This is particularly important for Latin America, in view of the high turnover rate among the economic authorities in a number of countries, as well as the difficulty of determining these authorities’ actual coordination capacity owing to various restrictions. Moreover, the strengthening of policy coordination through macroeconomic dialogue may foster the establishment of institutions that can help to find cooperative solutions among all of the countries in the region.

**Source:** Rodrigo Cárcamo, “Foundations of macroeconomic policy coordination: fostering dialogue as a policy tool in Latin America”, *Macroeconomía del desarrollo series*, No. 39 (LC/L.2420-P/I), Economic Commission for Latin America and the Caribbean (ECLAC), Santiago, Chile, November 2005. United Nations publication, Sales No. E.05.II.G.167

## Chapter IV

# Domestic performance

### A. Economic activity and investment

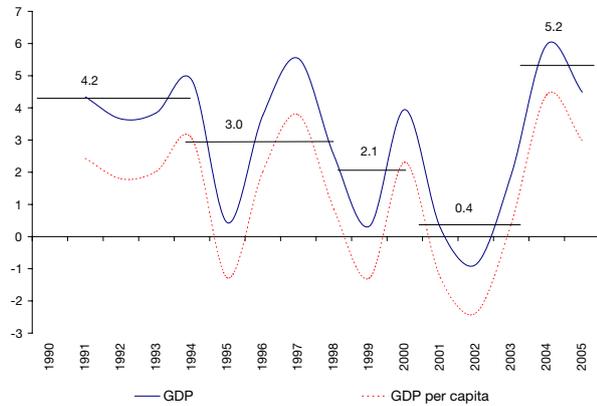
Driven by strong domestic and external demand, the economies of Latin America and the Caribbean grew by 4.5% in 2005, following the previous year's 5.9% expansion. The slowdown in relation to 2004 occurred largely because the region's two largest economies, Brazil and Mexico, underperformed the regional average. Nonetheless, the regional growth rate is still above the average for the 1990s and the first few years of the 2000s. Economic growth was widespread, with all countries posting positive rates except for Guyana. The strongest expansions were recorded in the Bolivarian Republic of Venezuela (9.3%) and in Argentina and the Dominican Republic (9.2% each). The lowest growth rates were in Haiti (1.8%), Brazil (2.3%) and El Salvador (2.8%). Guatemala, Mexico and Paraguay grew by around 3%, Ecuador, Honduras, Nicaragua and Bolivia by about 4% and the remaining countries by between 5% and 7%. Despite the occurrence of intense hurricanes in 2005, GDP growth in the English- and Dutch-speaking Caribbean was similar to the rates registered by the Latin American countries (4.5%). The highest rates were posted in Antigua and Barbuda (5.6%), Saint Kitts and Nevis (7%), Saint Lucia (7.3%) and Trinidad and Tobago (7%).<sup>1</sup>

The 2005 figures mean that the region has recorded three consecutive years of GDP growth, expanding by a cumulative 12.9% during 2003-2005 in relation to 2002 (per capita GDP rose by 8% in the same period). The

annual average growth rate for that three-year period was the region's highest in the last 15 years (1990-2005) (see figure IV.1).

<sup>1</sup> The unweighted average growth rate among the countries of the region was 5%, while the median was 4%. Cuba was not included in the regional calculations.

Figure IV.1  
**LATIN AMERICA: GDP AND PER CAPITA GDP**  
 (Percentages calculated on the basis of figures in constant 2000 dollars)



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

Growth of both GDP and per capita GDP was widespread across the subregions. The expansion was more pronounced in South America (among Andean and Southern Cone countries alike), but partly represented a recovery of activity levels following the downturns of 1999-2000 and 2001-2003. Although per capita GDP growth rates in Mexico, Brazil and the Central American countries fell short of the regional average in 2004-2005,

Table IV.1  
**LATIN AMERICA AND THE CARIBBEAN: GDP AND PER CAPITA GDP, AVERAGE ANNUAL GROWTH RATES**  
 (Percentages calculated on the basis of figures in constant 2000 dollars)<sup>a</sup>

	Gross domestic product					Per capita gross domestic product				
	1990-1994	1995-1998	1999-2000	2001-2003	2004-2005	1990-1994	1995-1998	1999-2000	2001-2003	2004-2005
Central America	3.4	5.0	4.3	2.4	4.5	1.2	2.8	2.2	0.3	2.4
South America	4.4	3.1	0.6	0.2	6.1	2.7	1.5	-0.9	-1.3	4.6
Caribbean	0.8	3.5	3.7	3.8	4.0	-0.1	2.7	3.0	3.2	3.5
Andean countries	4.0	3.0	-0.5	-0.1	8.4	1.9	1.1	-2.2	-1.8	6.6
Southern Cone	7.7	4.1	-1.4	-1.3	8.4	6.1	2.7	-2.6	-2.5	7.2
Brazil	3.5	2.6	5.2	0.7	3.6	1.7	0.8	3.5	-0.7	2.2
Mexico	2.8	2.6	2.6	1.3	3.6	1.2	1.0	1.0	-0.2	2.2
Latin America	4.2	3.1	2.1	0.4	5.2	2.3	1.3	0.5	-1.1	3.7
Latin America and the Caribbean	4.1	3.1	2.1	0.5	5.2	2.3	1.4	0.5	-1.0	3.7

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

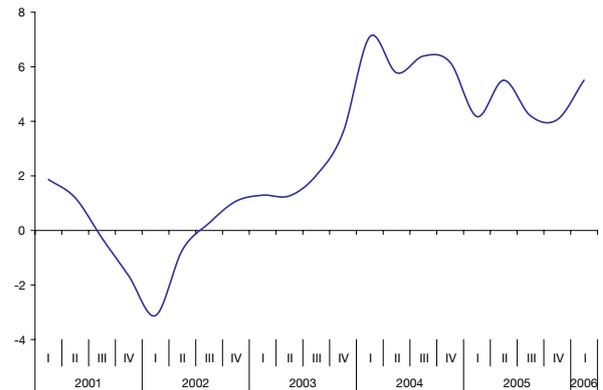
<sup>a</sup> The periods were defined as years in which the rates of variation in regional per capita GDP had the same sign (years in which this increased and years in which it decreased), with the years of separation being defined as those in which the variation in regional per capita GDP was negative.

they are nonetheless higher than the rates recorded in the early 1990s (see table IV.1).

In 2006, the region as a whole is expected to continue growing at around 5%, but trends are likely to vary across countries. Whereas growth in certain Central American economies, along with Brazil and Mexico, looks set to gather pace, most other countries will see a slightly slower expansion. The trend of the international economy, and in particular the conduct of monetary policy in the United States, Europe and Japan, together with the behaviour of international financial markets and these factors' economic policy implications for the region's countries, give rise to uncertainties that could affect the region's outlook, especially from 2007 onward.

Economic activity levels picked up gradually throughout 2005, although quarterly growth rates were below those recorded in 2004 (see figure IV.2). Nonetheless, the situation varied from country to country (see figure IV.3). Year-on-year quarterly growth rates show that, while economic activity in some countries tended to slow, particularly in the second half of the year (Brazil and Chile), elsewhere it picked up speed (e.g. Dominican Republic); but in most cases the quarterly growth rate was similar to the annual average rate.<sup>2</sup> The year-on-year growth rate in the first quarter of 2006 rose in relation to the second half of 2005 as a result of an expansion of economic activity in Brazil and Mexico. Regional GDP growth strengthened from 4.1% in the second half of 2005 to 5.5% in the first quarter of 2006.

Figure IV.2  
**LATIN AMERICA: YEAR-ON-YEAR QUARTERLY GDP GROWTH RATES**  
 (Percentages calculated on the basis of figures in constant 2000 dollars)



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

<sup>2</sup> Year-on-year quarterly growth rates correspond to the rate of growth in one quarter compared to the same quarter a year earlier.

Figure IV.3  
**LATIN AMERICA (14 COUNTRIES): YEAR-ON-YEAR QUARTERLY GDP GROWTH RATES**  
*(Percentages calculated on the basis of figures in local currency at constant prices)*

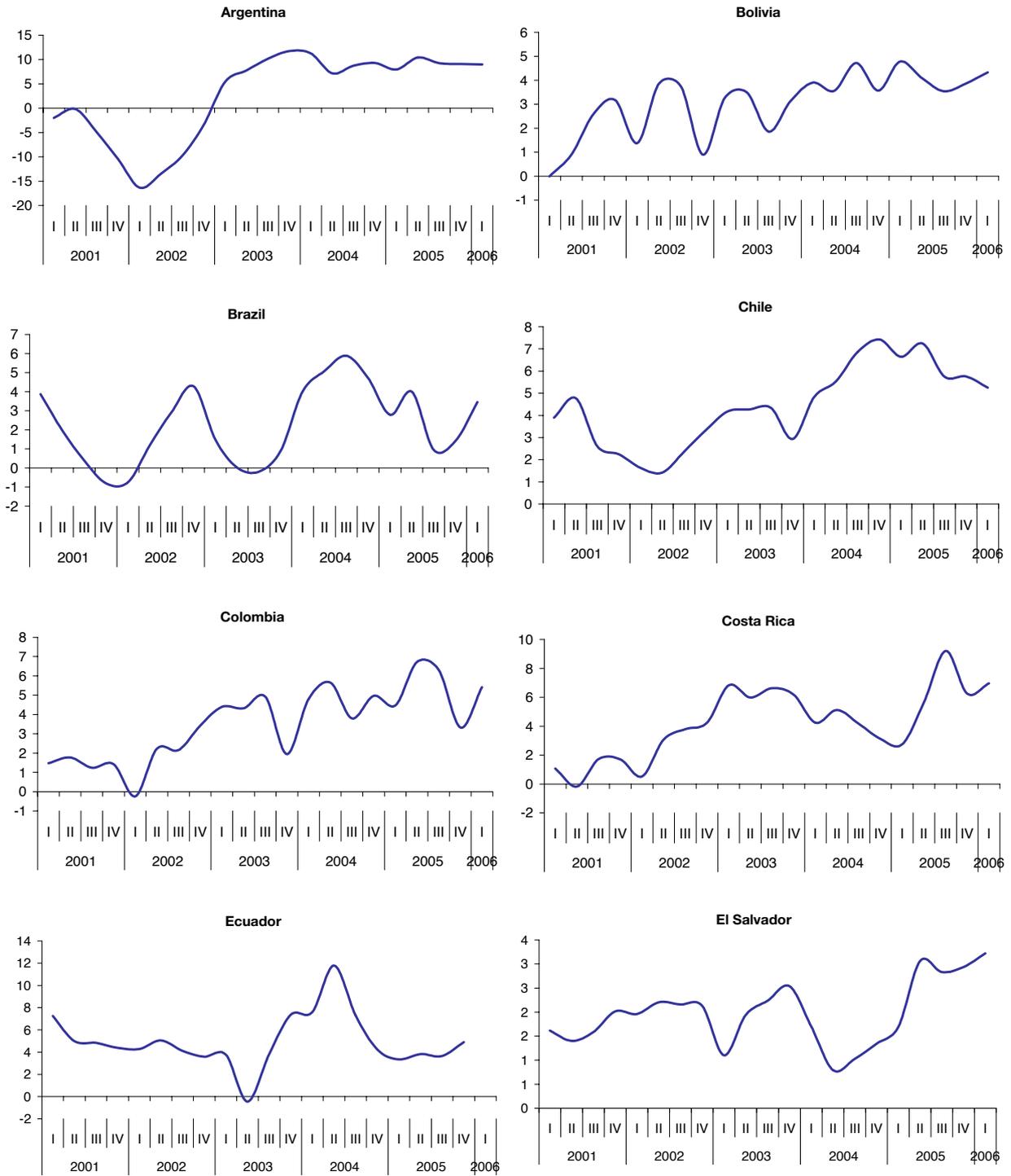
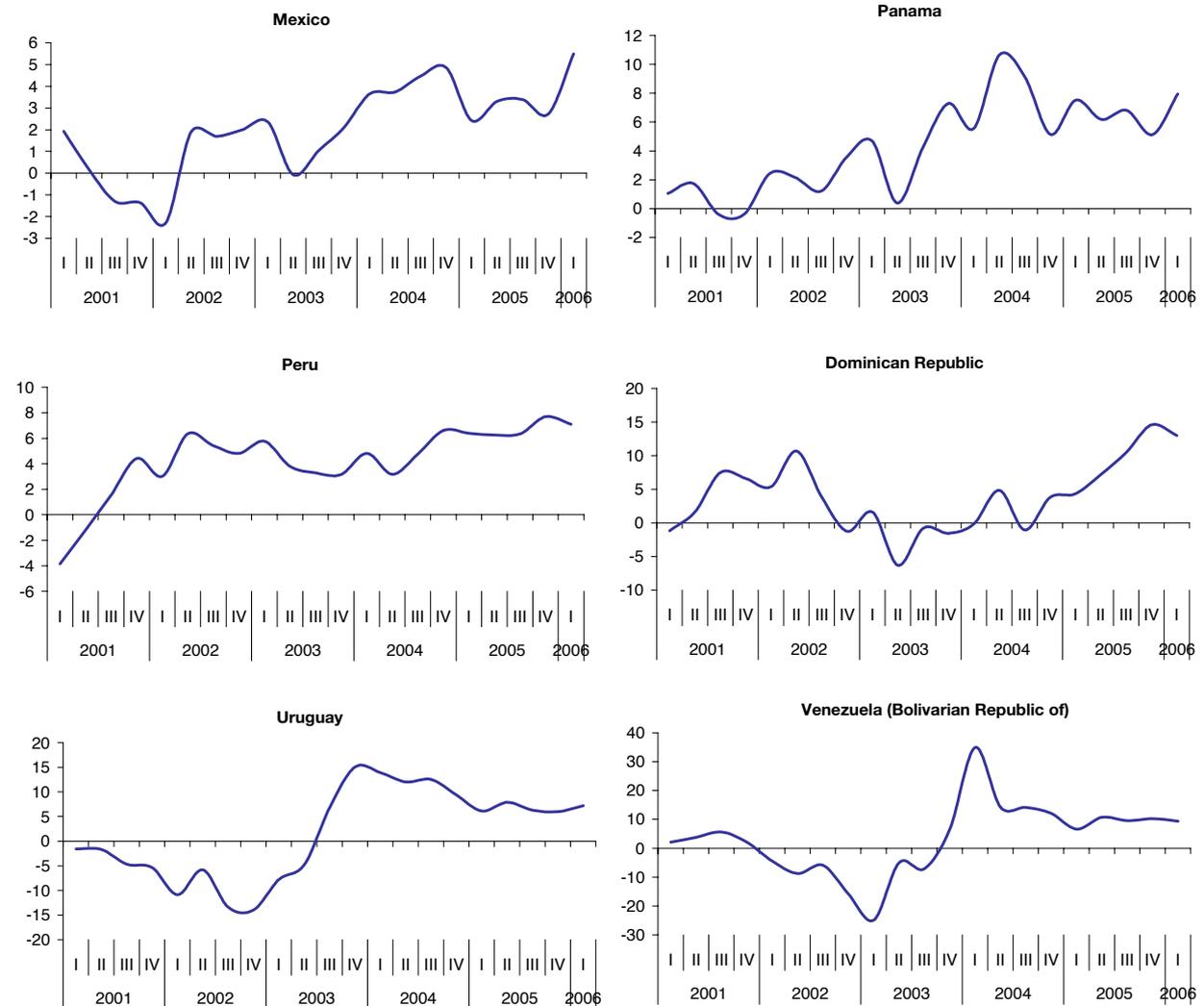


Figure IV.3 (concluded)



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

The comparison of seasonally adjusted regional GDP growth rates with those of the immediately preceding quarter shows that, despite upturns in a number of quarters, the pace of expansion in 2005 was generally slower than in 2004 (see figure IV.4). In the first quarter of 2006, the region as a whole grew by 1.4% relative to the fourth quarter of 2005, but this figure also mainly reflects the upswing in economic activity in Brazil and Mexico.

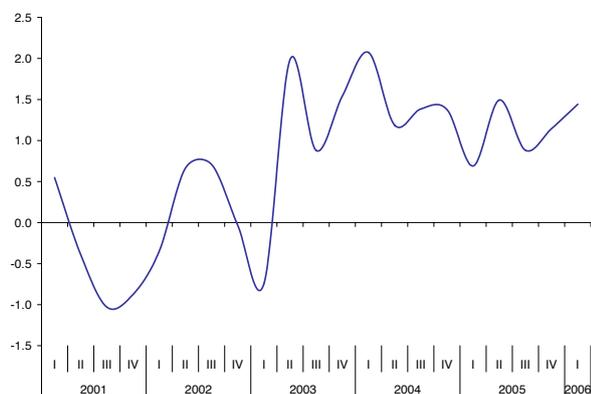
The positive trend displayed by the international economy since 2003 provided the backdrop for economic expansion in Latin American and Caribbean countries in 2005, boosting activities with links to the external sector, in particular. The region's exports of goods and services have been growing in volume since the fourth quarter of 2003, driven by burgeoning world demand.

This external stimulus, which was sustained throughout 2004, made it possible for the strong performance of the export sector to be transmitted to other activities. This in turn spurred domestic demand, triggering a recovery of investment and consumption and fuelling a considerable increase in import volumes.

The persistence of this favourable external climate, in conjunction with higher rates of capacity utilization in many sectors, low levels of investment following the sustained decline seen in 1999-2003, exchange-rate appreciation in relation to the levels posted in 2002-2003 and easier credit, all combined to drive the expansion of investment which had begun in 2004. At the same time, private consumption was encouraged by lower interest rates and the greater availability of credit, in conjunction with higher wages. In

Figure IV.4  
**LATIN AMERICA: SEASONALLY ADJUSTED QUARTERLY  
 GDP GROWTH RATES IN RELATION TO THE IMMEDIATELY  
 PRECEDING QUARTER**

(Percentages calculated on the basis of figures in constant 2000 dollars)



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

fact, although the other components of regional aggregate demand also expanded, total consumption was the only component in which growth in 2005 outstripped the 2004 figure. In 2005, regional export growth (8.4%) continued to outpace GDP, while the rise in imports (11.4%) reflected the buoyancy of domestic demand (5.1%).

The various sectors of economic activity reflected trends in the different components of expenditure. Stronger external demand continued to drive mining and hydrocarbon production (3.6%), although this sector underperformed regional GDP, except in Bolivia, Brazil, El Salvador, Haiti, Honduras, Paraguay and Peru. The strengthening of domestic demand also had favourable effects on manufacturing activity (3.2%), both in sectors serving the domestic market and in those where production is largely destined for exports within the region. Stronger domestic demand in the individual countries thus promoted an upturn in intraregional trade, particularly in manufactured products. Although bilateral exchange rates against the dollar fell in most countries throughout 2005, the real effective exchange rate remained favourable in many cases, thanks to the substantial devaluation of local currencies that occurred in 1999-2003. Moreover, in countries whose currencies are tied to the United States dollar (Ecuador, El Salvador and Panama), the depreciation of the dollar against other currencies in 2005 enhanced the competitiveness of their exports to some extent.

Activity in the agricultural sector grew by 2.2% regionally, although performances varied from country to country. While Mexico experienced a contraction, most countries recorded increases, although they were smaller than overall GDP growth rates, except in the cases of Argentina, Bolivia, Ecuador and El Salvador. The construction industry experienced robust growth (6.4% in regional terms) in most of the countries in 2005, and in Argentina and the Bolivarian Republic of Venezuela it posted rates of over 20%; this, in turn, fuelled an increase in gross fixed capital formation.

In general, services were more buoyant than sectors linked to goods production. Consumption growth stimulated commerce (which rebounded by 5.6% regionally), while expansion in the transport and communications sector (7.8% regionally) reflected activity in the goods-producing and communications sectors, particularly mobile telephony. Meanwhile, the performance of tourism-related activities, such as hotels and restaurants and transport, benefited from increasing tourist arrivals both from the region and elsewhere. The upswing in disposable income in several Latin American countries, in conjunction with local-currency appreciations and brisker economic activity generally, set the stage for an increase in recreational and business travel among the countries of the region. In 2005, the number of tourist arrivals climbed by 13.6% in Central America, by 12.7% in South America and by 5.4% in Caribbean countries.<sup>3</sup> Cruise line tourism was hurt by the hurricanes that battered that subregion, and the number of passengers shrank by about 2% on aggregate.<sup>4</sup>

One of the most notable aspects of the region's performance in the last two years has been the substantial increase in gross national disposable income, which rose by 5.9% and 7.1% at constant prices in 2005 and 2004, respectively. As figure IV.5 shows, this stronger income growth was common to most countries of the region and, apart from the Dominican Republic, Panama and Uruguay, the average annual increase in gross national disposable income surpassed GDP growth in all the countries in 2004-2005. This brisker pace of growth is basically explained by substantial gains from trade arising from the variation in the terms of trade, which amounted to 1.7% of GDP at 2000 prices (0.4% in 2004).<sup>5</sup>

Explanations for this larger increase in gross national disposable income vary from country to country (see figure IV.6). In some cases, it represents gains from trade arising from terms-of-trade movements, particularly in countries where the purchasing power of exports increased the most,

<sup>3</sup> World Tourism Organization (UNWTO), *World Tourism Barometer*, vol. 4, No. 1, January 2006.

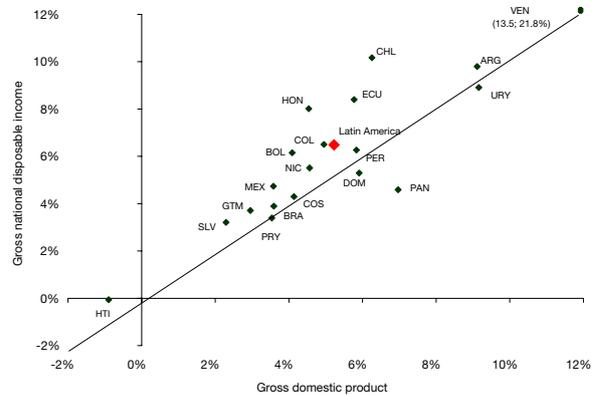
<sup>4</sup> See Caribbean Tourism Organization, *Caribbean Tourism Performance in 2005*, February 2006.

<sup>5</sup> See box I.1.

i.e. exporters of metals and minerals and hydrocarbons. In Argentina, the greater increase in disposable income stemmed from a reduction in factor payments, while in El Salvador, Haiti, Honduras and Nicaragua, it is attributable to an increase in current transfers received from abroad — mostly in the form of remittances from nationals of those countries living elsewhere.

As a result of this increase in gross national disposable income, the region recorded its highest level of national saving since 1990 (22.4% of GDP in current dollars). National saving rates have been rising steadily since 2002 (see figure IV.7), with considerable upswings being noted in several countries. The region also reported a higher negative external saving rate for the third straight year, equivalent to 1.5% of GDP in 2005 (up from 1.0% in 2004

Figure IV.5  
**LATIN AMERICA: GDP AND GROSS NATIONAL DISPOSABLE INCOME, 2004-2005, AVERAGE ANNUAL GROWTH RATES FOR THE BIENNIUM**  
(Percentages calculated on the basis of figures in constant 2000 dollars)



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

#### Box IV.1

##### THE CRICKET WORLD CUP AND ITS EXPECTED EFFECT ON ECONOMIC ACTIVITY IN ENGLISH-SPEAKING CARIBBEAN COUNTRIES

In 2007 the cricket world cup will be held in the English-speaking Caribbean for the first time since the tournament began in 1975. Nine countries will combine to host the event: Antigua and Barbuda, Barbados, Grenada, Guyana, Jamaica, Saint Lucia, Saint Kitts and Nevis, Saint Vincent and the Grenadines, and Trinidad and Tobago. The opening match is scheduled to take place in Jamaica on 11 March, and the final will be held in Barbados. Antigua and Barbuda and Jamaica will host six of the eight most important games in this tournament.

This event is expected to have a considerable effect on the economies involved. The construction sector has grown vigorously on the back of renovation and rebuilding works at cricket grounds, together with an expansion and upgrading of tourism infrastructure, which has promoted physical investment in these countries. The tournament is also expected to boost expenditure and tourism.

Fiscal accounts are also likely to be significantly affected in the countries involved, since much of the construction work will be undertaken by government agencies and will thus entail increased

public investment. Governments have also awarded concessions with a view to attracting investment; in some cases this has spurred private investment as concession holders brought their investment projects forward.

In addition to the preparatory work, the event itself will have major repercussions on the external accounts of the countries involved. Movements on the current account of the balance of payments are expected to run in both directions. On the one hand, a significant increase in tourist flows to the region is expected, with a consequent upswing in income from travel operations. On the other hand, there is likely to be a substantial rise in merchandise imports owing to purchases of construction materials from other countries. Long-term capital inflows into the country, both official and private, are also likely to climb substantially.

Given the size of their economies, the greatest economic impact will probably be felt by members of the Organization of Eastern Caribbean States (OECS). According to preliminary calculations, preparations for the tournament in this

group of countries will involve expenditure amounting to 10% of their GDP (US\$ 1 billion). Calculations suggest that grants received by Antigua and Barbuda for the reconstruction and renovation of cricket grounds will raise capital transfers to the country from 2.4% of GDP in 2004 to 24.4% in 2005. In the case of Jamaica, official forecasts put the additional Government expenditure at 1.2% of GDP.

One of the aims of the authorities in these countries is to obtain permanent benefits from these investments, and world cup marketing strategies are being designed and fine-tuned for this purpose. Another aim is to capitalize upon the resulting international exposure to promote these countries widely as tourist destinations.

Staging this event poses major challenges for the tourism sector. First, there needs to be a guarantee that the planned expansion of hotel capacity will actually be ready by the time of the tournament; second, national authorities and a number of Caribbean hotel associations are debating the question of hotel price levels. The rise in airfares could also dampen the expected surge in tourism flows.

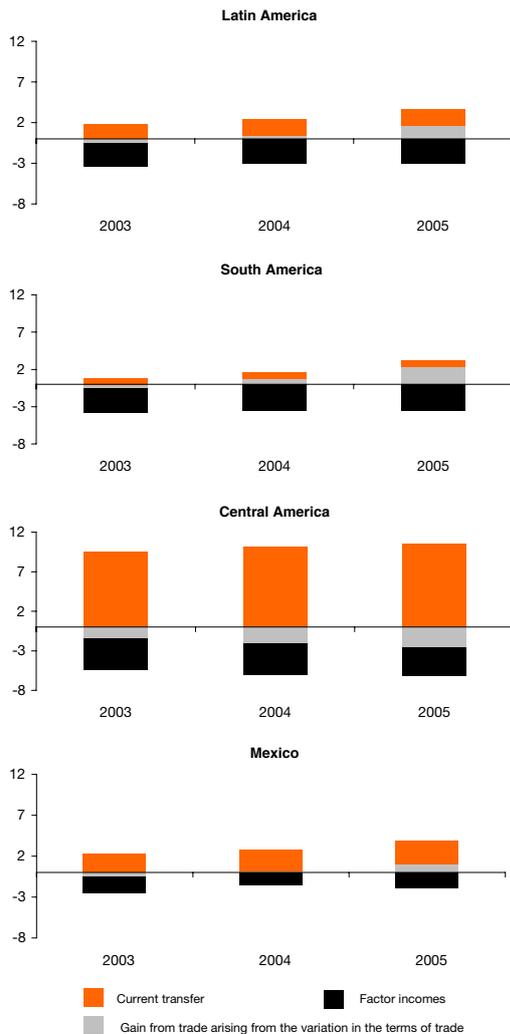
<sup>a</sup> The cricket world cup is held every four years. The first was staged in England; the most recent was held jointly in South Africa, Zimbabwe and Kenya in 2003.

and 0.5% in 2003), thanks to trade surpluses and the large volume of current transfers. As a result, and repeating the pattern of the last two years, regional investment was entirely financed out of national saving, while the surplus (external saving) was used to repay debt, build up assets abroad and accumulate reserves. At the subregional level, this pattern was particularly clear in South American countries, whereas external saving continued to play a major role in financing gross domestic investment in Central American countries and Mexico.

Although economic activity was brisk throughout most of the region, it was particularly so in the South American countries (see table IV.2). As mentioned above, the positive

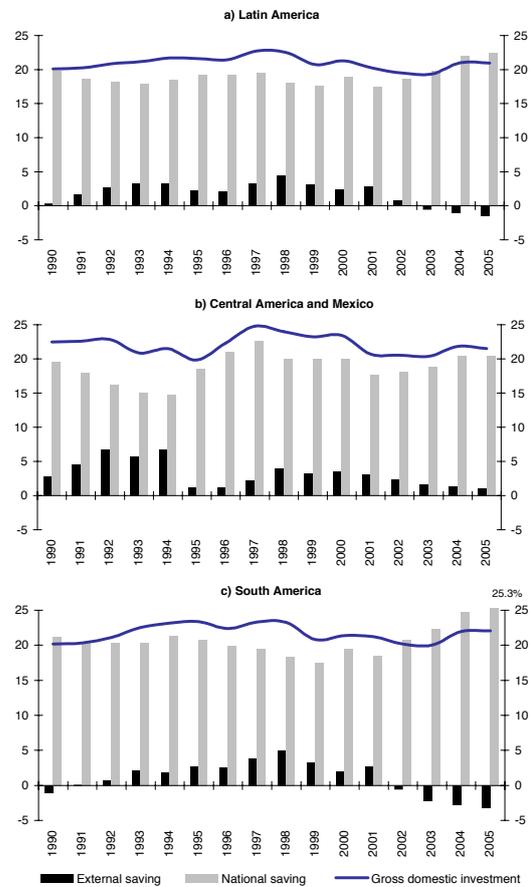
results posted in 2004-2005 partially represented a recovery from the 1999-2003 recession, and this was especially true in that subregion. In the Southern Cone countries, all components of expenditure had declined during that period except for the volume of goods and services exports. This was not the case in the Andean countries, however, where exports declined along with investment and imports, while consumption rose slightly. In the Southern Cone, import volumes decreased more sharply (5.5% per year on average), and both subregions experienced similar reductions in investment (annual averages of 6.5% and 6.4%, respectively). In Brazil, these aggregates behaved in much the same way as they did in the Southern Cone, albeit on a smaller scale: average annual total consumption grew very slowly, investment declined, and the stalling of domestic demand was reflected in a reduction in the volume of goods and services imports.

Figure IV.6  
**LATIN AMERICA: COMPONENTS OF GROSS NATIONAL DISPOSABLE INCOME**  
*(Dollars (year 2000) and, percentages of GDP)*



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

Figure IV.7  
**LATIN AMERICA: SAVING-INVESTMENT RATIO**  
*(Percentages of GDP in dollars at current prices)*



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

Box IV.2  
**INVESTMENT AND GROWTH**

Latin America's modest recovery after a period of stabilization and reforms following the 1980s debt crisis has sparked additional interest in the factors that contribute to economic growth in the region and, in particular, the role of investment as a source of economic growth. With a backdrop provided by liberalization of the region's economies in the 1990s and early 2000s, growth and investment staged a modest recovery from their 1980s slump. Rates of growth have not yet regained the levels of the 1960s and 1970s, however, and are lagging behind those of other emerging economies.

The role of investment in the economic growth process is a key issue both in growth theory and in policy formulation. This lends added importance to the criteria used in deciding whether to employ large-scale investment programmes as a mechanism for boosting the growth rate, along with considerations regarding the role played by productivity, the definition of areas to be given preference, and the policies to be implemented.

Economists continue to disagree about the role of investment in the growth process. Some see it as the key explanatory factor for economic growth, while others acknowledge the important part played by fixed investment but argue that productivity is what marks the difference between fast and slow growth. Still others focus on specific categories of fixed investment.

Data for the six largest Latin American countries (Argentina, Bolivarian Republic of Venezuela, Brazil, Chile, Colombia and Mexico) shed some light on this issue. Investment growth in 1960-2002 was examined from three different perspectives. First, growth-accounting methodologies were used to measure the contributions made by the sources of GDP growth (capital, labour and total factor productivity) in the six countries during the period under study. Then the effects of investments in machinery and equipment and in construction were estimated. The third step was to prepare estimates for the effects of private and public investment on per capita GDP growth in those countries.

The findings indicate that investment has played an important role in the six largest Latin American countries, but that total factor productivity has made the difference between faster and slower growth experiences. When additional elements are factored into the traditional growth-accounting methodology —physical capital series adjusted for utilization rates, physical capital expressed in terms of GDP and a breakdown of the labour factor between its physical and human capital components— no evidence was found on the role of total factor productivity in promoting economic growth that would alter the conclusions reported in other growth-accounting studies.

Evidence was also found that physical investment had a significant effect on the growth of per capita GDP. Differences in the economic policies applied in the various countries were also important factors in explaining different economic growth rates, including policies relating to inflation control, external debt, open trade practices and education. In the case of physical investment, investment in machinery and equipment made the largest contribution to per capita GDP growth.

The study also found that, although secondary education was an important contributor to per capita GDP growth in the 1960s and 1970s, its role has tended to decline since then, partly because the coverage of secondary education has increased. The evidence suggests that education policies need to incorporate new ways to expand the human capital stock, mainly through efforts to improve the quality of training and dynamic adoption of new technologies. Moreover, analysis of the effect of the public and private components of investment on per capita GDP growth shows that the private component has been the more important.

Lastly, the evidence also indicates that there is a relationship of mutual causality between growth and private investment and that stable macro-economic conditions, particularly in terms of prices, are a prerequisite for applying countercyclical public investment policies.

**Source:** Mario A. Gutiérrez, "Economic growth in Latin America: The role of investment and other growth sources", *Macroeconomía del desarrollo series*, No. 36 (LC/L.2341-P/I), Santiago, Chile, Economic Commission for Latin America and the Caribbean (ECLAC), June 2005. United Nations publication, Sales No. E.05.II.G.84.

In Southern Cone countries, the depreciations of 2002 boosted export earnings in local-currency terms, restored the profitability of goods-producing sectors and fostered greater export competitiveness. This, together with the presence of idle capacity in a number of production sectors, stronger external demand and rising prices for the raw materials exported by these countries, made it possible to re-energize economic activity. The revival was

due firstly to the expansion of goods and services exports, in some cases accompanied by import substitution, and secondly to a growth spurt in other sectors of the economy. This fuelled a substantial recovery of domestic demand that was linked to consumption growth and the upturn in investment.

In the Andean countries, the adjustment of domestic demand was significantly smaller in 1999-2003, since

Table IV.2  
**LATIN AMERICA: COMPONENTS OF AGGREGATE SUPPLY AND DEMAND,  
 AVERAGE ANNUAL GROWTH RATES<sup>a</sup>**

(Percentages calculated on the basis of figures in constant 2000)

	Total consumption				Gross capital formation				Exports of goods and services				Imports of goods and services			
	1990-1994	1995-1998	1999-2003	2004-2005	1990-1994	1995-1998	1999-2003	2004-2005	1990-1994	1995-1998	1999-2003	2004-2005	1990-1994	1995-1998	1999-2003	2004-2005
Central America	4.8	5.1	3.5	4.3	10.9	9.2	-0.1	3.9	9.2	7.5	2.0	7.1	8.3	9.6	1.9	6.9
South America	4.6	3.3	-0.3	5.1	8.6	6.1	-2.8	13.3	6.9	6.7	4.2	12.1	18.2	10.2	-4.1	19.2
Andean countries	3.5	2.6	0.9	8.1	11.1	6.3	-7.0	26.5	6.2	6.4	-0.5	9.7	14.2	7.8	-2.8	24.0
Southern Cone	8.8	3.8	-1.8	7.9	18.9	6.0	-6.9	20.1	7.1	10.2	3.0	11.5	26.1	9.9	-5.5	22.4
Brazil	2.6	3.2	0.1	1.9	3.6	4.5	1.4	6.1	7.0	3.4	9.9	13.9	15.4	12.8	-3.8	11.9
Mexico	3.7	0.9	3.4	4.1	8.1	3.1	1.2	3.5	8.8	17.7	5.5	8.0	14.2	10.6	6.8	10.1
<b>Latin America</b>	<b>4.3</b>	<b>2.7</b>	<b>1.0</b>	<b>4.8</b>	<b>8.7</b>	<b>4.9</b>	<b>-1.5</b>	<b>10.0</b>	<b>7.6</b>	<b>10.4</b>	<b>4.5</b>	<b>9.9</b>	<b>15.3</b>	<b>10.3</b>	<b>1.0</b>	<b>13.5</b>

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

<sup>a</sup> The Andean countries are Bolivia, the Bolivarian Republic of Venezuela, Colombia, Ecuador and Peru; the Southern Cone comprises Argentina, Chile, Paraguay and Uruguay; and Central America consists of Costa Rica, the Dominican Republic, El Salvador, Guatemala, Haiti, Honduras, Nicaragua and Panama.

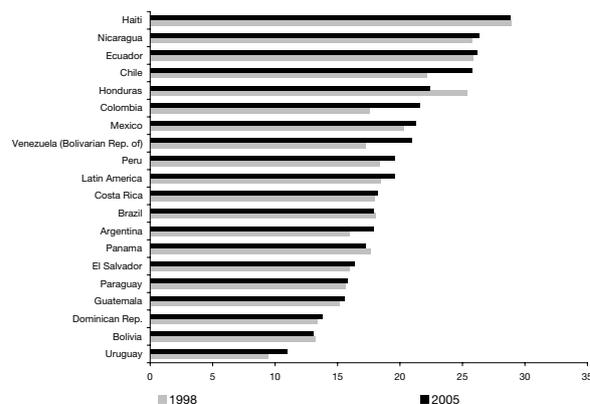
global consumption continued to expand. The reduction in average annual exports from these countries reflected the drop in volumes exported by the Bolivarian Republic of Venezuela. The exports of goods and services by the other countries in this subregion, measured at constant prices, climbed by 3.8% in the period. The Andean countries also witnessed the largest increase in national income relative to GDP, which fuelled a sharp upswing in domestic demand and especially in investment. The comparison between these two groups of countries shows that while economic growth in the Southern Cone in 2004-2005 initially responded to an expansion of export volumes, growth in the Andean countries reflects a stronger upturn in domestic demand, particularly for investment, which has been financed by the substantial rise in disposable income in these countries. Although this phenomenon was also seen in the Southern Cone, it was more pronounced among the Andean countries. Nonetheless, in some countries, particularly those that experienced sharp decreases in economic activity in earlier years, former levels of investment and imports have yet to be fully regained.

In the Central American countries and Mexico, although consumption, investment, exports and imports all grew more vigorously in 2004-2005, growth figures were similar to those achieved in other periods of expansion. Export performance has been closely linked to the business cycle in the United States, but has also been affected by the growing competitiveness of Asian countries, especially China, as exporters of manufactured products to the United States market. At the same time, the subregion's currencies have undergone real appreciations, which has eroded the competitiveness of their exports of manufactures to the United States and limited their growth. The trend of

domestic demand has been associated with a sustained increase in remittances from nationals living abroad.

As shown in table IV.2, gross domestic investment, measured in constant 2000 dollars, was one of the most dynamic components of demand in 2004-2005. In fact, gross fixed capital formation is the component with the highest annual average growth rate during this period, at 11.7%, compared to a figure of 9.9% for goods and services exports. Nonetheless, while the region's gross fixed capital formation in 2005 surpassed the 1998 figure (the highest level since 1990) in absolute terms, it is still below that year's value in relation to GDP (see figure IV.8). This overall result was reflected in the national figures for most countries in the region.

Figure IV.8  
**LATIN AMERICA: GROSS FIXED CAPITAL FORMATION**  
 (Percentages of GDP, in constant 2000 dollars)



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

As noted above, several factors have been fuelling robust investment growth in 2004-2005. In the first place, investment had been lagging behind other sectors of demand as a result of its persistent decline in 1999-2003, so the sharp increase represented a recovery of previous levels. Second, following the depreciations of 1999-2003, which had significantly raised the local-currency prices of imported capital goods, local currencies have now been appreciating sharply against the dollar. A third factor has been the increased buoyancy of external demand in 2004-2005. In 1999-2003, and particularly in 2001-2003, external demand was weak owing to the sluggish growth of European countries, recession in the United States in 2001, and low levels of demand among Latin American countries, which also hurt trade within the region. The slump in external demand was also reflected in low international commodity prices, which dampened export earnings.

In the second half of 2003 these trends began to reverse direction: commodity prices rose sharply, external demand for raw materials strengthened substantially and there was synchronized growth among the developed economies internationally. In addition, interest rates remained low in 2004-2005, both in the region and internationally, despite hikes in several countries, particularly in the second half of 2005. This, combined with easier credit both in individual countries and internationally, buttressed an increase in gross fixed investment (see table IV.3).

Another factor had to do with the increase in national savings rates during this biennium, which reversed the trend of 1999-2003, albeit to varying extents across countries. In current dollars and as a percentage of GDP, national saving declined gradually from 19.5% in 1998 to

17.5% in 2001. This reduction was not offset by greater external saving, which dropped from 4.5% of GDP in 1998 to 0.8% in 2002 and turned negative thereafter, leading to a reduction in regional investment. In 2004-2005, the growth of national income in the region and the lagged recovery of consumption led to a significant increase in national saving. This was also true for the South American countries and, to a lesser extent, for the Central American countries and Mexico. The increase in national saving at a time when capital goods prices on international markets remained flat significantly boosted the purchasing power of the former in terms of imported capital goods, with the size of the rise in each country depending on how much the savings rate had climbed (see figure IV.9).<sup>6</sup>

In 2004-2005, investment in construction and in machinery and equipment, particularly imported items, expanded. Construction-related investment was particularly dynamic, especially in view of its low previous levels, while fixed investment in durable equipment also increased considerably. In 1999-2003, both categories had declined, although machinery and equipment by relatively less. As a result, the latter's share of investment has been rising over time in most countries and now accounts for roughly 40% of total gross fixed capital formation.<sup>7</sup>

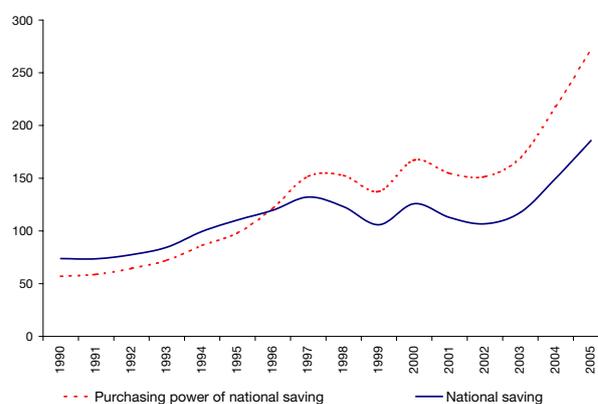
The available data indicate that the import content of gross fixed capital formation in machinery and equipment

Table IV.3  
**LATIN AMERICA: COMPONENTS OF GROSS DOMESTIC INVESTMENT, AVERAGE ANNUAL RATE OF VARIATION**  
(Percentages calculated on the basis of figures in constant 2000 dollars)

	1990-1994	1995-1998	1999-2003	2004-2005
Gross capital formation	8.7	4.9	-1.5	10.0
Gross fixed capital formation	7.8	4.1	-2.2	11.7
Construction	7.1	3.2	-2.6	9.0
Machinery and equipment	9.0	5.6	-1.6	15.6

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

Figure IV.9  
**LATIN AMERICA: NATIONAL SAVING IN CURRENT DOLLARS AND ITS PURCHASING POWER IN TERMS OF IMPORTED CAPITAL GOODS<sup>a</sup>**  
(Series expressed in indices: 1995=100)



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

<sup>a</sup> Calculated on the basis of the index of capital goods import prices, base year 2000.

<sup>6</sup> The unitary value index of capital goods imports from the United States was used as a proxy for an index of the international prices of capital goods, since that country imports a very wide range of products from several regions of the world. Measured by this index, the international prices of capital goods have been steadily falling over the last few years.

<sup>7</sup> This percentage varies across countries and from year to year.

expanded until 1997-1998, before giving ground to goods of national origin.<sup>8</sup> Then, in 2004-2005, the import component of investment in machinery and equipment rebounded to 90% of total investment in that category in Chile, nearly 70% in Guatemala, about 60% in Mexico and Peru, slightly over 50% in Argentina (after having dropped to 30%) and around 30% in Brazil.

Another important issue concerns the destination sectors of imported machinery and equipment. From 1998 to 2000 (2002 in many countries), capital goods imports declined, before staging a recovery in the region from 2003 onward thanks to the increase in gross fixed capital formation recorded in that year. An analysis of imports by type of product shows that most countries registered significant increases in imports of transport equipment, electrical material (except in Uruguay), machinery for the mining sector in some of the countries with significant activity in this sector, and equipment for the communications sector.<sup>9</sup> In those where agricultural

exports provide a large component of foreign sales, there was also an increase in imports of agricultural machinery. Foreign purchases of power-generating machinery and equipment rose more slowly, with very few exceptions, and in some countries actually declined.<sup>10</sup> The aggregate data available for 2005 also reveal a sizeable increase in capital goods imports and the persistence of trends noted in 2003 and 2004 in terms of the destination sectors of imported machinery and equipment.

Few of the region's countries publish up-to-date national accounts series giving a breakdown of the public and private components of investment. Nonetheless, the available data suggest that public investment has generally been maintained at around 20% of gross fixed investment,<sup>11</sup> except in Bolivia and Chile. In Bolivia, public investment slumped from 60% in the early 1990s to 23% in 1998 before rising again to 47% in 2004; in Chile public investment accounts for roughly 10% of total gross fixed investment.

## B. Domestic prices

Latin America and the Caribbean recorded a weighted average inflation rate of 6.1% in 2005, compared to 7.4% a year earlier, and the downward regional trend of this indicator thus continued. The simple average of the individual countries' inflation rates was 7.3%, compared to 8.6% in 2004.

The results for 2005 reflect the trend in inflation rates in Brazil and Mexico, which declined from 7.6% and 5.2% in 2004, respectively, to 5.7% and 3.3% in 2005. Steeper reductions were achieved in Haiti (from 20.2% in 2004 to 14.8% in 2005), Peru (from 3.5% to 1.5%), Dominican Republic (from 28.7% to 7.4%), Uruguay (from 7.6% to 4.9%) and the Bolivarian Republic of Venezuela (from 19.2% to 14.4%), whereas Argentina, Chile, Ecuador, Paraguay, and Trinidad and Tobago recorded the largest increases. Inflation rates in the other countries of the region

were similar to those reported in 2004. Although several countries posted double-digit increases in the consumer price index (CPI), for the first time there was no rate above 16% — the year's highest being the 14.8% registered in Haiti. Inflation in English- and Dutch-speaking Caribbean countries rose in 2005, with the simple average climbing to 6.6% in 2005, compared to 4.3% in 2004.

The trends that had been emerging in the second half of 2004 persisted throughout 2005. Cost-push factors displayed mixed trends, as illustrated by the prices of imported products. The international prices of metals and minerals and of oil and other fuels all increased sharply, even surpassing the already-high rates recorded in 2004, but the upward trend of international prices for foods and agricultural raw materials eased overall and in some cases actually reversed direction, although coffee and sugar

<sup>8</sup> The available data are published by the following countries: Argentina, Brazil, Chile, Guatemala, Mexico and Peru.

<sup>9</sup> An analysis was made of data held in the ECLAC Foreign Trade Data Bank for Latin America and the Caribbean (BADECEL), in accordance with the Standard International Trade Classification SITC Rev. 3, Section 7, "Machinery and transport equipment". The following groups were excluded from this section: 781, "motor cars and other motor vehicles principally designed for the transport of persons (other than motor vehicles of the type used for public transport), including station wagons and racing cars"; and 784, "parts and accessories of motor vehicles," since these correspond more to consumer durables or intermediate goods. Data are available up to 2004. For 2005, the analysis was based on the trade statistics published by individual countries.

<sup>10</sup> Corresponding to SITC Rev. 3, Division 71.

<sup>11</sup> The percentages refer to the official national accounts series published by the individual countries, at constant prices.

prices were considerably higher in 2005 than in 2004. The prices of manufactured goods on international markets did not vary markedly during the year. Lastly, trends in real wages and salaries were also mixed: Argentina, Chile and Uruguay saw the largest increases, while real wages and salaries in other countries either were broadly unchanged or else slipped back slightly.

Consumer demand benefited from the increase in real wages and salaries in certain countries, as well as

from stronger labour-market indicators and greater access to inexpensive credit. This enabled several countries to make upward adjustments in the prices of some services (e.g., health and education) and in products whose prices respond readily to increases in demand, such as clothing and footwear and household equipment.

In this setting, performances varied from country to country (see table IV); some countries witnessed a sharp reduction in inflation rates relative to their cumulative

Table IV.4  
**LATIN AMERICA AND THE CARIBBEAN: CONSUMER PRICE INDEX, 2004, 2005 AND 2006**  
(Percentage rates of variation)

	Cumulative inflation for the year		Cumulative inflation for the period		Cumulative 12-months inflation in May each year	
	2004	2005	2005	2006	2005	2006
	December 2003- December 2004	December 2004- December 2005	December 2004- May 2005	December 2005- May 2006	May 2004- May 2005	May 2005- May 2006
Argentina	6.1	12.3	5.2	4.4	8.6	11.5
Bolivia	4.6	4.9	1.2	1.4	5.3	4.3
Brazil	7.6	5.7	2.7	1.8	8.1	4.6
Chile	2.4	3.7	1.4	1.5	2.7	3.7
Colombia	5.5	4.9	3.5	2.7	5.0	4.0
Costa Rica	13.1	14.1	6.4	4.3	14.5	11.9
Ecuador	1.9	3.1	1.8	1.9	1.8	3.1
El Salvador	5.3	4.3	2.1	2.2	4.4	4.2
Guatemala	9.2	8.6	3.2	2.8	8.9	7.5
Haiti	20.2	14.8	4.8	5.9	12.6	14.1
Honduras	9.2	7.8	3.7	2.5	9.4	5.8
Mexico	5.2	3.3	1.1	0.6	4.6	3.2
Nicaragua	8.9	9.7	5.0	6.9	9.6	11.3
Panama	1.5	3.4	1.9	1.3	3.3	3.3
Paraguay	2.8	9.9	5.2	4.2	7.2	8.7
Peru	3.5	1.5	0.8	1.5	1.8	2.2
Dominican Republic	28.7	7.4	1.1	2.7	3.9	8.6
Uruguay	7.6	4.9	0.8	1.5	1.8	2.2
Venezuela (Bolivarian Rep. of)	19.2	14.4	7.4	3.6	17.4	10.4
Antigua and Barbuda	2.8	2.5	...	...	...	...
Bahamas	2.1	1.8	...	...	...	...
Barbados	4.3	7.4	-0.3	0.7 <sup>a</sup>	4.1	8.5 <sup>a</sup>
Belize	2.8	3.7	...	...	...	...
Dominica	0.8	2.7	...	...	...	...
Grenada	2.5	5.9	...	...	...	...
Guyana	5.5	8.2	...	...	...	...
Jamaica	13.7	12.9	3.4	1.3	14.9	10.6
Saint Kitts and Nevis	1.7	7.2	...	...	...	...
Saint Vincent and the Grenadines	1.7	3.9	1.2	0.7 <sup>a</sup>	1.7	3.4 <sup>a</sup>
Saint Lucia	3.5	6.7	...	...	...	...
Suriname	9.3	15.8	1.2	-0.4 <sup>b</sup>	7.2	14.0 <sup>b</sup>
Trinidad and Tobago	5.6	7.2	2.5	2.2 <sup>b</sup>	7.0	6.9 <sup>b</sup>
<b>Latin America and the Caribbean (weighted average)</b>	<b>7.4</b>	<b>6.2</b>	<b>2.8</b>	<b>2.0</b>	<b>7.0</b>	<b>5.4</b>
Latin America (unweighted average)	8.6	7.3	3.1	2.8	6.9	6.6
Caribbean (unweighted average)	4.3	6.6	1.6	0.9	7.0	8.7
Latin America and the Caribbean (unweighted average)	6.8	7.0	2.8	2.4	6.9	7.0

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

<sup>a</sup> January 2006 in relation to December 2005.

<sup>b</sup> April 2006 in relation to December 2005.

values in 2004, whereas others posted increases. The latter stemmed from price hikes in response to stronger domestic demand, adjustments in the prices of regulated goods and services, and prices increases for food products, transport and basic services. The appreciation of various countries' currencies mitigated the higher prices of imported products to some extent (see table IV.5). Against this backdrop, the authorities of most of the region's countries continued to base their monetary policies on inflation targeting and the avoidance of sharp increases in consumer price indices.

The price indices for product groups consisting mainly of goods and those composed primarily of services also displayed varied trends.<sup>12</sup> Goods prices fuelled inflation in 2005 in one group of countries, while the prices of services climbed more sharply in another. The first group includes Argentina, Bolivia, the Bolivarian Republic of Venezuela, Colombia, Ecuador, Paraguay and Uruguay, along with the Central American countries; the second

group consists of Brazil, Chile, the Dominican Republic, Mexico and Peru.

In Brazil, the reduction in the general inflation rate in 2005 was largely due to a sharp slowdown in the goods category owing to lower food prices in the third quarter of the year. In Mexico, the annual rate reflects a reduction in food prices in the second half of the year and a downturn in the price of housing services. The decrease in electricity prices in the third quarter of the year resulted in a smaller rise in administered prices, but this trend began to reverse itself in the last few months of 2005. In the Dominican Republic, a sharp exchange-rate appreciation tempered price increases for imports and food products. In Chile, despite the larger relative increase in services prices, goods prices also rose, unlike what happened in 2003 and 2004, thereby contributing to the higher inflation rate in 2005.

Although domestic demand, particularly private consumption, was quite buoyant in 2005 in several countries, it was not so strong as to generate major increases in consumer prices, and core inflation was therefore below the general rate except in Brazil and Uruguay.<sup>13</sup>

In the first five months of 2006, some of the trends seen in 2005 have continued, while others have changed. Apart from manufactures, the prices of imported goods have generally increased: food products on international markets have displayed uneven trends, while the prices of agricultural raw materials are rising and the prices of metals and minerals and of oil and fuel products have continued to climb sharply. On foreign currency markets, the appreciation of bilateral exchange rates against the dollar seen in 2005 has intensified in some countries, while in others the local currency has depreciated. Real salaries and wages in the first quarter of 2006 were higher than a year earlier.

Thus, over the 12 months to May 2006, inflation rates eased in some countries relative to cumulative figures as of May 2005, but other countries recorded increases. The latter represented price corrections resulting from the expansion of private consumption, adjustments in regulated prices and higher food prices. Core inflation rose more sharply in the initial months of the year in regional terms, reflecting price increases for education and health services, basic services, and clothing and household equipment in response to the upturn in private consumption (see figures IV.10 and IV.11).

Table IV.5

**LATIN AMERICA AND THE CARIBBEAN: NOMINAL EXCHANGE RATE, LOCAL CURRENCY PER UNITED STATES DOLLAR, 2004, 2005 AND 2006**  
(Percentage rates of variation)

	2004 <sup>a</sup>	2005 <sup>a</sup>	2006 <sup>b</sup>
Argentina	1.9	1.8	1.8
Bolivia	2.8	-0.1	-0.4
Brazil	-8.1	-11.8	-1.7
Chile	-6.6	-8.1	3.3
Colombia	-13.3	-5.3	8.4
Costa Rica	9.6	8.3	2.7
Ecuador	0.0	0.0	0.0
El Salvador	0.0	0.0	0.0
Guatemala	-3.6	-1.8	-0.2
Haiti	-11.5	15.5	-4.4
Honduras	5.0	1.4	0.0
Mexico	0.3	-4.3	3.3
Nicaragua	5.0	5.0	2.0
Panama	0.0	0.0	0.0
Paraguay	2.2	-2.1	-5.6
Peru	-5.2	4.5	-4.0
Dominican Republic	-16.5	12.1	-4.9
Uruguay	-10.1	-8.5	-1.7
Venezuela (Bolivarian Rep. of)	20.0	11.9	0.0
Antigua and Barbuda	0.0	0.0	0.0
Bahamas	0.0	0.0	0.0
Barbados	0.0	0.0	0.0
Belize	0.0	0.0	0.0
Dominica	0.0	0.0	0.0
Grenada	0.0	0.0	0.0
Guyana	2.8	0.3	-0.1
Jamaica	20.7	2.0	1.9
Saint Kitts and Nevis	0.0	0.0	0.0
Saint Lucia	0.0	0.0	0.0
Saint Vincent and the Grenadines	0.0	0.0	0.0
Suriname	3.4	0.9	0.2
Trinidad and Tobago	0.0	0.2	-0.1

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

<sup>a</sup> December each year in relation to December of the previous year.

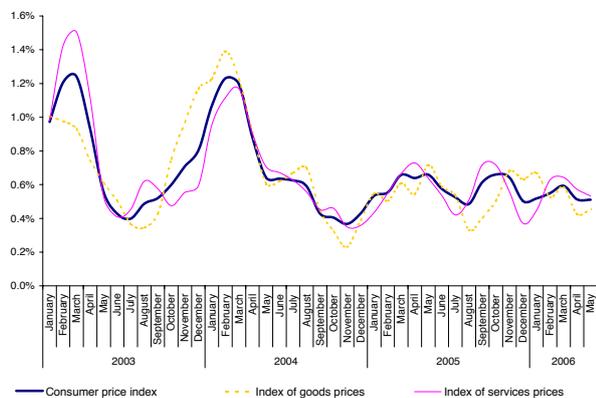
<sup>b</sup> May 2006 in relation to December 2005.

<sup>c</sup> April 2006 in relation to December 2005.

<sup>12</sup> These indices were calculated using the same procedure for all the countries, which involved grouping food and beverages, clothing and footwear, and household equipment within the goods index and placing those relating to transport services, housing and education, culture and recreation, and health services within the services index. The indices are constructed on the basis of the groups of goods and services included in the product baskets used in the consumer price index for each of the region's countries.

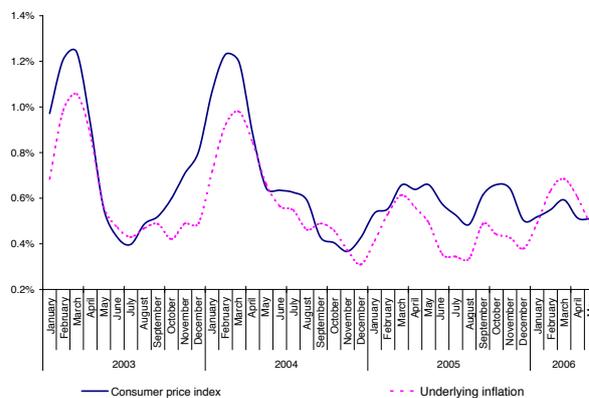
<sup>13</sup> A common methodology was used to calculate the core inflation rate which excludes fuels, fuel products and perishable food products from the consumer price index.

Figure IV.10  
LATIN AMERICA: VARIATION IN CONSUMER, GOODS AND SERVICES PRICE INDICES  
(Three-month unweighted moving average)



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

Figure IV.11  
LATIN AMERICA: VARIATION IN THE CONSUMER PRICE INDEX AND THE CORE INFLATION INDEX  
(Three-month unweighted moving average)



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

Table IV.6  
LATIN AMERICA AND THE CARIBBEAN: WHOLESAL PRICE INDEX, 2004, 2005 AND 2006

	Cumulative inflation for the year		Cumulative inflation for the period		Cumulative 12-months inflation in May each year	
	2004	2005	2005	2006	2005	2006
	December 2003-December 2004	December 2004-December 2005	December 2004-May 2005	December 2005-May 2006	May 2004-May 2005	May 2005-May 2006
Argentina	7.9	10.7	3.5	3.3	7.7	10.6
Bolivia	...	...	...	...	...	...
Brazil	14.7	-1.0	0.9	0.2	8.5	-1.7
Chile	7.8	3.2	4.3	8.9	4.5	7.7
Colombia	4.6	2.1	2.4	4.4	3.0	4.0
Costa Rica	17.7	12.1	5.2	5.8	12.9	12.8
Ecuador	4.3	2.3	10.5	16.0	1.9	27.4
El Salvador	13.2	7.1	2.9	5.3	11.8	9.7
Guatemala	...	...	...	...	...	...
Haiti	...	...	...	...	...	...
Honduras	...	...	...	...	...	...
Mexico	8	3.3	1.6	5.3	3.8	7.1
Nicaragua	...	...	...	...	...	...
Panama	...	...	...	...	...	...
Paraguay	4.7	10.8	5.1	1.9	8.6	7.7
Peru	4.8	3.7	0.8	0.9	1.4	3.8
Dominican Republic	...	...	...	...	...	...
Uruguay	5.1	-2.2	-1.5	6.5	-4.0	5.8
Venezuela (Bolivarian Rep. of)	22.5	14.2	9.4	5.3	18.9	10.0
<b>Latin America (unweighted average)</b>	<b>9.6</b>	<b>5.5</b>	<b>3.8</b>	<b>5.3</b>	<b>6.6</b>	<b>8.7</b>

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

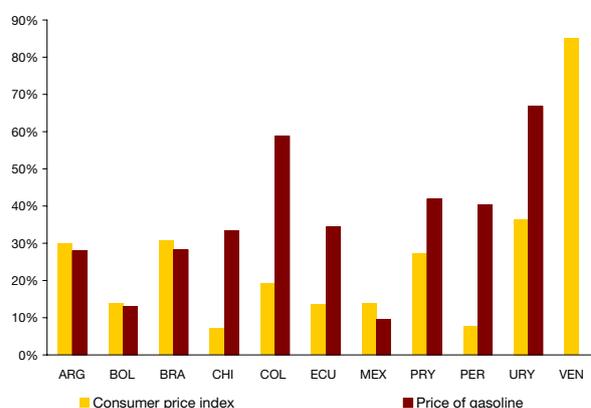
Other price indexes published in the region's countries also display varied patterns. The wholesale price index (WPI) in countries for which information is available rose by less than the consumer price index in 2005 except in El Salvador, Paraguay and Peru (see table IV.6). Then, in the first few months of 2006, it gathered

pace in several countries, and the 12-month variation to May 2006 came in higher than the corresponding figure of a year earlier. The trend of this indicator in Brazil and Chile is interesting: in Brazil, although the WPI for May 2006 was at the same level as it was in December 2005, it displays a negative 12-month variation. In Chile, the

WPI rose by a cumulative 8.9% in the first five months of 2006 as a result of the higher price of oil imports.

As mentioned above, the rise in international oil and fuel prices has been a highly influential factor in domestic price trends. Although this situation has mostly affected the net hydrocarbon importers, it has also had consequences for countries that are net exporters of crude oil but importers of fuels and other refined products. The end effect of the higher prices of fuels, transport and basic services on domestic prices in specific countries has depended on national policies regarding the regulation and setting of domestic prices. Gasoline prices in South American countries have been analysed as a means of providing an indicator of fuel price increases in general.<sup>14</sup> Comparing 2005 with 2004, the steepest rises in gasoline prices occurred in Peru (8.9%), Colombia (7.4%), Bolivia and Chile (both 5.7%). Since 2002, when fuel prices began to rise sharply on international markets, the price of gasoline has risen considerably more than the cumulative variation in the consumer price index in Chile, Colombia, Ecuador, Paraguay, Peru and Uruguay; in the Bolivarian Republic of Venezuela, the prices of these products have remained constant throughout the period (see figure IV.12).

Figure IV.12  
SOUTH AMERICA AND MEXICO: CONSUMER PRICE INDEX AND GASOLINE PRICES, CUMULATIVE VARIATION, 2003-2005



Source: Economic Commission for Latin America and the Caribbean (ECLAC), "Precio de los combustibles en América del Sur y México", statistical data [on line] <http://www.eclac.cl/dnmi/>.

## C. Employment and wages

The relatively high levels of economic growth attained over the last few years has had a substantial effect on the region's labour markets; in 2005 there was a significant increase in the employment rate for the third straight year, which on this occasion rose by 0.5 percentage points to 53.6% of the working-age population. Nonetheless, this improvement simply represents a return to the regional employment rate achieved in 1997.<sup>15</sup>

The recovery of employment levels since 2003 has undergone a major qualitative change as it increasingly shifts towards the creation of wage-based jobs. This trend reflects businesses' greater confidence in the

prospects for future growth and has set the stage for a significant expansion of formal-sector employment in many countries.

With favourable economic trends as a backdrop, the unemployment rate shed more than one percentage point, falling to 9.1% (its lowest level since the mid-1990s). This improvement is the net effect not only of higher employment, but also a decline in the labour supply. In fact, the participation rate slipped by 0.3 percentage points to 59.2% of the working-age population, with the urban labour force expanding by a below-trend rate of just 1.8%.

Patterns seen over the last few years attest to the

<sup>14</sup> See Economic Commission for Latin America and the Caribbean (ECLAC), Natural Resources and Infrastructure Division [online] <http://www.eclac.cl/dnmi/>.

<sup>15</sup> This is measured as a weighted average of employment rates in 16 countries representing 88.9% of the total population of Latin America and the Caribbean. The employment rate indicates the percentage of the working-age population that is employed.

fact that relatively robust economic growth has positive effects on labour markets. Nonetheless, the unemployment rate remains high, and an estimated 18 million people are still out of work. Although in 2004 and 2005 there was a clear upturn in formal employment, a longer-term view indicates that over the last 25 years the vast majority of new jobs have been created in the informal sector. Moreover, a large proportion of new jobs are low paying, and short-term job contracts are becoming more prevalent in the formal sector. A final point to be made in this connection is that the reactivation of the labour

market in 2005 did not elicit significant increases in real wages, which edged up by just 0.5%. Consequently, to improve the employment situation of large sectors of the labour force in the region, a lengthy period of high economic growth will be needed to boost labour demand, in addition to complementary employment and labour-market policies.<sup>16</sup> In early 2006, the decline in the regional unemployment rate was continuing but at a slower pace, as the net effect of a rise in the employment rate and a moderate upturn in the participation rate, while real wages began to display more significant increases.

## 1. A considerable drop in unemployment

The regional urban unemployment rate (as a weighted average) dropped sharply from 10.2% to 9.1%, which was its lowest level since 1994. In absolute terms, the reduction corresponds to roughly 2 million people distributed across all but four of the 21 countries for which information is available; in eight cases the unemployment rate fell by one percentage point or more (see table A-22 of the statistical appendix).

The simple average of unemployment rates therefore dropped sharply as well (from 10.0% to 9.1%), with significant reductions being recorded in all the subregions (see table IV.7).

The unusually sharp decrease in the regional unemployment rate is accounted for by the combined effect of strong job creation and a reduction in the region's labour-force participation rate.

Table IV.7  
LATIN AMERICA AND THE CARIBBEAN: LABOUR MARKET INDICATORS, 1991-2005

	1991	1995	2000	2001	2002	2003	2004	2005 <sup>a</sup>
<b>Unemployment rate<sup>b,c</sup></b>								
Weighted average	7.9	10.0	10.3	10.1	11.0	11.0	10.2	9.1
Simple average	9.9	10.6	10.3	10.6	11.1	10.9	10.0	9.1
<b>Total participation rate<sup>c,d</sup></b>								
Weighted average	58.5	58.8	59.2	58.7	58.9	59.3	59.5	59.2
Simple average	57.0	58.3	59.0	59.0	59.2	59.2	59.5	59.5
Male participation rate <sup>e</sup>	74.6	75.1	73.8	73.5	73.0	72.5	72.7	72.4
Female participation rate <sup>e</sup>	38.0	41.7	43.8	44.3	44.2	45.0	44.9	45.4
<b>Employment rate<sup>c,d</sup></b>								
Weighted average	53.9	53.3	52.9	52.5	52.1	52.6	53.1	53.6
Simple average	51.2	52.0	52.4	52.2	52.1	52.3	53.0	53.5
<b>Real average wage</b>								
Weighted average	86.8	95.2	100.0	100.1	98.5	94.5	95.5	95.9
Median	82.5	94.1	100.0	101.0	102.9	103.3	103.6	103.8
<b>Real minimum wage</b>								
Weighted average	90.2	92.7	100.0	104.5	104.4	105.9	111.6	117.7
Median	97.5	96.3	100.0	101.7	101.7	103.0	103.6	105.6

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

<sup>a</sup> Preliminary figures.

<sup>b</sup> 23 countries.

<sup>c</sup> Series adjusted to account for methodological changes in Argentina (2003), Brazil (2002) and Mexico (2005).

<sup>d</sup> 16 countries.

<sup>e</sup> Simple average for 14 countries.

<sup>16</sup> See Economic Commission for Latin America and the Caribbean (ECLAC), *Economic Survey of Latin America and the Caribbean, 2004-2005* (LC/G.2279-P/I), Santiago, Chile, August 2005, chapter V.

## 2. Reduction in the labour-force participation rate

At the regional level, the weighted average of total labour-force participation rates fell from 59.5% to 59.2%, thereby signalling a slow-down in the expansion of the economically active population. This reduction was somewhat surprising, since in recent years relatively rapid economic growth has generally prompted an upturn in the labour supply in response to better opportunities.

The decline in the participation rate was not all that widespread, however, as in 11 of the 19 countries for which information is available the rate either increased or was unchanged; as a result, the simple average of the countries' participation rates did not decrease. Nonetheless, economies in which participation rates declined include several of the largest in the region (Argentina, the Bolivarian Republic of Venezuela, Brazil, Colombia and Peru), which is why the weighted regional average did, in fact, fall.

In the long run, labour participation depends on individual factors such as age, sex and education level, in conjunction with predominant sociocultural values. As noted in an earlier edition of the *Economic Survey*,<sup>17</sup> it is hard to project the short-term behaviour of this rate because of the diversity of strategies deployed by households in different economic circumstances; but while a variety of reactions are seen in all countries, there are patterns that distinguish some cases from others, as figure IV.13 illustrates. Mexico provides the clearest example of a positive correlation between labour participation and economic growth in recent years; in Argentina and Brazil the trend is less clear, although the participation rate in these countries has also moved broadly in line with growth over the last 10 years.

In contrast, Colombia and especially the Bolivarian Republic of Venezuela are countries where the participation rate tends to climb during periods of slow economic growth and vice versa. Apparently, in these countries, the perceived benefit of having an additional income-earner tends to prevail in downswings, while the income effect predominates in upswings. In Peru, participation patterns have been more varied, although the behaviour of the labour supply is broadly similar to that described for the previous two countries.

An analysis of events in 2005 in medium-sized or large countries shows that the reduction in the participation

rate at the regional level can be explained by a number of factors. In the Bolivarian Republic of Venezuela, Colombia and Peru, the drop in participation reflects a continuation of the pattern of behaviour in the labour force seen during times of relatively rapid economic growth. In Brazil, the decrease in participation may represent a continuation of the shrinkage of the labour supply that has occurred in this country whenever economic growth has been weak. Nonetheless, given that the Brazilian economy continued to create jobs (the employment rate rose by 0.4 percentage points), it is unlikely that this has been caused by a discouraged-worker phenomenon; instead, people's withdrawal from the labour market seems to have been motivated primarily by an income effect. Argentina, for its part, saw a clear-cut departure from the procyclical behaviour of the labour supply that previously characterized that country.

In Argentina, the Bolivarian Republic of Venezuela and Brazil, the steepest drop in labour participation occurred among young people. In Argentina, the employment rate for this age group rose at the same time, whereas in Brazil it declined only slightly, by 0.1 percentage points. Thus, at least in these cases, a discouragement effect has apparently not been a factor in the reduction of the labour-force participation rate among the young population. Instead, the increase in household incomes — largely thanks to the expansion of employment — is likely to have made it possible for a segment of young people to withdraw from the labour market and, at least for a significant proportion of them, to continue with their studies. In the Bolivarian Republic of Venezuela, labour participation among young people between 15 and 24 years of age dropped by 5.8 percentage points between 2003 and 2005, while the employment rate for this age group rose by 0.4 percentage points. The vast majority of young people who withdrew from the labour market did so to pursue educational activities, with the proportion of students in this age group rising from 30.8% in 2003 to 34.2% in 2004 and 37.8% in 2005.

A breakdown of the trend in regional average participation rates by gender shows that the female participation rate has continued to trend upward, while the male participation rates has continued to decline

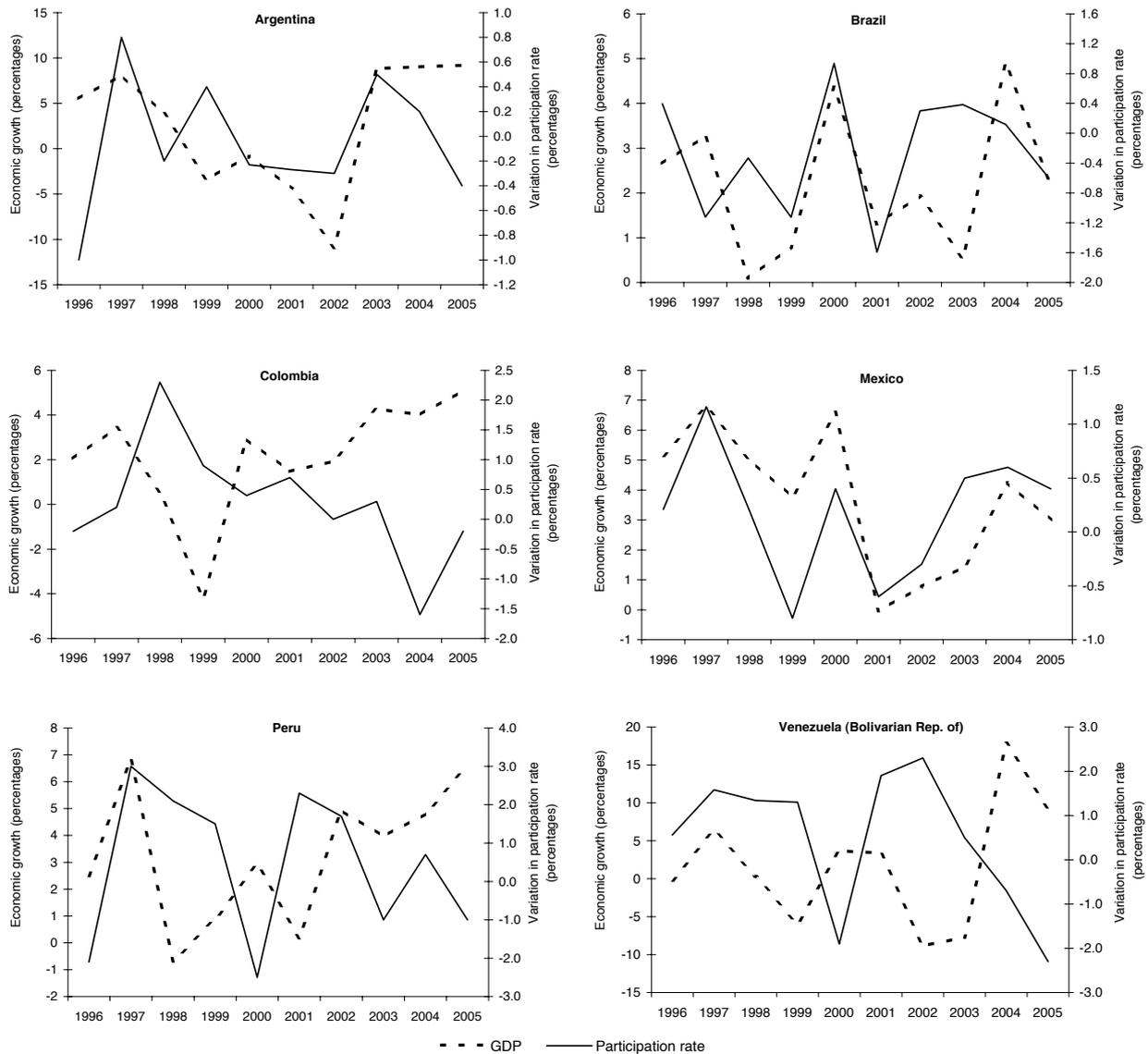
<sup>17</sup> Economic Commission for Latin America and the Caribbean (ECLAC), *Economic Survey of Latin America and the Caribbean, 2001-2002* (LC/G.2179-P/E), Santiago, Chile, August 2002, pp. 86-89.

(see table IV.7). Exceptions are medium-sized or large countries in which overall labour participation dropped sharply and the female labour participation rate weakened,

in some cases considerably (in Argentina and Brazil by 0.7 percentage points and in the Bolivarian Republic of Venezuela by 3.0 points).

Figure IV.13

**ECONOMIC GROWTH AND LABOUR PARTICIPATION**



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

### 3. Expansion of employment

The number of employed persons climbed by about 3% in the region as a whole, thereby raising the employment rate by 0.5 percentage points. Employment growth was

substantial for the third consecutive year and was quite widespread in 2005 across the different countries (see table IV.8).

Table IV.8  
**LATIN AMERICA AND THE CARIBBEAN: LABOUR MARKET INDICATORS, BY COUNTRY, 2004 AND 2005**

	Employment rate		Unemployment rate		Real average wage <sup>a</sup>		Real minimum wage <sup>a</sup>	
	2004	2005 <sup>b</sup>	2004	2005 <sup>b</sup>	2004	2005 <sup>b</sup>	2004	2005 <sup>b</sup>
Argentina	39.7	40.5	13.6	11.6	10.0	6.1	54.5	31.8
Bolivia	55.0	...	6.2	...	2.4	...	-4.2	-5.1
Brazil	50.6	51.0	11.5	9.8	0.7	-0.3	3.4	5.8
Chile	48.5	49.2	8.8	8.0	1.8	1.9	2.8	1.9
Colombia	53.2	54.0	15.4	14.0	1.0	1.1	1.8	1.2
Costa Rica	50.9	53.0	6.7	6.9	-2.6	-1.9	-1.6	0.3
Ecuador	49.7	50.1	11.0	10.7	...	...	2.4	3.0
El Salvador	48.2	48.3	6.5	7.3	...	...	-1.4	-4.5
Guatemala	54.3	...	4.4	...	-2.4	...	0.3	-1.4
Haiti	...	...	...	...	...	...	-14.7	-13.2
Honduras	47.6	48.6	8.0	6.5	...	...	0.8	5.8
Jamaica	56.8	56.7	11.7	11.3	...	...	-12.0	4.1
Mexico	55.8	56.6	5.3	4.7	0.2	-0.1	-1.3	-0.1
Nicaragua	49.6	50.8	9.3	7.0	-2.2	0.2	4.0	4.0
Panama	55.9	57.4	14.1	12.0	0.3	1.9	0.9	-3.0
Paraguay	58.8	58.2	10.0	7.6	-2.7	1.1	-3.3	2.0
Peru	61.6	60.7	9.4	9.6	1.1	-1.9	4.6	-1.6
Dominican Republic	46.0	45.9	18.4	18.0	-24.2	16.7	-14.4	18.7
Trinidad and Tobago	50.9	51.4	8.4	8.0	...	...	-3.6	1.5
Uruguay	57.8	58.6	13.1	12.2	0.0	4.6	-0.2	70.2
Venezuela (Bolivarian Rep. of)	58.1	58.1	15.3	12.4	-3.9	0.1	11.3	11.8

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

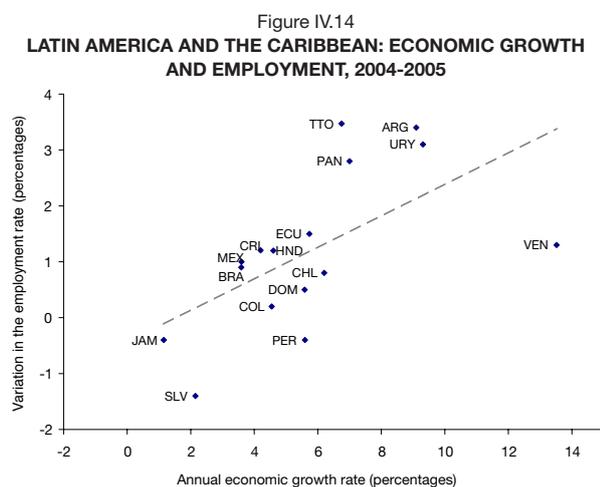
<sup>a</sup> Rates of variation.

<sup>b</sup> Preliminary figures.

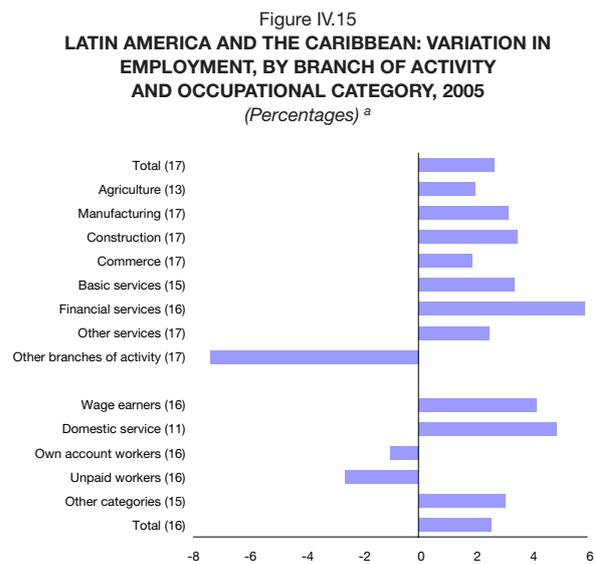
As figure IV.14 shows, the quite close correlation existing between economic growth and the variation in the employment rate in 2004-2005 explains this upturn.

The characteristics of job creation have changed significantly over the last few years. In terms of occupational categories, the high concentration of new employment in own-account activities in 2003 gave way to an increase in wage-paying job creation in 2004 and, in 2005, new

jobs were concentrated almost exclusively in this sector (see figure IV.15).<sup>18</sup> Wage employment rose by 4.2% on average in 2005, reflecting a very strong response by labour demand to economic growth.<sup>19</sup>



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



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

Note: Figures in parentheses indicate the number of countries considered.  
<sup>a</sup> Preliminary figures.

<sup>18</sup> In 2003, own-account work and wage employment were up by 4.8% and 2.8%, respectively, compared to figures of 2.9% and 3.7% for 2004.

<sup>19</sup> This calculation did not include Mexico because data were no longer comparable following a methodological change. Accordingly, to evaluate the effects of the expansion of economic activity on labour demand, this country also needs to be excluded from the calculations relating to economic growth. The expansion of the region's economy, excluding Mexico, amounted to 5.1%.

## Box IV.3

## CHANGES IN THE CHARACTERISTICS OF LABOUR DEMAND

The structure of employment has become increasingly heterogeneous over the last few decades and has frequently been associated with a tendency towards polarization and greater inequality. Studies conducted at the aggregate level in several parts of the world have not found any single cause for these processes, but in most cases technological change has been identified as the main one, with demand for skilled labour being stimulated at the expense of lower-skilled labour. Other factors that have been mentioned in this connection are market restructuring, labour reforms, reduction of the real minimum wage, weakening of labour unions, and relative prices that are unfavourable to labour because of prevailing macroeconomic policies. Nonetheless, there are major discrepancies regarding the weightings assigned to each of these factors.

As some studies have claimed that the influence of the various factors varies between sectors, one methodological proposal has been to deepen the analysis and study changes in the characteristics of labour demand at the sector level. A review of the literature on changes in Latin America's production sectors, particularly with regard to the effects of technological and organizational change on the demand for labour and its characteristics, reveals the existence of mixed trends. On the one hand, there has been a significant degree of upskilling in the occupational structure, both in relation to new jobs that call for higher qualifications and as regards increasingly demanding requirements for personnel in existing posts. This is not happening across the board, however, since some job categories have not exhibited these kinds of trends of this type and, what is more, simultaneous deskilling processes are to be observed in some cases, even within the same firm or business. In the

latter case, the wage gap can be expected to widen as more highly skilled personnel are rewarded while pay raises for workers in less demanding positions are restricted. This process has probably been intensified by organizational changes that make labour-market conditions more heterogeneous, such as outsourcing.

A case study of the Chilean port sector provides evidence of the varied effects that organizational and technological changes have had on employment and working conditions. Organizational changes in this sector included the introduction of a differentiated system of port concessions and alterations in the work system, while technological changes included the use of new types of cranes as well as information and communication technologies. These changes raised the sector's productivity, but many of the expectations in terms of employment were only partially fulfilled. For example, although the skill requirements of port workers generally increased, the work did not become concentrated in a small number of highly skilled workers, as had been predicted. In mixed systems, where part of the port is operated by a single enterprise (single operator) and another by several active firms (multi-operators), the high level of unemployment in the main port zones added to the labour supply. This, compounded by strong pressure to reduce costs, the discontinuous nature of the work and rising productivity's effect in driving down labour demand, led to an increase in the proportion of work undertaken by temporary staff working a small number of shifts per month. The result was increasing polarization in the port labour force, with a relatively small group of highly skilled and increasingly multi-functional staff at the top of the occupational structure and a growing contingent of relatively low-skilled temporary workers at its base. Middle-

ranking port workers have lost ground in this new occupational structure.

Differences in organizational structure are also reflected in the distribution of the available work and, hence, income. Whereas in mixed systems (single operators and multi-operators) there is growing underemployment, with a declining number of shifts per worker and the resulting drop in their average incomes, the data on ports organized by a single operator point to more favourable trends.

The study thus provides grounds for a rejection of technological determinism. The effect of new technologies depends on how production processes are reorganized, and in such situations there is no immediate adaptation of the organizational structure, nor a single or obvious way of bringing this about. Factors unrelated to technological change also affect the characteristics of employment in the sector.

This study also highlights the fact that any public intervention aimed at leveraging the positive effect of technological and organizational change on employment and at reducing its negative consequences needs to take account of the specific characteristics of the sector in question. Above all in activities that involve discontinuous labour demand, such as port work, organizational change affecting human resources needs to be undertaken from a sector-level perspective. In fact, the Chilean port system is still searching for the best way to integrate its strategic objectives (productivity gains with lower costs and fewer interruptions of port activity) and the consequent technological and organizational change, with a human-resource policy that is sustainable in the long term. Achieving these goals requires better coordination on various levels: between firms in the sector, between them and workers, and among firms, workers and the public sector.

In addition, the growth of own-account employment virtually came to a standstill. There are two dynamics that drive the increase in this category of employment: the exploitation of opportunities created by expanding economies for the production and sale of goods and services; and self-employment creation to compensate for a lack of business-generated labour demand. Following several years of economic revival, and in a setting of dynamic labour demand, the second type of strategy seemed to lose its appeal in 2005, and some people took advantage of new wage employment opportunities to abandon own-account work. This seems to explain the slight contraction in this type of employment, although new informal jobs were also no doubt created during the year to capitalize upon the growing domestic demand for goods and services.<sup>20</sup>

Employment in domestic service grew at a robust 4.9%, in keeping with the procyclical pattern it has followed over the last few years, which may be reflecting middle-class households' income and job prospects. Lastly, in 2005, unpaid family work continued on its long-term downward path, which has recently been interrupted only in years of very low growth, such as 2001 and 2002, when, given the lack of job options, some young people seem to have preferred to contribute to the economic activities of their families.

An analysis of regional employment growth by branch of activity shows that the manufacturing sector continued to take advantage of domestic demand growth and favourable competitiveness conditions to expand production and hire workers. The upturn in domestic demand is also creating jobs in construction. Financial services, real estate and business services, in which the number of jobs shrank early in this decade, expanded by 5% or more for the third straight year.

It is also interesting to note that in commerce and in community, social and personal services —the two largest non-agricultural branches of activity in terms of employment, which have accounted for the majority of new jobs in recent years— employment grew more slowly than the overall increase, even though 47% of new jobs were created in these two branches.

Nonetheless, in 2005, as in 2004, job creation was more diversified than in most of the 1990s and the start of this decade. Up to 19% of new jobs were created in manufacturing, 9% in construction and 19% in the financial services, real estate and business services sector.

In several countries, the upturn in economic growth has resulted in formal job creation at rates that frequently

outpace aggregate employment growth. Table IV.9 shows the performance of formal employment in a number of countries in the region. "Formal employment" is defined as jobs covered by a comprehensive social security system or, in two cases (Jamaica and Peru), as the employment of workers who are hired by formal enterprises.

Table IV.9  
LATIN AMERICA AND THE CARIBBEAN: FORMAL EMPLOYMENT INDICATORS, 1998-2005  
(Index 2000=100)

	1998	1999	2000	2001	2002	2003	2004	2005 <sup>a</sup>
Argentina <sup>b</sup>	95.7	99.3	100.0	101.0	93.1	96.2	107.0	118.4
Brazil <sup>c</sup>	100.8	98.2	100.0	102.9	101.6	104.2	109.5	115.7
Chile <sup>b</sup>	97.0	96.1	100.0	101.6	103.4	105.9	109.6	118.2
Costa Rica <sup>d</sup>	94.2	98.5	100.0	97.6	104.0	106.9	110.9	116.1
El Salvador <sup>d</sup>	82.6	102.1	100.0	102.7	102.4	107.8	104.9	106.9
Guatemala <sup>d</sup>	97.7	98.3	100.0	102.2	104.9	105.5	108.9	...
Jamaica <sup>e</sup>	107.3	103.8	100.0	98.0	97.4	96.3	97.3	98.4
Mexico <sup>d</sup>	89.3	94.4	100.0	99.5	98.6	98.2	99.5	102.5
Nicaragua <sup>d</sup>	84.1	91.4	100.0	101.8	101.0	103.7	112.9	123.2
Peru <sup>e</sup>	109.0	102.7	100.0	98.1	98.1	99.8	102.5	107.1
Uruguay <sup>d,f</sup>	...	...	...	100.0	94.6	90.6	92.6	95.9

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

<sup>a</sup> Preliminary figures.

<sup>b</sup> Workers covered by the pension system.

<sup>c</sup> Workers covered by social and labour legislation.

<sup>d</sup> Workers covered by social security.

<sup>e</sup> Workers in medium-sized and large firms.

<sup>f</sup> Index 2001=100.

The table shows how indices of formal employment reflected the weakness of labour demand in years of sluggish economic growth in the late 1990s and at the start of the current decade and also how those indices have recovered since then. This upturn is the combined result of dynamic wage-based job creation and the formalization of casual employment relationships.

In addition to higher employment, some countries also saw an improvement in the index of visible underemployment (employed persons who are working for less than what is normally considered a full working day and want to work more). Visible underemployment declined in Argentina, Brazil, Colombia, Ecuador, Paraguay and Peru, but increased in Chile, Costa Rica, El Salvador, Honduras and Uruguay. Other indicators of employment quality show that, despite the buoyancy of formal employment, a large proportion of new jobs are of low quality. Thus, in Brazil, Colombia, Costa Rica, Honduras and Uruguay, the proportion of employed workers receiving incomes below a certain level (invisible underemployment) rose; and in Chile and Mexico, formal employment contracts involve predominantly temporary jobs.

<sup>20</sup> In fact, in 9 of the 16 countries for which there is information, own-account employment retreated in absolute terms in 2005.

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#### 4. Little variation in wages

As was the case in 2004, the upturn in economic activity in 2005 had a greater effect on employment than on wages: real average wages in the formal sector in most countries recorded modest variations of between plus or minus 2%. The regional median and regional weighted average of real average wages rose by just 0.2% and 0.5%, respectively (see table IV.7).

Exceptions to this pattern included a number of countries that are recovering from deep economic crises in which high inflation rates had eroded real wage levels. These countries (Argentina, Dominican Republic, Uruguay) recorded increases in excess of 4% (see table IV.8). To support the recovery of the purchasing power of labour incomes, the authorities in these three nations implemented active wage policies involving substantial hikes in the real minimum wage (32%, 19% and 70%, respectively). The fact that in the Bolivarian Republic of Venezuela, Brazil

and Honduras real minimum wages also rose by more than 5% suggests that this instrument is being used differently than in the 1990s. During most of the last decade, the minimum wage was managed cautiously in order to avoid fuelling labour costs and stoking inflationary pressures; as a result, between 1990 and 1997 its median real value for 20 countries slipped by 0.9% per year. In contrast, since 1998, wage increases have been more widespread, and between 1997 and 2005 the median annual growth rate was 1.3% while the weighted average rose by 2.7%. The sharp rise in the real minimum wage in 2005 led to increases of 2.0% in the regional median and 5.5% in the regional weighted average. This type of more active wage policy was not implemented across the board, however, since in seven countries the real minimum wage declined or remained unchanged in 2005, and in another four it climbed by no more than 2%.

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#### 5. Prospects for 2006

In the first few months of 2006, the unemployment rate has continued to fall, although at a more measured pace, and the rate is forecast to drop from 9.6% in the first half of 2005 to 8.8% for the first six months of 2006. Since regional employment is continuing to grow vigorously, the slower rate of decline in unemployment is accounted for by the fact that the regional participation rate has not only ceased to fall but has actually begun to rebound slightly. The slackening of economic growth in Brazil in 2005 was reflected with a lag in a number of labour-market indicators, and employment growth stalled (see table IV.10). The acceleration of economic growth in Mexico —another of the region's largest economies— led to an upturn in the employment rate and, despite an increase in the labour supply, a fall in unemployment. The other countries for which information is available also registered improvements

in their respective unemployment and employment rates, with the rate of formal job creation remaining strong. The first quarter of the year saw significant increases in the rate of growth of formal employment in Mexico and Peru (5.5% and 6.2%, respectively), while this rate eased somewhat in Argentina and Brazil, although formal job creation remains vigorous (8.6% and 5.1%). The decrease in the unemployment rate is expected to slow in the second half of 2006, and an annual figure of 8.6% is projected, compared to 9.1% in 2005.

In the first few months of 2006, no country for which data are available reported a reduction in real wages, and in several cases wage growth actually picked up speed. A simple average of nine countries shows real wages in the formal sector rising by 3.2%, with substantial increases in Argentina, the Bolivarian Republic of Venezuela and Uruguay.

Table IV.10  
**LATIN AMERICA: UNEMPLOYMENT RATES, EMPLOYMENT RATES AND REAL AVERAGE WAGES, FIRST HALVES OF 2005 AND 2006**

	Unemployment rate		Employment rate		Real average wage <sup>a</sup>	
	2005	2006 <sup>b</sup>	2005	2006 <sup>b</sup>	2005	2006 <sup>c</sup>
<b>Latin America and the Caribbean</b>	<b>9.6</b>	<b>8.8</b>	<b>53.3</b>	<b>53.9</b>	...	...
Argentina	12.6	11.1	54.3	55.7	89.8	96.9 <sup>d</sup>
Brazil	10.3	10.0	50.7	50.6	82.4	83.9 <sup>d</sup>
Chile	8.3	8.3	49.3	50.2	108.6	110.3 <sup>d</sup>
Colombia	15.0	13.5	52.9	53.7	101.6	104.3 <sup>e</sup>
Costa Rica	...	...	...	...	105.9	105.9 <sup>d</sup>
Ecuador	11.1	10.3	49.4	50.0	...	...
Mexico	4.9	4.3	56.1	57.5	106.2	106.6 <sup>d</sup>
Nicaragua	...	...	...	...	103.2	107.0 <sup>d</sup>
Peru	10.5	9.1	60.6	60.8	...	...
Uruguay	...	12.5	...	52.9	80.5	84.9 <sup>f</sup>
Venezuela (Bolivarian Rep. of)	13.3	10.7	57.5	58.2	74.6	77.5 <sup>e</sup>

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

<sup>a</sup> Index 2000=100.

<sup>b</sup> Estimate.

<sup>c</sup> Preliminary figures.

<sup>d</sup> January-April average.

<sup>e</sup> January-March average.

<sup>f</sup> January-May average.



## Chapter V

# External sector

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### A. Balance-of-payments current account

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#### 1. The current account

Worldwide economic growth has resulted in more buoyant international trade and has boosted demand for raw materials and helped push up prices. This trend has not been seen in all commodities, but the upswing has included most energy products, some industrial metals and certain agricultural products such as sugar, bananas and coffee. In the last three years, this external demand shock has fuelled a significant increase in economic activity in Latin America which has been coupled with surpluses on its balance-of-payments current account. This growth trend and improved external balance have been seen in countries whose export structures are based on commodities whose prices have risen. In other words, these results are due to an exogenous factor: higher prices for commodities that some countries possess in abundance.

For the third year in a row, the region posted a surplus on the balance-of-payments current account, with the 2005 surplus amounting to US\$ 35.325 billion, or the equivalent of 1.5% of Latin America's GDP. The capital and financial accounts of the balance of payments (including errors

and omissions) recorded a surplus of US\$ 21.650 billion, or 0.9% of regional GDP. The overall balance therefore took the form of a surplus of US\$ 56.977 billion (2.4% of regional GDP). Reserve assets rose by US\$ 35.265 billion (equivalent to 1.5% of regional GDP), the region

made US\$ 26.816 billion in payments on loans from the International Monetary Fund (IMF) (1.1% of GDP), and exceptional financing amounted to US\$ 5.105 billion (0.2% of regional GDP).

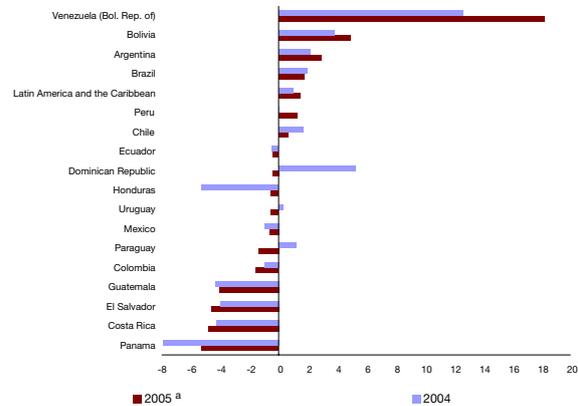
The positive balance on the current account reflected surpluses on the merchandise trade account (US\$ 80.627 billion, or 3.4% of regional GDP) and in current transfers (US\$ 48.694 billion or 2.1% of regional GDP). In contrast, the services account posted a deficit of US\$ 18.519 billion (0.8% of regional GDP), while the deficit on the income account came to US\$ 75.476 billion, or 3.2% of regional GDP.

In 2005 only nine Latin American countries improved their current account balances relative to 2004 (when 14 countries had shown advances over 2003), while seven countries registered a current account surplus, which was one less than in 2004 (see figure V.1).<sup>1</sup> All of the seven except Haiti were South American countries. As in 2003 and 2004, current transactions were within the interval of +/-three points of regional GDP in 10 of the region's countries. The median of the distribution went from a deficit of 0.5 percentage points of GDP in 2004 to one of 0.8 percentage points. Argentina and the Bolivarian Republic of Venezuela are the only countries to have had an uninterrupted string of current account surpluses since 2002. In 2005, Nicaragua posted the region's largest current account deficit (16.2% of its GDP), while the Bolivarian Republic of Venezuela turned in the biggest surplus (20% of its GDP). If the latter country were factored out of the calculations, then the region's current account balance in 2005 would have been US\$ 9.966 billion instead of US\$ 35.325 billion.<sup>2</sup>

In 2005, the Caribbean countries posted a current account deficit of US\$ 136 million (0.3% of their GDP). This was an improvement over the situation in 2004, when the current account deficit amounted to 0.9% of the subregion's GDP. As shown in figure V.2, all the countries of this subregion registered a current account deficit in 2005 except Trinidad and Tobago, which had a surplus of US\$ 2.741 billion (21.2% of its GDP). This result is a reflection of the rising value of that country's hydrocarbon exports; it was also the only State to post a merchandise trade surplus.<sup>3</sup> If the accounts of Trinidad and Tobago were factored out of the equation, then the Caribbean countries would have had a current account deficit of US\$ 2.939 billion (12% of the GDP of the Caribbean countries other than Trinidad and Tobago).

Latin America also displays substantial subregional

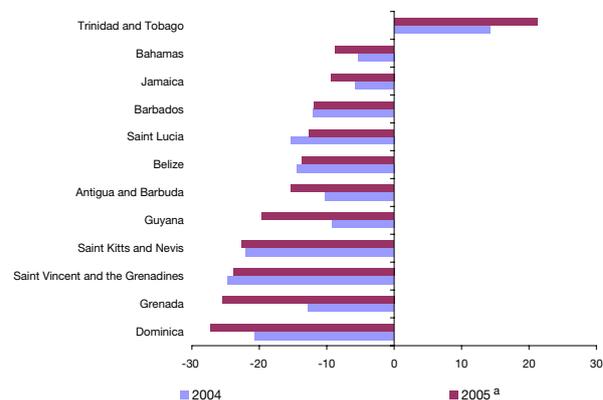
Figure V.1  
**LATIN AMERICA AND THE CARIBBEAN:  
CURRENT ACCOUNT BALANCE**  
(Percentages of GDP at current prices)



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

<sup>a</sup> Preliminary figures.

Figure V.2  
**CARIBBEAN COUNTRIES: CURRENT ACCOUNT BALANCE**  
(Percentages of GDP at current prices)



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

<sup>a</sup> Preliminary figures.

differences in terms of the current account balance (see figure V.3). The improvement in South America's current account reflected a larger merchandise trade surplus, especially in the Andean countries, thanks to the increase in petroleum exports from the Bolivarian Republic of Venezuela. In Central America, the slight improvement seen in the current account was related to the upturn in

<sup>1</sup> In terms of the basic balance (i.e., the sum of the current account balance and net foreign direct investment), four countries posted a deficit in 2005: Costa Rica, El Salvador, Guatemala and Nicaragua.

<sup>2</sup> This is the equivalent of 0.45 % of regional GDP (excluding the Bolivarian Republic of Venezuela).

<sup>3</sup> The current account balance of Caribbean countries (as a simple average) was -14.1%.

the income account. Here too, worker remittances made a major contribution to the positive balance in current transfers of almost 9.3 percentage points of GDP.

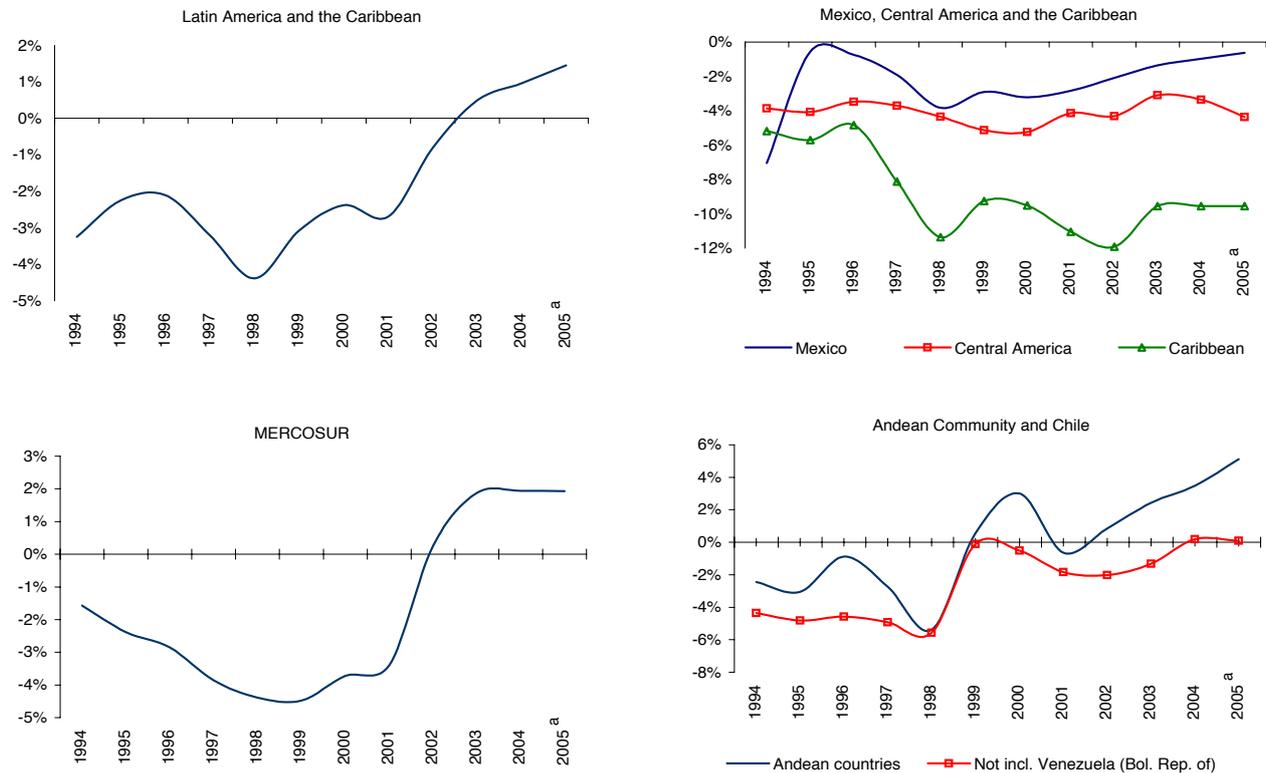
South America turned in a surplus of US\$ 44.899 billion in 2005 (the equivalent of 3% of the subregion’s GDP). This was half a percentage point higher than in 2004, with improvements observed in the merchandise trade balance (a surplus of 7.2% of GDP, which was 0.3 percentage points higher than the year before) and the income account (whose deficit narrowed by 0.5 points). The services balance deteriorated by 0.1 percentage points of GDP, while net current transfers were down by 0.2 points.

The countries of the Andean Community recorded a surplus of almost US\$ 24.790 billion, or 6.8% of their GDP (2.6 percentage points higher than in 2004).<sup>4</sup>

In 2005, the trade balance of The Andean Community’s trade surplus expanded by 2.3 points of GDP, while the surplus on its income account rose by 0.4 points. Contributing factors to this result included the balances posted by the Bolivarian Republic of Venezuela and Bolivia thanks to higher hydrocarbon prices on international markets, while the current transfers account recorded a slight decline. The MERCOSUR countries’ current account surplus amounted to US\$ 19.407 billion (1.9% of the group’s GDP) in 2005, while they witnessed a deterioration in their trade balance (by 0.3 percentage points of GDP), services balance (0.2 points) and current transfers (0.09 points).

The current account deficit in Central America totalled US\$ 5.020 billion, or 5.2 percentage points of the subregion’s GDP (an improvement of 0.4 points over the preceding year). All the Central American countries

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



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.  
<sup>a</sup> Preliminary figures.

<sup>4</sup> The Bolivarian Republic of Venezuela has announced its departure from the Andean Community in 2006. The country is therefore included in all analyses of the Andean Community for 2005.

posted negative balances for current transactions. The subregion's trade deficit was equivalent to 13.8% of its GDP, which was 0.2 percentage points less than in 2004. The higher prices brought by hydrocarbons have been a determining factor in this result, since all of these countries are net importers. Net current transfers closed at a level similar to the figure recorded for 2004.

A comparison with emerging economies in other world regions shows, for instance, that some oil producers in the Middle East (such as Saudi Arabia and Kuwait) posted major increases in their current account balances in 2004 and 2005. In 2004, Saudi Arabia's current account surplus climbed by 7.7 percentage points of GDP, while Kuwait's rose by 13.5 points. In 2005, Saudi Arabia's current account surplus increased by 7.4 percentage points. In contrast, most emerging countries in Eastern

Europe and Central Asia saw their current account balances deteriorate in 2005. This was the case for Bosnia and Herzegovina, Bulgaria, Croatia, Estonia, Hungary, Moldavia, Montenegro, Serbia, Ukraine and Turkey.<sup>5</sup> Some Asian economies, such as the Republic of Korea and Indonesia, recorded reductions of 2.3 and 0.1 points in their respective current account balances; the merchandise trade balances of both countries also deteriorated. As in Latin America and the Caribbean, results vary widely and are largely dependent on the export and import structures of the countries concerned.

Events in the first few months of 2006 —particularly the upswing in international prices for metals and petroleum— suggest that Latin America will record a current account surplus for 2006 that is at least as large as its 2005 surplus.

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## 2. Trade in goods and services

In 2005, Latin America's balance of goods and services stood at US\$ 62.108 billion, or 2.6% of GDP. Growth rates for exports and imports were 20.0% and 18.2%, respectively, with both of these figures being lower than the rates recorded in 2004. Increases in export volumes contributed 8.1% to the expansion of external sales, while higher price contributed 11%. For imports, these two factors' contributions were equivalent to 12.1% and 5.5%, respectively. These growth rates for the value of exports and imports were quite high, especially when compared to those from the early part of this decade.

Changing price levels were one of the main determinants of the region's merchandise trade result. If the 2004 import and export baskets are held constant, then price increases widened the merchandise surplus by almost US\$ 28.993 billion. The value of Latin America's merchandise exports climbed by 20.3%, of which 11.7% is attributable to price increases and 7.7% to higher volumes. As illustrated by Colombia, Chile and the Bolivarian Republic of Venezuela —three of the countries with the largest percentage increases in external sales— the

difference between the rise in prices and the expansion of volumes was greater than the regional average.<sup>6</sup> This helps to demonstrate that the increase in Latin American exports is linked to higher prices for raw materials (especially metals and petroleum). As for imports, their value increased by 17.9%. Unlike the case of exports, however, the increase in import volumes (10.8%) exceeded the rise in prices (6.4%). This may be linked to the fact that the region's economic growth in 2005 drove up demand for imported goods and to the appreciation of many of its countries' currencies, which made imports cheaper in relative terms. This was not the case in all the countries, however. In El Salvador, Guatemala, Honduras and Nicaragua, for instance, prices made a more significant contribution than volumes to the increase in imports owing to the higher prices paid for fuel imports.

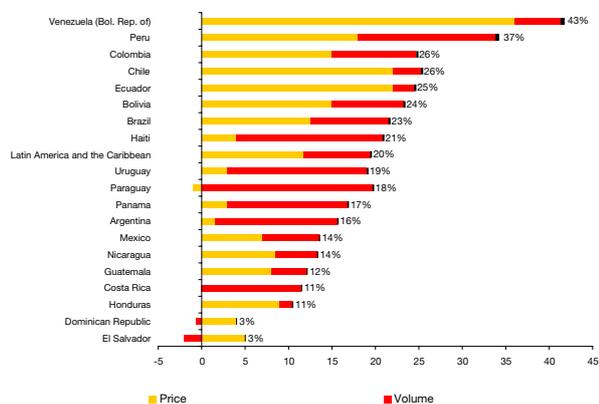
In 2005, the value of the Andean Community's external sales rose by US\$ 28.4 billion, which was an increase of 36% and 4.2 percentage points of these countries' GDP. This group's imports expanded by US\$ 15.5 billion, which was an upturn of 29.5% (1.8

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<sup>5</sup> Some of these countries are running deficits on their current accounts and are therefore highly dependent on capital inflows, which could easily undergo changes in an international context of rising interest rates.

<sup>6</sup> In the Bolivarian Republic of Venezuela, prices increased by 5.3% and volumes by 36.0%; in Colombia, prices rose by 9.7% and volumes by 15.0%; and in Chile, prices climbed by 3.2% and volumes by 22%.

Figure V.4  
**LATIN AMERICA AND THE CARIBBEAN: PERCENTAGE  
 VARIATIONS IN MERCHANDISE EXPORTS F.O.B.,  
 BY UNIT PRICE AND VOLUME, 2005<sup>a</sup>**



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

<sup>a</sup> Preliminary figures.

points of its GDP). The MERCOSUR countries' exports swelled by US\$ 27 billion (a growth rate of 19.7%) and its imports by US\$ 16.8 billion (an 18.6% increase).

Trade within these integration schemes has been relatively limited compared with other economic integration groups, and intra-group trade has been gradually declining in the Andean Community and MERCOSUR.<sup>7</sup> In 2005, exports within the Andean Community represented 9.6% of its total exports, compared with 10.5% in 2004. These trade flows' peak level over the last 16 years reached its peak (14.2%) in 1998 and since then has been fluctuating between 8.8% y 10.6%. Intra-MERCOSUR exports represented 13.2% of total external sales in 2005, which was far below the record level of 25.3% recorded in 1998. In contrast, trade within the Central American Common Market (CACM) is trending upward, reaching a record high of 28.7% of the subregion's total exports in 2005. Trade within the Caribbean Community (CARICOM)

has also been expanding in recent years, thanks in large part to Trinidad and Tobago's crude oil sales.

A number of changes in the region's integration schemes are now in the making, following the Bolivarian Republic of Venezuela's announcement of its departure from the Andean Community (of which it was a founding member) and its intention to join MERCOSUR and to conclude trade and various cooperation agreements with Bolivia and Cuba as part of the recent People's Trade Agreement (PTA). As for the Andean countries, the Andean Trade Promotion and Drug Eradication Act (ATPDEA), which has been in force since 1991, is due to expire in December 2006. At the Special Meeting of the Andean Council of Presidents (held in Quito in June), Bolivia, Colombia, Ecuador and Peru signed a letter requesting that the United States extend the Act. This would mainly benefit Bolivia and Ecuador, as Peru signed a free trade agreement with the United States in April 2006 (ratification by Congress is still pending in both countries, although this is expected to occur by the end of the year), while Colombia is expected to sign a similar agreement soon.

Various Latin American countries are in the process of negotiating free trade agreements with the United States, have recently signed such accords or are about to do so. For instance, the Dominican Republic — Central America — United States Free Trade Agreement (CAFTA-DR) was implemented by El Salvador in the first quarter of 2006 and by Nicaragua and Honduras in the second quarter. This agreement is expected to enter into force in Guatemala and the Dominican Republic and to be approved by the Costa Rican Congress in the second half of 2006, while Panama is engaged in the final round of negotiations on this treaty with the United States. The Central American countries are also negotiating an agreement with Canada, and in November are expected to begin talks on a free trade agreement with the European Union.<sup>8</sup> In addition, nations such as Brazil, Chile and Peru are negotiating bilateral agreements with countries in Asia and Africa.<sup>9</sup>

<sup>7</sup> For a more detailed analysis, see José Durán and Raúl Maldonado, "América Latina y el Caribe: la integración regional en la hora de las definiciones", Comercio internacional series, No. 62 (LC/L.2454-P), Santiago, Chile, Economic Commission for Latin America and the Caribbean (ECLAC), December 2005.

<sup>8</sup> The Dominican Republic is not taking part in the negotiations with the European Union being pursued by the Latin American bloc of countries.

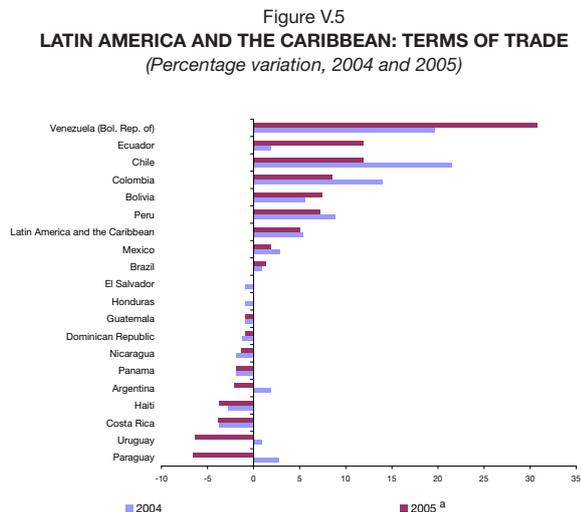
<sup>9</sup> For a more detailed analysis, see M. Kuwayama, J. Durán and V. Silva, "Bilateralism and regionalism: re-establishing the primacy of multilateralism: A Latin American and Caribbean perspective", Comercio internacional series, No. 58 (LC/L.2441-P/E), Santiago, Chile, Economic Commission for Latin America and the Caribbean (ECLAC), December 2005.

### 3. Terms of trade

Although recent years have seen a significant improvement in Latin America's average terms of trade, this trend has not manifested itself equally in all subregions (see figure V.5).

In 2005, Latin America's terms of trade went from strength to strength: improving by 5.7% compared with the 5.2% increase recorded in 2004. In 2003, the region's terms of trade had improved by 2.1%. As shown in figure V.6, Latin America's terms of trade are in an upward phase of the business cycle and are closely linked to the Latin America's commodity export price index (the statistically significant correlation of 0.52 has risen to 0.65 since the beginning of the 1990s).<sup>10</sup>

The countries that recorded the largest increases in their terms of trade in 2005 were the Bolivarian Republic of Venezuela (a rise of 30.8%) and Ecuador and Chile (11.9% each). Chile, which is an oil importer, recorded an increase in its terms of trade as higher copper prices more than offset the rise in crude oil prices on international markets. At the other extreme, the terms of trade of Costa Rica, Paraguay and Uruguay decreased by 8.2%, 7.8% and 5.7%, respectively. An even clearer picture of the improvement in the region's terms of trade in recent years is provided by a comparison between the average for



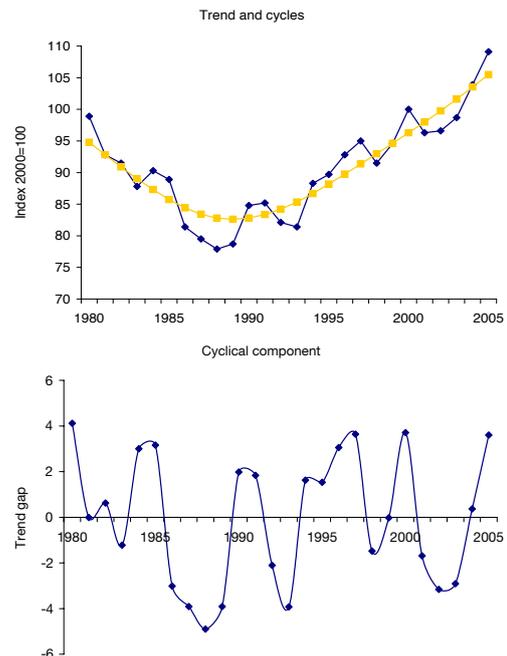
Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.

<sup>a</sup> Preliminary figures.

the 1990s and for 2005, which shows a 23.2% increase. This sharp upswing reflects the strength of demand for raw materials, which is being driven by world economic growth, and especially that of China and India, and of the political uncertainty that has generated additional oil price volatility.

This process has been quite uneven across subregions. In 2005, South America's terms of trade climbed by 6.5% while Mexico's increased 2.9% and Central America's fell by 3.3%. A comparison with the average for the 1990s shows that these subregions' terms of trade varied by 50%, 21% and -11.8%, respectively. Within the subregion of South America, there are considerable differences at the country level. In 2005, South America's terms of trade (excluding Chile and the Bolivarian Republic of Venezuela) rose by 1.8%. Higher oil and copper prices in 2005 have been a major factor in the improved terms of trade for South America as a whole.

Figure V.6  
**TERMS OF TRADE**



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

<sup>10</sup> The result varies across countries according to their export structure. The terms of trade of countries such as Brazil and Mexico are less closely correlated with commodity export price indices than those of Bolivia, Chile and the Bolivarian Republic of Venezuela because of the large proportion of manufactures in these first two countries' exports.

Box V.1

**THE OIL BILL IN CENTRAL AMERICA AND THE CARIBBEAN**

As mentioned earlier, Latin America has seen a major improvement in its terms of trade over the past three years.<sup>a</sup> Nonetheless, in 2004 and 2005 that improvement was mainly due to rising prices for energy products and certain minerals, and as a result, a number of net importers of these goods have witnessed a deterioration in both their terms of trade and their trade balances.

The higher prices being fetched by petroleum and petroleum products<sup>b</sup> were also responsible for the upswing in the value of net oil importers' external purchases in 2005. This had a particular impact on two subregions — Central America and the English-speaking Caribbean — that are mostly made up of small economies and net oil importers.<sup>c</sup> It is hard for these economies, which have limited means for substituting alternative energy sources, to absorb the impact of the soaring oil bill. If world oil prices continued rising at the present rate, these countries' balance of payments could worsen and their economic growth could even be held back.

**Central America**

Rising prices for oil and petroleum products had various consequences in Central America. In terms of the subregion's external accounts, the rising

oil bill led to a considerable worsening of the trade balance, while fuel price adjustments pushed up inflation at the domestic level.

The oil bill for Central America soared by 39% in 2005, an increase of US\$ 1.559 billion, or 34.8% of the overall increase in the cost of imports. If the Dominican Republic and Haiti are included, the increase amounts to US\$ 2.386 billion (the equivalent of 37.2% of the overall increase in imports). The countries for which the growing oil bill represented the greatest proportion of increased spending on imports were Haiti (96.1%), El Salvador (50.5%) and Guatemala (49.2%). All the countries of the subregion apart from Panama registered a deterioration in their merchandise trade balances. As a percentage of the overall current account deficit for Central America, the oil bill rose from 83% in 2004 to 118% in 2005.

Over the past three years, Central America's oil bill has risen by 0.4%, 0.7% and 1.1% of GDP, respectively. If the Dominican Republic and Haiti are included, the figures are 0.7%, 0.6% and 1%, respectively. The country whose oil bill showed the greatest increase as a percentage of GDP in 2005 was Nicaragua (2.3%), whereas it had been the Dominican Republic in 2003 (2.9%) and Honduras

(1.7%) in 2004. The picture drawn by all of these figures shows just how serious an impact the rising prices of petroleum and petroleum products have been having on these economies.

**The English-speaking Caribbean<sup>d</sup>**

As in Central America, English-speaking Caribbean countries (including Trinidad and Tobago) often post sizeable balance-of-payments current account deficits. The rising oil bill, which climbed from 49.1% of the current account deficit in 2003 to 55.9% in 2005, has been one of the reasons why these deficits have been widening over the past three years.

In 2005, this subregion's external purchases of petroleum and petroleum products increased by 18.8% (the equivalent of US\$ 172 million), thus accounting for 34.8% of the overall growth of imports. The countries where the rate of increase in expenditure on crude oil and fuels was the highest relative to the rate of increase in total imports were Barbados (339.7%) and Guyana (36.8%).

As a percentage of GDP, the oil bill for the Caribbean countries expanded by 7.9% in 2003 and about 9.5% in 2005. The biggest increase in 2005 was recorded by Guyana, at 6.4% of GDP. In 2004, it was Barbados, with 2.3% of GDP, and in 2003, Jamaica, with 2.9% of GDP.

<sup>a</sup> At the subregional level, however, it should be noted that the terms of trade have worsened for Central America.

<sup>b</sup> In 2005, price indices rose by 36.7% for petroleum and by 33.4% for petroleum products.

<sup>c</sup> Because it is a net oil exporter, Trinidad and Tobago is not included in the English-speaking Caribbean for the purposes of this analysis.

<sup>d</sup> This analysis covers the countries in this subregion for which data are available. The oil bill for 2005 is known for the following countries: Bahamas, Barbados, Belize, Guyana, and the member countries of the Organization of Eastern Caribbean States (OECS). Information on the oil bill for Jamaica and Suriname is available up to 2004.

## B. Capital flows and external debt

### 1. Capital and financial account balance

In 2005, Latin America posted an overall balance of 2.4% of GDP, which was US\$ 44.6 billion higher than in 2004. This was made possible thanks to surging demand for raw materials exported by the region and an extremely favourable financial environment at the international level. As mentioned previously, US\$ 16 billion of this result was attributable to the current account surplus (1.5% of GDP) while US\$ 28.6 billion corresponded to the transformation of the US\$ 7 billion capital and financial account deficit (including errors and omissions) into a surplus of US\$ 21.6 billion (0.9% of GDP) in 2005. The overall balance was used to build up reserves by the equivalent of 1.5% of GDP and to pay the International Monetary Fund (IMF) (1.1% of GDP); in addition, exceptional financing amounting to 0.2% of GDP was recorded. The region therefore became a net recipient of capital flows while at the same time running a current account surplus. This was the first time that this had happened (with the exception of 2003, when both surpluses were much smaller) since the beginning of the data series in 1980 (see figure V.7).

Capital flows were received under two subheadings in the capital and financial account. First, foreign direct investment (FDI) amounted to US\$ 47.8 billion (2% of GDP), which was 9.7% higher than the previous year but nonetheless below the record net inflows for this data series of US\$ 79.3 billion (4.4% of GDP) registered in 1999. The main recipients of FDI in 2005 were Brazil and Mexico (with net inflows of almost US\$ 12 billion), followed by Colombia (US\$ 5.5 billion), Chile (US\$ 4.7 billion), Argentina (US\$ 3.5 billion) and Peru (US\$ 2.5 billion). Bolivia, on the other hand, closed out the year with US\$ 280 million of disinvestment.

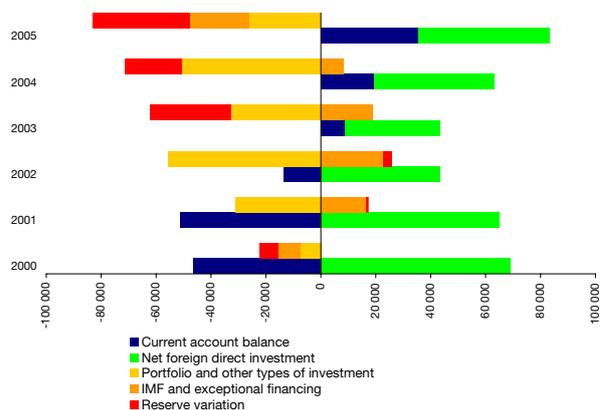
Second, at US\$ 26.2 billion (1.1% of GDP), the deficit in short-term capital flows was smaller than in 2004. This figure was the net result of two opposing flows: on the one hand, debt paydowns and external asset formation (particularly in the case of the Bolivarian Republic of

Venezuela) and, on the other, sizeable capital inflows in the form of portfolio investments.

International investors took advantage of the favourable economic conditions in Latin American and, in the case of Brazil and Mexico, of high interest rates, to channel resources into the financial assets of the region's countries. Buybacks of external bonds and external debt restructurings spurred the development of the countries' domestic bond markets, thereby attracting an increasing number of foreign investors. Some countries such as Brazil, the Bolivarian Republic of Venezuela and, in mid-June 2006, Colombia made progress adjusting their legislation in order to facilitate financial transactions and the entry of foreign investors into their domestic markets.<sup>11</sup>

With the exception of Costa Rica, El Salvador, Guatemala and Nicaragua, all Latin American countries posted a positive basic balance.<sup>12</sup> In the aforementioned

Figure V.7  
LATIN AMERICA AND THE CARIBBEAN:  
BREAKDOWN OF BASIC BALANCE, 2000-2005  
(Millions of dollars)<sup>a</sup>



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

<sup>a</sup> A minus sign (-) indicates an increase in reserve assets.

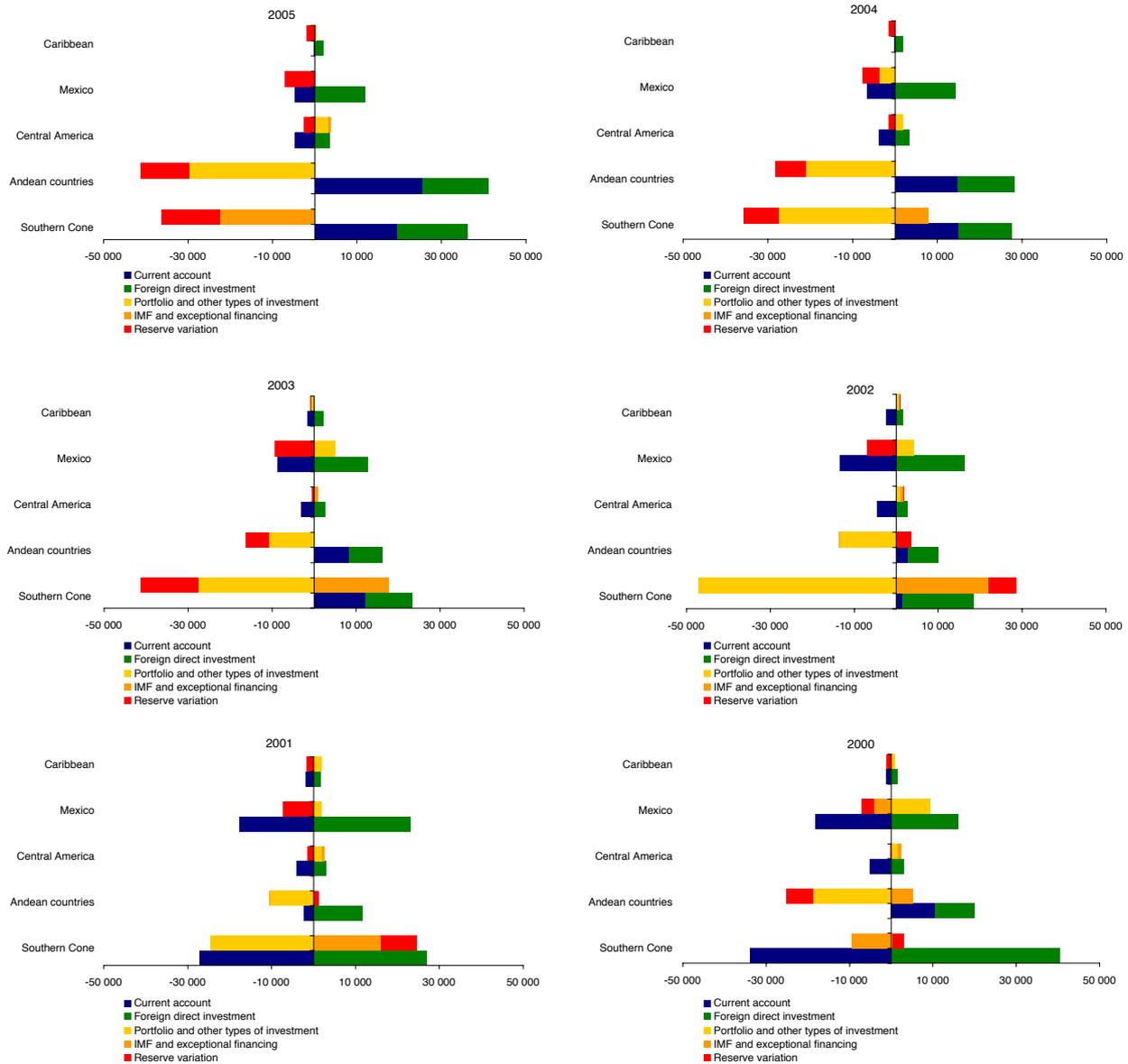
<sup>11</sup> Mexico and Peru also have similar legislation.

<sup>12</sup> The basic balance is the sum of the current account balance and FDI flows.

countries, inflows of FDI failed to entirely offset their current account deficits. In Bolivia, Brazil, Mexico, Panama, Paraguay and Uruguay, basic balance inflows combined with positive flows of short-term capital. The negative short-term capital flows of the other countries that posted

positive basic balances were attributable to external asset formation (as was the case in the Bolivarian Republic of Venezuela, Chile and Colombia) and to a decrease in net external liabilities. All of the countries except El Salvador recorded a build-up of reserves (see figure V.8).

Figure V.8  
**LATIN AMERICA AND THE CARIBBEAN: BREAKDOWN OF BASIC BALANCE BY REGION, 2000-2005**  
*(Millions of dollars)<sup>a</sup>*



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

<sup>a</sup> A minus sign (-) indicates an increase in reserve assets.

## 2. Management of external liabilities

High international liquidity, an almost flat yield curve in the United States, low interest rates and rent-seeking on the part of investors were all determining factors in the entry of capital flows into the region and the take-up of local-currency bond issues with lower cost.

The reduction in the region's external debt was coupled with a widespread restructuring of debt profiles in the interests of diminishing exposure to shifting external conditions (particularly interest-rate and exchange-rate movements). Liability management operations focused on extending external-debt maturities, retiring the more expensive debts, diversifying exchange risk by issuing debt instruments in currencies other than the United States dollar, and reducing that same form of risk by increasing the proportion of debt issued in local currencies.

Countries such as Argentina, Brazil, Panama, Peru and Mexico undertook external bonds buybacks, while certain countries also swapped external for domestic debt (Argentina, Colombia and Peru).<sup>13</sup> Mexico issued warrants that give investors the option of swapping dollar-denominated bonds for peso debt. In March 2006, Mexico issued warrants to swap US\$ 720 million worth of euro-denominated bonds for peso-denominated paper.

These external bonds buybacks came in response to a strategy aimed at eliminating obligations with high interest rates and more restrictive conditions. In early 2006, there was a spate of debt buy-back operations, including the withdrawal from the market of Brady bonds, which had been introduced at the end of the 1980s as part of non-performing debt swap operations. Many countries decided to take advantage of the buy-back option provided by Brady bonds to remove them from the market, which suggests that the market for such instruments may be coming to an end.

In August 2005, Brazil exchanged US\$ 4.2 billion in C-bonds (capitalization bonds) for US\$ 4.5 billion in A-bonds (amortization bonds), thereby extending this debt maturity from 2014 to 2018. In October, the remaining US\$ 1.2 billion in C-bonds was also retired. For a long time, C-bonds (a type of Brady bond introduced as part of the 1994 debt restructuring) were Brazil's main external debt instrument.

In late February 2006, Brazil and the Bolivarian Republic of Venezuela announced their intention to buy back US\$ 6.6 billion and US\$ 3.9 billion in Brady bonds,

respectively. For Brazil, this operation eliminates its Brady bond debt, while the Bolivarian Republic of Venezuela will clear out its par and discount Brady bonds. Mexico had retired all of its Brady bond debt back in mid-2003. Total debt held in Brady bonds in the region peaked at almost US\$ 150 billion in August 1996, but had shrunk to US\$ 10.1 billion by the end of April 2006. By that time, only nine countries were holding such bonds, and only four of those were Latin American (the Bolivarian Republic of Venezuela, the Dominican Republic, Panama and Peru).<sup>14</sup> At the beginning of June, Panama announced that it would buy back all its Brady bonds (almost US\$ 360 million) at the end of that month.

In addition to the retirement of Brady bonds, early 2006 saw a number of countries join the wave of buyback operations. These included Mexico, which in March retired bonds worth US\$ 2.9 billion by issuing US\$ 3 billion in dollars —denominated benchmarked bonds. Brazil announced that in 2006 it would buy back other short-term external debt bonds, while in March, Colombia retired US\$ 600 million in external bonds as part of its strategy to reduce the proportion of its debt in foreign currency. In May, Ecuador retired US\$ 740 billion in 2012 global bonds (some of its most costly debts) with a coupon rate of 12%, and announced that it would retire the remaining US\$ 510 million of such bonds by January 2007.

At the end of 2005, Brazil and Argentina announced that they would be paying off all their debts with the International Monetary Fund (IMF) (US\$ 15.5 billion and US\$ 9.5 billion respectively).

However, the ensuing market reactions in the two countries differed: in Brazil, the operation was considered an example of successful management of external debt and international reserves, while in Argentina it was deemed a rash decision that might have to be financed with more costly subsequent operations. Although this pushed up Argentina's risk rating, the concerns proved unfounded and the risk rating began to trend downward once again in January 2006.

At the end of March 2006, Uruguay announced the early payment of US\$ 630 million to IMF, while in May Mexico announced the early payment of US\$ 7.0 billion to the World Bank and the Inter-American Development Bank (IDB).

<sup>13</sup> Peru paid some of its debt to the Paris Club using funds that were raised partly on the domestic market.

<sup>14</sup> According to information from J.P. Morgan.

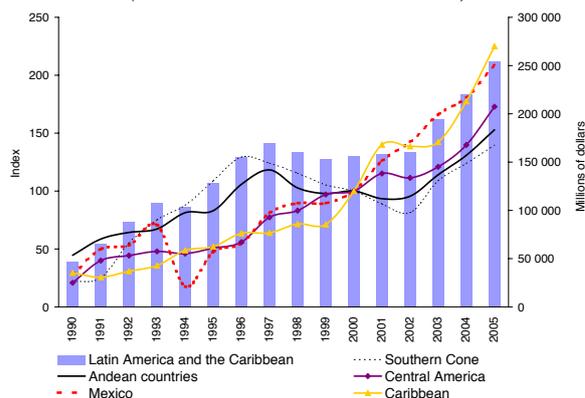
### 3. The region's international reserves

The payment of debt outstanding with IMF and many external bond buy-back operations were financed with the countries' international reserves, which have swelled thanks to their healthy current account balances, capital inflows and certain foreign-exchange policy measures.

Although the returns on some of the new issues were used to build up reserves (specifically earmarked for future external debt payments), the aggregate increase in reserves was partially curbed by asset formation abroad.

As a result, the international reserves of Latin America and the Caribbean in 2005 amounted to a record level of almost US\$ 255 billion, which is the equivalent of 10% of regional GDP and 15.7% higher than in 2004 (see figure V.9). All the countries except El Salvador recorded year-on-year growth in their stock of international reserves. The Dominican Republic posted the highest growth rate for reserves (130%), while Brazil and Mexico accounted for 50% of the region's reserves in absolute terms.

Figure V.9  
**LATIN AMERICA AND THE CARIBBEAN:  
INTERNATIONAL RESERVES**  
(Index: 2000=100 and millions of dollars)



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of figures from the International Monetary Fund (IMF).

Note: The Latin American and Caribbean region appears on the right-hand axis.

### 4. International bond issues

Despite the various bond buy-back operations, international markets recorded a high level of bond issues in 2005 and during the first six months of 2006. A large number of pre-financing operations were carried out in 2005 both to take advantage of low interest rates and in an effort to bypass election periods in 2006 that might heighten market volatility and drive up interest rates.

In 2005, Latin American and Caribbean countries issued US\$ 46 billion in bonds (see figure V.4). Sovereign bonds accounted for 53% of that total, while corporate bonds and bank paper represented 47%. The overall total was 26% higher than in 2004 and represents 29% of all emerging-economy issues. The region was outpaced only by the emerging economies of Europe, which accounted for 34% of the total. Meanwhile, Asian and Pacific emerging economies increased their share of total emerging-economy issues from 17% in 2004 to 27% in 2005.

One trend observed in 2005 was the use of international issues in local currencies. Brazil floated its first reissued issue on the international market for US\$ 1.5 billion, which was the largest local-currency issue to be made by any emerging-market issuer. These bonds have a 10-year maturity and a coupon rate of 12.5%. The Government of Colombia and several Brazilian, Mexican and Peruvian companies issued bonds on the international market in local currency.<sup>15</sup> These local-currency bond issues (including that of the Brazilian Government) totalled around US\$ 3.9 billion.

Another widespread pattern in the region was the lengthening of maturities (see figure V.10). Brazil reopened its issue of 2034 global bonds, issuing US\$ 500 million in May and the same amount in November 2005. In 2006, Brazil extended maturities by issuing US\$ 1 billion of 2037 global bonds in January (with a yield of 7.56%) and

<sup>15</sup> Some Brazilian banks also carried out similar bond issues.

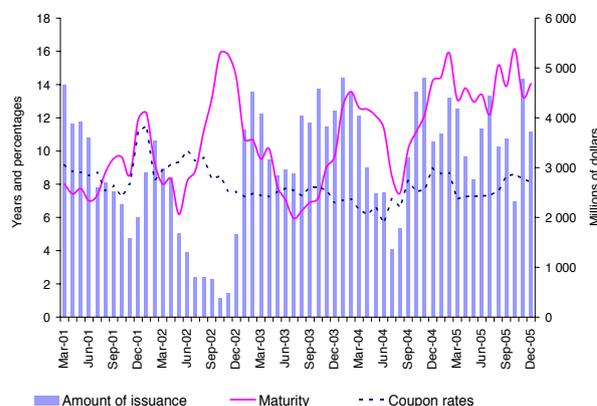
US\$ 500 million in March (with a yield of 6.83%), both with a coupon rate of 7.125%. Peru also issued a further US\$ 500 million in 2025 global bonds for the same purpose.

The first five months of the year saw other issues of long-maturity bonds by the Dominican Republic (21 years), Ecuador (9 years), El Salvador (29 years), Jamaica (30 years), Panama (20 years) and Uruguay (15 and 30 years).

By the beginning of April 2006, 70% of scheduled issues for the year had already been carried out, thereby covering the issuers against future rises in international interest rates.

In addition to sales of federal government bonds (BODENs) to the Bolivarian Republic of Venezuela on a number of occasions during 2005, Argentina placed a bond issue on the international market in March 2006 for the first time since the moratorium of December 2001. This US\$ 500 million issue of 5-year Bonar V bonds had a yield of 8.36% and carried a coupon rate of 7%. In May, a similar amount was issued at a somewhat lower yield (8.09%).

Figure V.10  
**LATIN AMERICA AND THE CARIBBEAN:  
INTERNATIONAL BOND ISSUES**  
(3-month moving averages – in years, percentages and  
millions of dollars)



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of figures from J.P. Morgan and Merrill Lynch.  
Note: The left-hand axis presents the same scale for years and percentages.

## 5. External debt to GDP ratio

In early January 2006, the International Monetary Fund (IMF) approved the Multilateral Debt Relief Initiative (MDRI) for countries covered by the Heavily Indebted Poor Countries (HIPC) Initiative, which include Bolivia, Guyana, Honduras and Nicaragua.

According to IMF data, debts existing prior to 1 January 2005 that are eligible for forgiveness amount to US\$ 231 million in the case of Bolivia, US\$ 65 million for Guyana, US\$ 154 million for Honduras and US\$ 201 million for Nicaragua (including remaining assistance under the HIPC Initiative). This translates into reductions in the external public debt of 4.7% for Bolivia, 5.9% for Guyana, 3.5% for Honduras and 3.8% for Nicaragua.<sup>16</sup>

In March 2006, the World Bank approved financing and implementation details for its MDRI contribution, which is aimed at cancelling the debt of the 17 most indebted poor countries with the International Development Association (IDA) from 1 July 2006. Although the Inter-American Development Bank is not part of the MDRI Initiative, it announced that it would analyse the feasibility of cancelling the debt it is owed by five of the region's countries (Bolivia, Guyana, Haiti, Honduras and

Nicaragua) and that the proposal would be discussed at the meeting of the Bank's Board of Governors in early April. However, no concrete measures have yet been implemented as a result of the meeting.

Countries' external debt operations —in the form of policies for liability reduction, restructuring of debt profiles and borrowing requirements— brought down the ratio of external debt to GDP in Latin America and the Caribbean from 37% in 2004 to 27% at the end of 2005.

Not only is the region less dependent on external financing in general, but it has also succeeded in reducing its exchange risk by increasing its external issues of local-currency bonds. In 2005, 80% of the region's sovereign issues were denominated in dollars, 10% in euros, 1% in yen and 9% in Brazilian reais, Colombian pesos, Mexican pesos, Peruvian soles and Swiss francs. The countries of the region have also increased their debts' maturity profiles and lowered the cost of external debt by retiring short-term and more expensive bonds from the market.

<sup>16</sup> Comparison with the external public debt of these countries as of December 2005.

## 6. Outlook for 2006

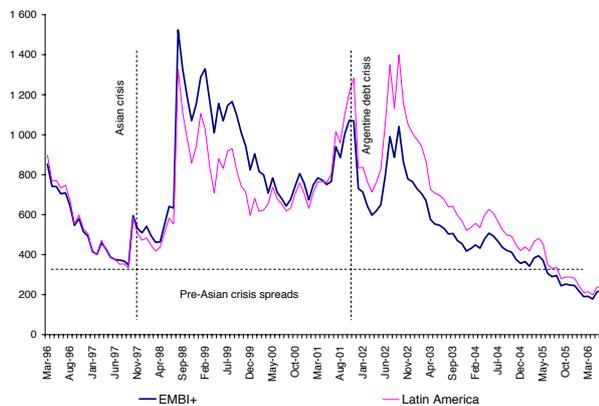
In 2005, international market conditions were a determining factor in achieving the above-mentioned results. In particular, continuing low interest rates, narrow interest rate spreads and excess liquidity were associated with robust external demand for raw materials exported by the region. This pushed up prices of those exports and gave a major boost to income.

The historical series of the region’s interest rates spreads measured by the Emerging Markets Bond Index (EMBI+) reached its lowest level of 2005 in September of that year, when it registered 280 basis points. At the beginning of 2006, spreads trended downward, posting a record low of 199 basis points in April (see figure V.11).

During 2006, however, the market began to reflect greater risk aversion in the face of rising interest rates in the United States. In May, when inflation increased by more than expected in the United States, financial markets cooled considerably (especially emerging markets). This reflected the reaction of investors to expectations of an interest rate hike and a resulting slowdown in world growth.

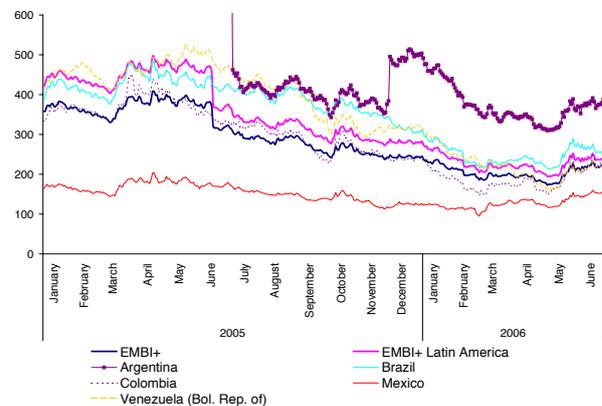
In May, Latin American stock markets and currencies contracted while interest rate spreads as measured by EMBI+ expanded (see figures V.12, V.13 and V.14). The spread was 239 basis points in May and 235 basis points in June. There is uncertainty about how long this situation might continue and the potential consequences of adjusting to international disequilibria. However, the macroeconomic conditions in the region (particularly the primary surpluses, build-up of international reserves and improved debt profiles) suggest that the region is now in a better financial position to face a potential retreat of capital or global recession. Despite the increase in risk premiums, the region’s fundamentals do not seem to be under threat, as the corrections that were made mainly took place in those markets and currencies with the highest levels of appreciation. However, this does not mean the region is devoid of risk factors such as a lack of development in domestic financial markets.

Figure V.11  
LATIN AMERICA: INTEREST RATE SPREADS,  
MEASURED BY EMBI+  
(Basis points)



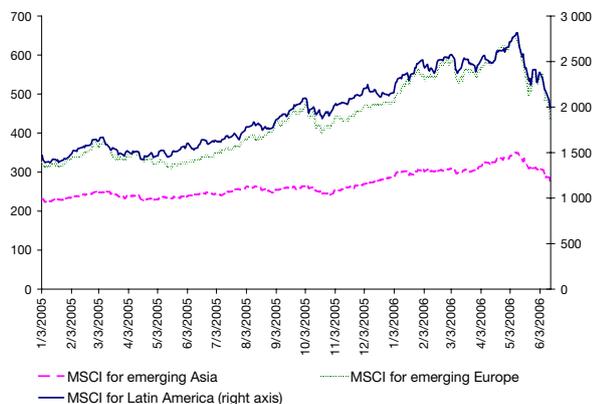
Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of figures from J.P. Morgan.

Figure V.12  
LATIN AMERICA: COUNTRY RISK  
AS MEASURED BY EMBI+ IN 2005 AND 2006  
(Basis points)



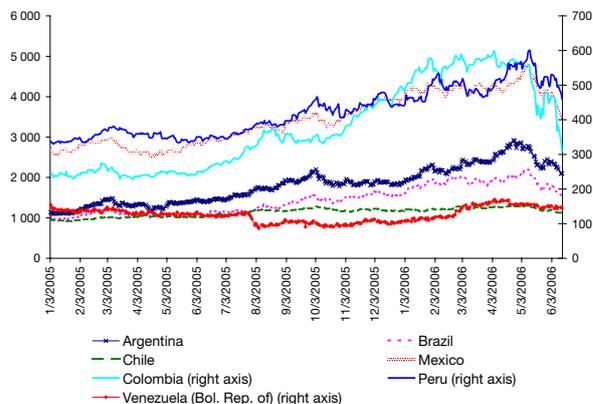
Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of figures from J.P. Morgan.

Figure V.13  
MORGAN STANLEY CAPITAL INTERNATIONAL  
INDEX (MSCI) FOR EMERGING MARKETS



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

Figure V.14  
LATIN AMERICA: MORGAN STANLEY CAPITAL  
INTERNATIONAL INDEX (MSCI)



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

Box V.2  
CAPITAL-ACCOUNT VOLATILITY AND CYCLICAL FLUCTUATIONS IN GDP  
IN LATIN AMERICAN COUNTRIES

In the economies of Latin America, fluctuations in economic activity and employment tend to be linked to external constraints and insufficient financing, factors which have at various times brought about sharp adjustments in aggregate demand.

Traditionally, authors have distinguished between two categories of determinants for capital inflows to emerging economies: pull factors (which relate to better investment opportunities in the countries receiving the flows) and push factors (external influences such as lower international interest rates and slower growth in industrialized countries).

The work of Budnevich and Le Fort on this subject contains an empirical

analysis of the relationship between the cyclical components of GDP and of external financing, particularly from private sources.<sup>a</sup> Push factors and pull factors are therefore controlled for in the estimates, and the causes of fluctuation in external financing are also considered. The authors conclude that the GDP of the United States and external financing — as measured by the capital account to GDP ratio — were procyclical in relation to domestic GDP, while the domestic interest-rate gap was countercyclical. As for external financing, the real exchange rate, the United States interest rate corrected by country risk (measured by the EMBI) and the domestic interest rate were all countercyclical.

The database used for this study

is a non-balanced panel comprising 13 countries for which annual balance-of-payments and national accounts data are available for the period 1983-2004: Argentina, the Bolivarian Republic of Venezuela, Bolivia, Brazil, Chile, Colombia, Costa Rica, the Dominican Republic, Ecuador, Mexico, Panama, Peru and Uruguay.

The conclusions of the study are reached by estimating specifications from two equations. One seeks to explain the cyclical fluctuation of GDP and the other accounts for the volatility of the capital account. Since the explanatory variables for both equations include the lagged dependent variable, estimates were prepared using the Arellano-Bond method.

Source: Guillermo Le Fort and Carlos Budnevich, "Entendiendo las volatilidades cíclicas de la cuenta de capitales y del PIB: un estudio de panel para países latinoamericanos", *Macroeconomía del desarrollo* series, No. 42 (LC/L.2452-P), Santiago, Chile, Economic Commission for Latin America and the Caribbean (ECLAC), November 2005. United Nations publication, Sales No.S.05.II.G.198.

<sup>a</sup> The authors used the Hodrick-Prescott filter to obtain the cyclical components or gaps.

## Chapter VI

# The role of the real exchange rate and investment in export diversification in Latin America and the Caribbean

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### Introduction

The region's unsatisfactory export performance has long been a central theme of ECLAC documents. The Commission's analysis indicates that the lack of buoyancy and high volatility of the region's export earnings are linked to its export structure's excessive concentration in a small number of natural-resource-intensive products entailing a low level of processing.<sup>1</sup> This analysis has led to the recommendation that the region should diversify its exports with a view to achieving a higher value-added structure with greater technological content. Such a structure would enable the region to sell more dynamic products on the international market, which would in turn reduce the volatility of export earnings and have a greater impact on GDP growth and employment.

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<sup>1</sup> In the early days of ECLAC, criticism of the limitations of export specialization based on natural resources emphasized the aspect of world demand, which tended to worsen the terms of trade. Although that argument was not completely abandoned, subsequent criticism of export performance focused on the lack of production linkages within the specialization in natural resources. Later still, ECLAC stressed that specializing in natural resources would not stimulate knowledge creation in the same way as the industrial sector would. In recent years, the potential of a specialization in natural resources has been assessed more favourably.

There is a general consensus that most of the region's countries have done little to diversify their export structure. The question arises as to why Latin America and the Caribbean have had so much difficulty in diversifying this structure during the past 30 years.

In order to diversify an economy's exports, it must be capable of producing new tradable goods and services. This requires the appropriate technical conditions and economic incentives to be present at the same time. Although ECLAC has tended to emphasize one aspect of the problem: the lack of policies and mechanisms for technical capacity-building or compensation of market failures that hamper the development of new skills. But these skills will not translate into regular goods production unless the right economic conditions prevail.

This raises the question as to what has been happening with regard to capacity-building and the profitability of producing tradables in the region over the last three decades. Individual countries' performances have clearly varied, but the insufficient expansion of export production appears to be associated with a feature common to most of the countries: macroeconomic instability that manifests itself as a combination of high inflation and sizeable variations in GDP growth. There seem to be two reasons for this. First, macroeconomic instability has reduced the profitability of tradable goods as a result of highly volatile real exchange rates, with prolonged periods

of real appreciation being interspersed with short-lived bouts of very steep real depreciation (usually caused by external shocks). Second, the region's macroeconomic instability also conspired against increased investment in physical and human capital and therefore against the expansion and diversification of the capacity to produce new goods.

The aim of this chapter is to present research findings regarding the determinants of export diversification in the region.<sup>2</sup> This research was undertaken in order to analyse how the proportions of certain types of industrial exports have been influenced by the following three variables (each of which has been affected by macroeconomic instability): the level of the real exchange rate; its variability; and investment in machinery and equipment. The countries analysed were: Argentina, Barbados, Bolivarian Republic of Venezuela, Bolivia, Brazil, Chile, Colombia, Costa Rica, Ecuador, El Salvador, Guatemala, Honduras, Jamaica, Mexico, Nicaragua, Panama, Paraguay, Peru, Trinidad and Tobago, and Uruguay.

The following section reviews concepts and empirical literature relating to the link between the production of tradable goods and these three variables (level of the real exchange rate, its volatility and investment). The third section discusses some stylized facts of export diversification, while the fourth presents an econometric analysis of panel data for the entire set of selected countries.

## A. Determinants of export diversification

Diversifying exports is about modifying an economy's pattern of specialization to produce new exportable goods. This requires technical capacity and an appropriate level of profitability.

An economy's technical capacity to produce new exportables depends on its endowments of human and natural resources and the stock of physical capital and knowledge it has accumulated. These determinants have

varying effects on the development of an economy's technical production capacity.<sup>3</sup> In the short and medium terms, developing the capacity to produce tradable goods basically depends on the development of knowledge and the growth of physical capital stocks, which in turn determine factor productivity.

The profitability of producing exportable goods compared with the rest of the economy depends on the

<sup>2</sup> Roberto Iglesias, "El rol del tipo de cambio real y la inversión en la diversificación de exportaciones en América Latina y el Caribe", *Macroeconomía del desarrollo series*, No. 43 (LC/L.2460-P), Santiago, Chile, Economic Commission for Latin America and the Caribbean (ECLAC), December 2005.

<sup>3</sup> Although the quantity and quality of natural resources in an economy cannot be taken as givens, they change very gradually as a function of the stock of knowledge and capital that is accumulated. Increased knowledge, whether generated at home or abroad, may make it possible to expand an economy's resource endowment and use it more efficiently (World Bank, *From Natural Resources to the Knowledge Economy: Trade and Job Quality*, Washington, D.C., 2002).

level of the real exchange rate and its volatility. Real, gradual and sustained devaluations appear to have been a fundamental factor in the diversification of the export supply by highly successful exporters (particularly in the case of Asian countries).<sup>4</sup>

Real exchange-rate volatility influences the projected profit ratios of projects focusing on the expansion of exportable production, as it generates uncertainty about future income streams and profits and increases the level of risk. In addition, the supply of such goods may take some time to respond to real devaluations or may be inhibited from doing so. This is why real exchange-rate

volatility is particularly detrimental for economies seeking to diversify their supply of tradable goods.

Investment and the real exchange rate's level and degree of volatility are thus three fundamental variables influencing the characteristics of an economy's export supply. Three main issues to be considered in this regard are: the relationship between the real exchange rate and changes in an economy's supply of exportables; the role of exchange-rate volatility in inhibiting the diversification of export production; and the way in which this volatility and macroeconomic instability influence the level of investment in tradables.

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## 1. Real devaluation as an instrument for the diversification of production

There are at least two ways in which real devaluations can have a positive effect on an economy's supply of export goods. First, they may increase profitability levels and, as a result, stimulate production of existing export goods and create incentives for the emergence of new tradable activities. Second, as real devaluations encourage and expand the production of existing and new tradables, they open up opportunities for achieving economies of scale and new knowledge in the sectors involved. This may enable these sectors to reach international productivity standards and thus permanently transform the country's pattern of specialization.<sup>5</sup>

### (a) The impact of devaluations on the profitability of exportable goods

In order for tradable goods to respond positively to devaluations, changes in the relative prices of tradables and non-tradables must be such as to raise the profitability of the former.<sup>6</sup> Whether this occurs or not will be determined by how the devaluation affects exporters' earnings and costs.

The region used to be reluctant to consider real devaluation as a means of expanding tradable production for two reasons. First, the high inflation that prevailed

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<sup>4</sup> According to Agosin and Tussie, most countries that achieved steady export growth maintained exchange rates that were attractive to their exporters ("An overview", *Trade and Growth. New Dilemmas in Trade Policy*, New York, St. Martin's Press, 1993). These exchange rates also tended to remain stable, thereby enabling tradable-goods producers to make long-term investments. Rodrik discusses the roles of the real exchange rate and investment in the expansion and diversification of exports in South-East Asia (D. Rodrik, "Getting interventions right: how South Korea and Taiwan grew rich", *NBER Working Papers*, No. 4964, 1984; and "Trade strategy, investment and exports: another look at East Asia", *NBER Working Papers*, No. 5339, 1985). Krugman (1987) analyses the dynamic process of production specialization that can be triggered by a real devaluation within an economy.

<sup>5</sup> P. Krugman, "The narrow moving band, the Dutch disease, and the competitive consequences of Mrs. Thatcher: notes on trade in the presence of dynamic scale economies", *Journal of Development Economics*, vol. 27, 1987.

<sup>6</sup> The duration of a real devaluation depends on how long it takes the real exchange rate to return to its purchasing power parity (PPP convergence). Recent evidence (from periods of flexible exchange rates and low inflation in developed countries) shows that this convergence process may be very slow, and domestic mechanisms to adjust prices in accordance with nominal valuation may vary greatly.

in most of the region's countries provided limited and fleeting opportunities for a real devaluation. Second, during the import-substitution industrialization (ISI) phase, real devaluations had ambivalent effects on the profitability of firms that sold a large proportion of their goods on the domestic market and whose cost structures were strongly influenced by the cost of imported inputs and of servicing foreign-currency debts.

The problems that impeded devaluations were not limited to the difficulty of altering relative prices in a context of high or chronic inflation. The region also faced stumbling blocks in its attempts to expand its supply of exportables. The factors that hindered or restricted the expansion of export supply following a devaluation,<sup>7</sup> particularly in the short run, included the low short-term elasticity of the export supply of certain natural-resource-intensive goods and the lower profitability and tighter liquidity constraints faced by export companies following devaluations. These increased liquidity constraints were the result of the devaluation-induced decrease in domestic demand, higher prices for imported inputs, reduced external financing and tighter monetary conditions within each of the affected national economies.

In short, the pessimistic view of how the supply of exportables would react to real devaluations was associated with two phenomena that were common in the region up until the 1990s: high inflation and a lower profit ratio for many manufacturing companies owing to their cost structures and the liquidity constraints associated with devaluations. Under these circumstances, real devaluations were short-lived or small in scale and tended to depress profitability and increase insolvency rates, with the result that the supply of exportables expanded very little.

### **(b) The dynamic effects of real devaluations**

A devaluation of the real exchange rate pushes up external demand for a country's tradable goods, which creates opportunities for expanding the production of

existing exports as well as for producing and exporting new goods. This can increase the economy's productivity in the short term or procyclically for a variety of reasons, including the emergence of economies of scale, increased utilization of factors of production and the effects of "learning by doing".

According to Krugman (1987), real devaluations can have lasting effects on an economy's relative productivity and its pattern of specialization. Exchange-rate policy can pave the way for the emergence of new production sectors, and experience and knowledge in these activities can thus be accumulated. In his model, a given sector's factor productivity depends on its cumulative production experience, both nationally and abroad. Relative productivity vis-à-vis the rest of the world therefore rises in those sectors that gain experience through producing. Dynamic scale economies resulting from the production process bring down costs and allow for new areas of specialization. According to this model, a new sector that has emerged thanks to this kind of exchange-rate policy's application will produce goods at increasingly lower costs thanks to the productivity gains it will realize as it accumulates more production experience, thus consolidating a new specialization pattern.<sup>8</sup>

Krugman describes some limitations on the possibilities for diversification based on exchange-rate policies. First, the increase in the number of sectors will lead to more employment and thus to higher wages. This will limit diversification, since very large productivity gains will be required to make a new sector profitable. He therefore suggests that real devaluations may produce a greater change in comparative advantages for countries with relatively large labour forces or relatively low wage levels.<sup>9</sup> Although knowledge- and experience-based specialization does not depend on the initial relative resource endowment, Krugman concludes that this endowment does affect factor remuneration and places a limit on the expansion of production opportunities.<sup>10</sup>

Second, the size of the domestic market also makes a

<sup>7</sup> There is a considerable amount of literature on the effects of devaluation on production, relative prices and exports in the region. Empirical studies that cover more than one country include: R.N. Cooper, "An assessment of currency devaluation in developing countries", *Government and Economic Development*, Gustav Ranis (ed.), New Haven, Yale University Press, 1971; and S. Edwards, *Real Exchange Rates, Devaluation and Adjustment: Exchange Rate Policy in Developing Countries*, Cambridge, MIT Press, 1989. For a more theoretical discussion of the impact of devaluation, see W.M. Corden, *Inflation, Exchange Rates and the World Economy: Lectures on International Monetary Economics*, Oxford, Clarendon Press, 1985; C.F. Diaz Alejandro, "A note on the impact of devaluation and distributive effect", *Journal of Political Economy*, vol. 71, 1963; P. Krugman and L. Taylor, "Contractionary effects of devaluation", *Journal of International Economics*, vol. 8, 1978; and, P.R. Agenor and P. Montiel, *Development Macroeconomics*, Princeton University Press, 1996.

<sup>8</sup> The relative productivity of the new production process vis-à-vis the rest of the world will increase in line with the accumulation of experience.

<sup>9</sup> Countries with high wages may find it difficult to find sectors in which a rise in productivity would suffice to achieve a relative cost advantage.

<sup>10</sup> Relatively large countries or those with more resources (in terms of labour) tend to have greater production experience and relative productivity vis-à-vis countries with fewer resources, since a larger workforce may be able to produce a higher number of goods.

difference in terms of diversification. In small countries that do not have large enough domestic markets to permit production to expand, exchange-rate policy may not succeed in speeding up productivity growth sufficiently to achieve comparative advantages for that sector.

Clearly, increases in the potential profitability of exportable goods brought about by real devaluations do not automatically create capacity for producing new varieties of goods. It is plausible to think, however, that increased profitability would encourage new or existing entrepreneurs to create that capacity by investing in research, imitating other countries, purchasing technology and training the labour force.

Yet the learning experience is basically limited because imitating and applying existing technologies may not be a linear or automatic process. Cimoli (1992)<sup>11</sup> stresses that, following a real devaluation, the possibility of diversifying the supply of tradable goods and changing an economy's pattern of specialization in relation to its trading partners will depend on the technological gap between them. This technological gap has two elements: imitation (based on technological asymmetries between the country and the rest of the world) and innovation.

According to Cimoli, an economy with no innovation capacity can diversify its export structure only by using its imitation capacity to produce goods based on consolidated technologies. This capacity may be relatively low, however, due to considerable technological asymmetries in relation to the rest of the world that entail differences in production coefficients and in product characteristics and performance. Cimoli emphasizes that, when faced with a real devaluation, an economy with major technological asymmetries in relation to its main trading partners can do not more than to use its imitation capacity to begin to produce a limited range of products using the best available technology, thereby accomplishing little in terms of narrowing the technological gap separating it from the rest of the world.

Real devaluations generate opportunities for diversification, but low technology-absorption and imitation capacities may limit the possibilities of taking advantage of them. This may have been the case for many Latin American economies in the past. The failure of exportables production to respond to a real devaluation may also have been linked to the region's very low levels of productive and technological development.

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## 2. Volatility of the real exchange rate and the reaction of exportable supply

To analyse the role of that volatility in real exchange rates plays in trade flows, it must be remembered that winning over or penetrating an external market has high costs stemming from the production, investment and marketing decisions inherent in such a strategy. These decisions include:

- (i) Extending production capacity;
- (ii) Acquiring knowledge and technology to adapt products and production processes to the foreign market so that high-quality goods can be offered at competitive prices; and

- (iii) Incurring the expenses involved in developing a distribution and marketing network.<sup>12</sup>

Krugman (1989)<sup>13</sup> states that investment aimed at winning entry into a foreign market is, to some extent, irreversible, since it involves sunk costs for the company concerned. Once the company has invested in the product and in developing a foreign clientele (which involves a high proportion of intangible assets relating to the acquisition of knowledge about external markets), it will be difficult for it to sell or liquidate the venture (or it can do so only at a price far below the investment value).

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<sup>11</sup> M. Cimoli, "Exchange rate and productive structure in a technological gap model", *Economic Notes*, vol. 21, Monte dei Paschi di Siena, 1992.

<sup>12</sup> Investment aimed at adapting products and developing distribution and marketing networks has similar characteristics to investment in technology. This kind of investment is knowledge-intensive, and the outcome is extremely uncertain, given the cultural distance between the domestic producer and the external market. As in the case for technology, those who invest to enter an external market cannot appropriate all the benefits, as their knowledge generates positive spillover effects for other exporters. Consequently, private investment levels are lower than what would be socially desirable. The volatility of the real exchange rate may reinforce this situation.

<sup>13</sup> P. Krugman, *Exchange-Rate Instability*, Cambridge, MIT Press, 1989.

As a result of the high costs of entering external markets, exportable supply displays atypical reactions to movements in the real exchange rate. For instance, small movements in the real exchange rate may not be sufficient to encourage a potential exporter to enter the external market if the resulting change in profitability will not offset the entry costs. According to Krugman, potential exporters' tendency to refrain from reacting to real devaluations is accentuated when the devaluation is expected to be temporary.

When the post-devaluation level of the real exchange rate is expected to be temporary, potential exporters who benefit from the higher real exchange rate will wait before investing in order to avoid losing profitability if the rate returns to its pre-devaluation level. Thus, in a context of high entry costs, if real devaluations are temporary or if real exchange rates are extremely volatile, potential exporters of non-traditional products may refrain from entering external markets altogether and traditional exporters may decide not to expand into any new markets.

The fact that most Latin American countries had experienced a rapid reversal of real devaluations must have contributed to the perception that such devaluations were likely to be short-lived. This perception and the existence of market entry and exit costs, discouraged potential exporters from entering external markets. These factors no doubt contributed to the forces that reduced the diversification of the region's supply of exportable goods.

Exporters' tendency to wait before entering or leaving an external market may grow stronger as real exchange rates become more volatile. For Krugman, the higher the volatility of the real exchange rate, the greater a difference there will have to be between entry costs and expected earnings in order for exporters to enter the market. In this context, there is more of an incentive to wait and avoid incurring such costs, as corporate decision-makers know that they can wait and carry out the investment at a substantially higher real exchange rate or avoid significant losses in the event of an appreciation of the real exchange rate.

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### 3. Devaluation of the real exchange rate, macroeconomic instability and investment in exportable goods

Rodrik (1995)<sup>14</sup> suggests that investment was a key factor in building export capacity in Asian countries. Compared with Asia, there is a much lower rate of investment in Latin America and the Caribbean. The region's macroeconomic instability and volatile real exchange rates may have been partly responsible for dampening the level of investment in the production of tradable goods and consequently for reducing the region's possibilities of diversifying its exports. According to the theory of investment under uncertainty and irreversibilities, the volatility of future investment returns may delay the decision to invest.<sup>15</sup> When macroeconomic volatility is chronic, as in Latin America, this can end up reducing the economies' level of investment.

#### (a) High inflation and investment

High inflation tends to be linked with variability in relative prices.<sup>16</sup> This affects long-term corporate decisions, as it increases the complexity of contracts and the frequency of negotiations while reducing the timeframes for planning. Companies avoid long-term commitments that would saddle them with a set of relative prices that could become detrimental to their profitability.

Tommasi (1994) studies how the instability of relative prices and reduced incentives to seek price information are related to the establishment of inefficient equilibria in the economic system.<sup>17</sup> In particular, his analysis emphasizes that high relative price variability can increase the risks

<sup>14</sup> D. Rodrik, "Trade strategy, investment and exports: another look at East Asia", *NBER Working Papers*, No. 5339, 1995.

<sup>15</sup> A. Carruth, A. Dickerson and A. Henley, "What do we know about investment under uncertainty?", *Journal of Economic Surveys*, vol. 14, 2000.

<sup>16</sup> According to J. Temple, recent empirical evidence indicates that the variability of relative prices increases with inflation and that variability seems to be associated with unanticipated components of inflation. Relative price variations caused by inflation appear to influence resource allocation ("Inflation and growth: stories short and tall", *Journal of Economic Surveys*, vol. 14, 2000).

<sup>17</sup> M. Tommasi, "The consequences of price instability on search markets: toward understanding the effects of inflation", *American Economic Review*, vol. 84, 1994.

that firms face when introducing a new technology, as it heightens the probability of generating inefficient relations with the suppliers of the technology or of that technology becoming unprofitable in the event of changes in relative prices.

For all of these reasons, macroeconomic instability may have exerted a negative effect on aggregate investment and the introduction of new technologies in the countries of the region. As discussed below, volatility and the difficulties involved in sustaining real devaluations may have had a particular impact on investment in exportable goods.

### **(b) Real devaluations and investment**

In the short term, real devaluations boost profitability and the external demand for the production of exportables. These two factors may then encourage decisions to expand production capacity in those sectors. However, the positive effects on profitability and external demand may be offset by a series of factors that can accompany devaluations, such as higher prices for imported equipment, external financing constraints, tightening of domestic credit terms and conditions, lower domestic demand for exportable goods and changes in the asset portfolios of export producers. These factors have a stronger impact in the short run and may taper off over the medium term, but, as noted earlier, the region has found it difficult to maintain real devaluations and the corresponding profit incentives for the production of exportables.

Burstein, Neves and Rebelo (2004) show that nominal devaluations have a greater impact on the prices of imported capital goods than on other products, such as consumer goods.<sup>18</sup> In developing countries, a high proportion of machinery and equipment is imported. A real devaluation may therefore increase investment costs and have an adverse effect on investment dynamics and technological modernization projects.

The expansion of investment in tradables may suffer from the financial constraints associated with devaluation. Devaluations in the region usually occur in response to an external financing crisis, but they do not immediately solve those crises. The shortage of external financing in the immediate aftermath of a devaluation hinders the importation of the machinery and equipment that are so

important for investment in tradable goods. In addition, devaluations may worsen local companies' financial position by pushing up its leverage ratio. Deteriorating solvency indicators and the lower value of foreign-currency assets make it more difficult for them to gain access to credit and external financing in the wake of a devaluation. Financial surpluses and self-financing resources shrink as a result of the increased debt-servicing burden relative to cash flow, thereby heightening the financial constraints on investment.

Devaluation also produces a tightening of domestic credit terms. This is the result of two sets of factors. First, devaluation quickens the pace of inflation, which obliges the monetary authorities to tighten monetary policy. Second, the domestic financial system's credit supply suffers because of the reduced quantity and higher cost of external resources and from the rise in the system's default rate, which in turn leads to wider spreads and higher interest rates on loans.

Weaker domestic demand for exportable goods is the result of changes in relative prices and falling real domestic expenditure (due to higher inflation and its various effects on spending capacity) and lower real wages. This weakening of domestic demand may make it possible to meet external demand without expanding production capacity in the short term.<sup>19</sup>

Such negative effects on investment may, as noted earlier, fade over the medium term. External demand and the recovery of domestic demand, combined with the increased financial resources provided by the boom in exports, may make it possible to take advantage of idle capacity and overcome financing constraints. For exportables production and investment to remain attractive, however, the real devaluation must be maintained over time. To achieve this, inflation must be controlled so that relative prices can shift in favour of tradable goods.<sup>20</sup> This ensures an appropriate incentive system for the export sector which paves the way for the expansion of exports and investment in tradable goods.<sup>21</sup>

In the past, Latin American economies found it difficult to maintain real devaluations and to generate a virtuous circle of export expansion, a reduction in the constraints affecting investment in tradables and an increase in production capacity. The erratic performance of the real

<sup>18</sup> "Investment prices and exchange rates: some basic facts", *NBER Working Papers*, No. 10238, 2004.

<sup>19</sup> This would not be a valid statement if tradable-goods companies' sales were made up entirely of exports prior to the devaluation.

<sup>20</sup> The following measures must be taken in order to avert a devaluation's inflationary impact in relatively stable economies: control of aggregate expenditure, openness and productivity-based nominal wage hikes. Another effect of a policy of controlling expenditure and real wages is to guide production towards exports as a way of compensating for the reduction in domestic demand, thereby changing the economy's aggregate demand structure by increasing the proportion of external demand in the medium term.

<sup>21</sup> Recent experiences in the region's largest economies indicate that macroeconomic stability has made it possible to maintain real devaluations.

exchange rate generated highly variable patterns in the production of exportables and inhibited the investment reflex of tradables producers.

The volatility of real exchange rates contributed to the limited diversification of exportable production in the region by reducing the demand and profitability expectations for investments in tradable goods. The impact of such volatility depends on several factors, including investors' attitude toward risk and the costs of adjusting investments in the event of changes in demand and profitability. Depending on the hypotheses formulated in regard to these factors, the relationship between volatility and investment can be negative or positive. Theoretical predictions regarding this relationship can therefore be ambivalent.

Carruth, Dickerson and Henley (2000) assert that the literature focusing on the irreversible nature of

investment indicates that greater volatility in real exchange rates can cause investment decisions to be delayed and can lead to a drop in the current level of investment even among risk-neutral investors. This is the result of the notion that a decision to invest is tantamount to a "perpetual call option". Increased uncertainty — i.e., an increase in the variance of the distribution of future returns — raises the value of the option represented by the postponement of the decision to invest. In addition, the irreversibility of investment projects may give rise to asymmetrical adjustment costs if volatility generates changes in demand and profitability conditions, and these costs may be greater in the case of a contraction than an expansion. This leads to the postponement of investment decisions at certain price intervals, but it does not necessarily create a negative relationship between volatility and investment.

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## B. Observations on export diversification in the region

According to the line of thought traditionally espoused by ECLAC, diversification is about more than merely reducing the export concentration index. Although the Commission now acknowledges that reducing the concentration index of total exports is important for income stability and the growth rate of export value, the diversification of exports is seen as the result of a country's industrialization as it moves from exporting a high proportion of primary goods and derivatives to selling more manufactured goods with a higher technology content.

The indicators used in the empirical analysis were selected on the basis of those that would best represent what ECLAC means by diversification. For the most part, these indicators are composed of export ratios or the proportions of total exports represented by certain types of industrial goods.<sup>22</sup> The ratio that best represents diversification as defined by ECLAC is exports of durables and diffusers of technical progress over total exports (XDDTP/XT). ECLAC regards these goods as having the dynamism and the high technological content necessary for the rapid growth of export value and of production linkages with the rest of the world economy.

The XDDTP/XT ratio may differ by destination market. For each country in the sample, the XDDTP/XT ratios were therefore established for exports to: (i) all Latin American and Caribbean countries, (ii) United States and (iii) the rest of the world. For South American countries, the United States was considered as part of the "rest of the world". For Central America and the Caribbean, the "rest of the world" excluded the United States and the entire Latin American and Caribbean market. South American exports of durables and diffusers of technical progress to Latin American markets may be favoured by trade preferences, so Latin America has also been excluded from the "rest of the world" category. The most objective diversification variable is therefore the XDDTP/XT ratio of sales to the rest of the world.

Table VI.1 shows the XDDTP/XT ratio of sales to the rest of the world by country and some weighted averages. The ratio for the sample as a whole went from 2.8% in 1970-1979 to 14.4% in 2000-2003. This result is largely attributable to Mexico, which has accounted for a large share of the region's total exports (especially since the 1990s) and which has an atypical trading pattern in

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<sup>22</sup> These proportions were obtained by grouping exports by intended use on the basis of the Standard International Trade Classification (SITC Rev.1) from the United Nations COMTRADE database (1970-2003). The category of traditional industrial goods is made up of two groups: foodstuffs, beverages and tobacco, and other traditional products. Non-traditional goods correspond to natural-resource-intensive products with high economies of scale, durables and diffusers of technical progress.

Table VI.1  
**EXPORTS OF DURABLES AND DIFFUSERS OF TECHNICAL PROGRESS AS A PERCENTAGE OF TOTAL EXPORTS  
 TO THE REST OF WORLD (XDDTP/XT), SELECTED PERIODS**

	1970-1979	1980-1989	1990-1999	2000-2003	Absolute difference (2000-2003/ 1970-1979)	Annual average growth rate (1971-2003)
Argentina	2.45	3.48	4.36	5.35	2.91	2.8
Barbados	4.96	13.80	12.18	14.01	9.05	4.5
Bolivia	0.05	0.06	8.24	12.81	12.75	17.9
Brazil	7.17	14.62	16.00	21.98	14.81	8.0
Chile	0.44	0.85	0.81	0.93	0.49	2.7
Colombia	0.46	0.50	0.80	1.49	1.03	7.1
Costa Rica	0.58	1.02	18.27	50.60	50.02	17.1
Ecuador	0.12	0.05	0.23	0.78	0.66	15.3
El Salvador	0.40	0.28	1.35	6.01	5.61	10.4
Guatemala	0.05	0.09	0.45	0.80	0.75	8.1
Honduras	0.00	0.01	1.19	0.80	0.80	20.3
Jamaica	0.36	0.25	0.08	0.09	-0.27	-5.7
Mexico	8.78	5.79	36.21	49.52	40.73	6.2
Nicaragua	0.30	0.02	6.50	0.77	0.47	-16.0
Panama	0.42	0.54	0.93	0.26	-0.16	10.0
Paraguay	0.01	0.02	0.33	0.58	0.58	29.0
Peru	0.21	0.73	0.81	1.24	1.03	11.4
Trinidad and Tobago	0.89	2.22	4.24	1.33	0.44	-0.7
Uruguay	0.00	0.81	1.58	2.17	2.17	8.9
Venezuela (Bolivarian Rep. of)	0.14	0.46	1.12	1.32	1.18	4.3
Weighted average, Latin America and the Caribbean	2.75	6.35	9.86	14.39	11.65	
Weighted average without Mexico	2.55	6.41	7.35	10.62	8.07	
Weighted average without Mexico, Brazil and Argentina	0.24	0.56	1.45	2.63	2.39	

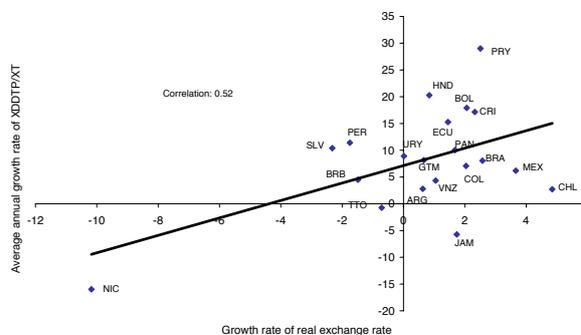
Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of United Nations, Commodity Trade Database (COMTRADE).

regional terms. Excluding Mexico, the weighted average remained almost unchanged in the 1970s and 1980s — when Mexico accounted for a smaller share of the region’s exports — but fell to 10.6% in 2000-2003 (almost four percentage points less than the regional average including Mexico). Regional averages are heavily influenced by the performance of Brazil and Argentina, which, together with Mexico, are the region’s largest economies and often turn display atypical patterns. Excluding these countries, the average XDDTP/XT ratio of the remaining countries was 0.24% in 1970-1979 and 2.6% in 2000-2003 (almost 12 percentage points less than the average for the sample as a whole).

What follows is an attempt to associate the XDDTP/XT ratio for exports to the rest of the world with possible determinants. Figure VI.1 relates average annual rates of variation in the real exchange rate to changes in the XDDTP/XT ratio in sales to the rest of the world in 1971-2003.

As expected, there is a positive association between the rate of variation in the XDDTP/XT ratio in sales to the rest of world and the rates of variation in real exchange rates in the countries analysed for the sample. Atypical performances in the fitted line were found in the cases of Chile and Mexico, whose XDDTP/XT ratios expanded less than expected given their economies’ real devaluation

Figure VI.1  
**AVERAGE ANNUAL RATES OF VARIATION IN THE PROPORTION  
 OF EXPORTS OF DURABLES AND DIFFUSERS OF TECHNICAL  
 PROGRESS RELATIVE TO TOTAL EXPORTS TO THE  
 REST OF WORLD AND IN THE REAL EXCHANGE RATE**  
*(Averages, 1971-2003)*



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of United Nations, Commodity Trade Database (COMTRADE).

rates, and in those of Honduras, Peru and El Salvador, where exports of durables and diffusers of technical progress as a percentage of total exports expanded more than expected given their real devaluations.

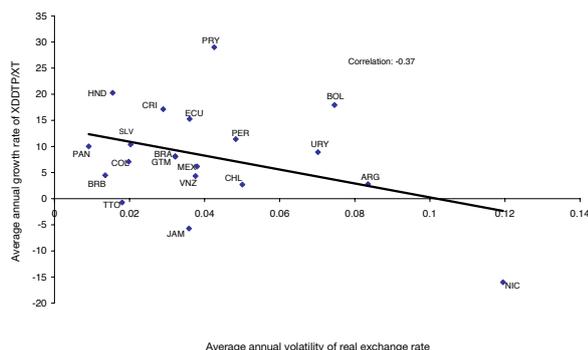
Figure VI.2 depicts a negative relation between the average annual volatility of the real exchange rate and the growth rate of the XDDTP/XT ratio. The fitted line

appears to underestimate the performance of low-volatility countries such as Bolivia, Costa Rica, Honduras and Paraguay.

Imports of capital goods are a crucial part of investment in the production of tradable goods. Figure VI.3 shows the relationship between the average growth of capital goods imports and the variation in XDDTP/XT for each country in the sample.

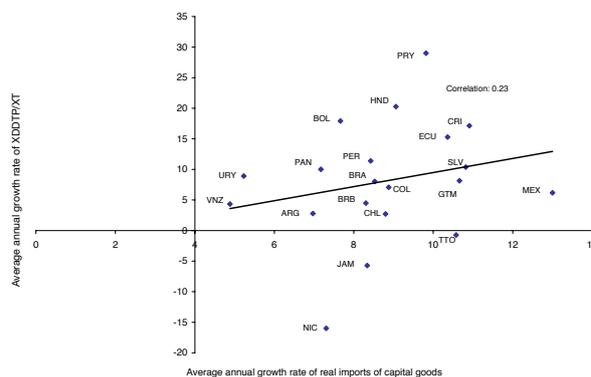
The calculations yield a positive relationship between the two variables. Costa Rica, Paraguay, Honduras and Bolivia registered a high variation in XDDTP/XT compared with the rates of expansion of their capital goods imports. By contrast, imports of capital goods rose substantially in some countries that did succeed in increase the XDDTP/XT ratio very much (Argentina, Chile, Jamaica, Nicaragua, and Trinidad and Tobago).

Figure VI.2  
ANNUAL GROWTH RATE OF THE PROPORTION OF EXPORTS OF DURABLES AND DIFFUSERS OF TECHNICAL PROGRESS RELATIVE TO TOTAL EXPORTS TO THE REST OF WORLD (XDDTP/XT) AND ANNUAL VOLATILITY OF THE REAL EXCHANGE RATE (Averages, 1971-2003)



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of United Nations, Commodity Trade Database (COMTRADE).

Figure VI.3  
ANNUAL GROWTH RATE OF THE PROPORTION OF EXPORTS OF DURABLES AND DIFFUSERS OF TECHNICAL PROGRESS RELATIVE TO TOTAL EXPORTS TO THE REST OF WORLD (XDDTP/XT) AND REAL IMPORTS OF CAPITAL GOODS (Averages, 1971-2003)



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of United Nations, Commodity Trade Database (COMTRADE).

### C. Econometric analysis of the determinants of export diversification

To assess the determinants of export diversification, the following equation was estimated using panel data:

$$EXP_{it} = \rho EXP_{i(t-1)} + \beta X_{it} + c_i + u_{it} \quad (1)$$

where  $EXP_{it}$  is the export diversification variable;  $X_{it}$  corresponds to a vector that contains the variables: real exchange rate, real exchange rate volatility, investment, productivity and world demand;  $c_i$  is the fixed effect of each country; and  $u_{it}$  is the random error.

The diversification variable considered was the ratio of exports of durables and diffusers of technical

progress to total exports (XDDTP/XT) for sales to the rest of the world. On the basis that sales to certain markets benefit from economic complementarity and integration agreements, the variable excludes Latin American and Caribbean markets for all countries in the sample and also excludes sales to North America for Mexico, Central America and the Caribbean countries. Sales to the “rest of the world” are a better reflection of the determining influence of the selected economic variables on sales of durables and diffusers of technical progress.

The choice of the ratio of exports of durables and diffusers of technical progress to total exports (XDDTP/

XT) as an indicator of diversification should be explained. This choice does not imply that this is the only, best or most representative indicator of the export diversification process. Nor does it imply a rejection of other export diversification options such as those implemented by some Latin American countries. The ratio in question simply happens to be the proxy that best represents the ECLAC tenet that diversification is tantamount to increasing the proportion of products with the highest value added, the greatest technological content and, therefore, the least natural-resource content.

Usually, empirical analyses of diversification include structural variables or variables representing factor endowments. In this case, investment (and, more specifically, imports of machinery and equipment) may be considered a proxy for changes in an economy's production capacity that can be used to gain a greater understanding of the XDDTP/XT relationship. However, this is clearly insufficient. The accumulation of knowledge is also reflected in changes in production capacity and is even more important in terms of producing complex or high-technology goods. There is thus a need for an indicator of an economy's level of knowledge or knowledge-related production capacity. Labour productivity or the level of schooling of the labour force are two proxies used in the literature to capture the impact of knowledge on production capacity.

This study did not use representative data on education, as not all countries had such data available for the 1970s. The problem with using enrolment rates includes the fact that, for durables and diffusers of technical progress, university enrolment would have to be considered in addition to primary enrolment. The decision was therefore taken to use a labour productivity index, based on the average output per worker in the countries concerned. Labour productivity, thus defined, rose during the 1970s but then subsequently slowed or remained constant. As a result, the productivity levels of most of the sample countries declined relative to those of the Organisation for Economic Co-operation and Development (OECD). This variable was calculated on the basis of two different definitions: absolute productivity and productivity as compared to the average of the seven main OECD economies. The results were not significant and had a negative sign.

The dynamic panel data partly resolves the problem of the role of factor endowment, as XDDTP/XT in period  $t$  is the result of that ratio in  $t-1$ , of the level and volatility of the real exchange rate and of investment in machinery and equipment in  $t$ . The lagged dependent variable captures production capacity and profitability determinants up until  $t-1$ . Between  $t-1$  and  $t$ , the structure of the economy undergoes few changes, and XDDTP/XT shifts according to variations in economy's profitability and stock of machinery and equipment.

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## 1. The data

The ratio of exports of durables and diffusers of technical progress to total exports (XDDTP/XT) was calculated on the basis of the product classification used in the United Nations COMTRADE database. In selecting the country sample, priority was given to the availability of data over time.<sup>23</sup>

Each country's real effective exchange rate was calculated using the weighted geometrical mean of the exchange rate with each of that country's trading partners, weighted by each year's export structure.<sup>24</sup>

The volatility of the real exchange rate was calculated as the standard deviation of the first difference of the natural logarithm of the real effective exchange rate. The

other two options considered for measuring the volatility of the real exchange rate were the 12 months of the year in question and a total of 36 months (the previous, current and following years).

As explained in section B, investment in tradable goods has a large component of machinery and equipment. In most of the region's countries, imported equipment plays an important role in domestic investment, given the existing shortcomings in the countries' domestic production of capital goods. Imports of capital goods were therefore considered to be a proxy for investment in machinery and equipment.<sup>25</sup>

The following two options for representing the

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<sup>23</sup> The Dominican Republic, whose exports boomed during the 1990s, was excluded due to a lack of sufficient data in terms of the classification used in this study.

<sup>24</sup> The real effective exchange rate was calculated by the Economic Development Division of ECLAC.

<sup>25</sup> Information on capital goods imports was compiled by the Statistics and Economic Projections Division of ECLAC.

variable of capital goods imports were considered: the index of real imports of capital goods and the level of capital goods imports in terms of GDP. Values for real imports were obtained by adjusting each country's nominal imports according to the United States price index for capital goods imports.<sup>26</sup> The capital goods imports/GDP ratio was calculated using constant-dollar series for imports and GDP.

Productivity corresponds to income per worker. Data for GDP are in constant 1995 dollars (from the Statistics and Economic Projections Division of ECLAC). Data on countries' labour forces were obtained from the

World Bank's *World Development Indicators*. The two productivity criteria used were each country's labour productivity and each country's relative productivity. The latter is the quotient of each country's productivity and the average productivity of the seven main OECD countries.

The following three indices were used for world demand: real world imports (nominal world imports adjusted by world import prices); real imports of industrial countries (nominal imports adjusted by the average import price index of industrialized countries); and the physical industrial output of industrial countries.<sup>27</sup>

## 2. Results

### (a) For all the countries in the sample

Table VI.2 shows the estimates for the complete sample.<sup>28</sup> The equation in column (1) was arrived at after experimenting with other specifications:

- (i) Two definitions of productivity yielded coefficients that were not significant and carried a negative sign;
- (ii) The indicator for volatility of the real effective exchange rate (REER) in 36 months revealed that the best volatility measure in econometric terms is the 12-month trend;<sup>29</sup>

- (iii) Out of all the indicators of world demand, real world imports were the best proxy for world demand;
- (iv) the Real capital goods imports index yielded less satisfactory results than the capital goods imports/GDP ratio.

The value shown in brackets below the coefficients is the standard error for that coefficient. With the exception of world demand and the constant variable, all the variables are statistically different from zero with at least a 10% confidence margin (p-values below 0.10). Column (2) is the same specification as equation (1) without the constant. This formula yields values different from zero

Table VI.2  
RESULTS OF THE ESTIMATES FOR ALL THE COUNTRIES IN THE SAMPLE

	Coefficient P> z		Coefficient P> z		Coefficient P> z		Coefficient P> z		Coefficient P> z		Coefficient P> z	
	(1)	(2)	(2)	(2)-Robust estimate	(2)-Two steps	(2)	(2)	(2)	(2)	(2)	(2)	(2)
XDDPT/XT (t-1)	0.54 (0.033)	0.00	0.53 (0.032)	0.00	0.53 (0.09)	0.00	0.39 (0.11)	0.00	0.39 (0.11)	0.00	0.00	0.00
Real world imports (T-1)	0.67 (0.44)	0.12	0.40 (0.10)	0.00	0.40 (0.21)	0.06	0.03 (0.21)	0.06	0.03 (0.21)	0.06	0.90	0.90
REER (T)	0.876 (0.15)	0.00	0.86 (0.14)	0.00	0.86 (0.48)	0.08	0.70 (0.40)	0.08	0.70 (0.40)	0.08	0.08	0.08
Volatility of the REER over 12 months(T)	-0.10 (0.05)	0.03	-0.11 (0.04)	0.02	-0.11 (0.10)	0.32	-0.08 (0.02)	0.32	-0.08 (0.02)	0.32	0.00	0.00
Imports of capital goods/GDP (T)	0.136 (0.06)	0.02	0.13 (0.057)	0.02	0.13 (0.11)	0.22	0.48 (0.23)	0.22	0.48 (0.23)	0.22	0.04	0.04
Constant	-0.02 (0.02)	0.49	...	...	...	...	...	...	...	...	...	...
Sargan test	Prob. > chi2 = 0.0336		Prob > chi2 = 0.031				Prob > chi2 = 1.0					
Wald test (Chi2)	373.2		...		...		...		...		...	...
1st-order auto-correlation (p-value)	0.0		0.0		0.0		0.0		0.0		0.0	0.0
2nd-order auto-correlation (p-value)	1.0		0.9		0.9		0.9		0.9		0.7	0.7

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of United Nations. Commodity Trade Database (COMTRADE).

<sup>26</sup> This index was chosen because it represents a diversified basket of capital goods and therefore represents the approximate import prices that the countries in the sample pay for capital goods.

<sup>27</sup> Data from the International Monetary Fund, *International Financial Statistics*.

<sup>28</sup> The estimate was arrived at using variables in natural logarithms, and the coefficients therefore represent elasticities.

<sup>29</sup> A 60-month volatility indicator was also used, with the same result.

Box VI.1  
METHODOLOGY

The choice of panel data methodology was based on two factors. First, the aim was to determine how export diversification in the region as a whole reacts to the selected economic variables. Second, the country series contained few observations, which made it difficult to approach the analysis as a set of seemingly unrelated equations or, alternatively, to produce a traditional time series analysis of each individual country.

The usual hypothesis employed for panel data is one of strict exogeneity of the explanatory variables, that is, the explanatory variables in each time period are not correlated with the error for the same period. In the structure defined in (1), this hypothesis is unsuccessful owing to the dynamic introduced by the lagged dependent variable.

The relevant hypothesis thus becomes one of sequential exogeneity, that is,  $EXP_{it}$  is not correlated with the error when  $s \leq t$ . The solution proposed by Arellano and Bond (1991) consists in the first-difference estimate of the above equation (the “generalized method of moments (GMM) approach”) using lagged

values of the dependent variables as instruments.

The validity of the instruments can be tested for a period of time  $T > 3$ , as in this case, since the model is overidentified: for a given time  $t$ , there are numerous instruments available, which are lagged values of the variables. The validity of instruments for the estimate is tested using the null hypothesis of the Sargan test. The higher the p-value of the test, the more confidence we can have in not rejecting the null hypothesis of the test, which indicates that the instruments used for the estimate are valid.

The strict exogeneity hypothesis can also fail for the other explanatory variables  $X_{it}$ . If  $u_{it}$  is not correlated with  $X_{is}$  where  $s \leq t$ ,  $X_{it}$  can be said to be predetermined. If  $X_{is}$  is contemporaneously correlated with  $u_{it}$ ,  $X_{it}$  is considered to be endogenous.

Bond (2002) maintains that the classification of  $X_{it}$  variables as predetermined, whether endogenous or exogenous, is arbitrary to some degree, although there are tests to validate the assumptions. In general, economic

arguments must be found to justify the model chosen and the way in which the variables are mutually affected.

Strict exogeneity is assumed in the real effective exchange rate (REER), the volatility of the real exchange rate (RER), world demand (WD) and of (INVEST), in other words, DDTP/XT does not affect these variables either in the same period or in future periods. These variables are determined by other factors of the economy and exports of durable goods to the rest of the world do not exert pressure on them.

The estimated model was:

$$EXP_{it} = \rho EXP_{i(t-1)} + \beta_1 TCRE_{it} + \beta_2 VOL_{it} + \beta_3 INVEST_{it} + \beta_4 DM_{i(t-1)} + c_i + u_{it} \quad (2)$$

Where  $\rho$  is close to one, it can be demonstrated that the lagged values are weak instruments for the estimation. Arellano and Bover (1995) and Blundell and Bond (1998) solve this problem by adding levels equations to differenced equations in the estimate. This method is known as the GMM System. Since the  $\rho$  in the estimates are statistically different from 1, the GMM difference is used.

Source: Economic Commission for Latin America and the Caribbean (ECLAC).

for world demand. In both equations, there is evidence of first-order auto-correlation in residuals, as expected, but not of second-order auto-correlation.<sup>30</sup>

Lastly, in both specifications, the Sargan test gives a low p-value, indicating that the instruments used for the estimate are not valid. Since various instruments exist for a given period of time, one solution proposed by Bond (2002)<sup>31</sup> is to limit the number of instruments or the degree of lag judged as acceptable when choosing which variables to use as instruments. Various adjustments were

made along these lines, such as limiting the number of lags used as instruments, but the p-value of the Sargan test did not improve.

The fact that countries react differently to these variables or the presence of heteroskedasticity may account for the unsuitability of these instruments. As Mexico posted the best performance in terms of exports of durables and diffusers of technical progress, interactive dummy variables were estimated for the real exchange rate (RER), RER volatility and investment in order to

<sup>30</sup> The lower the p-value of the test, the more confident our rejection of the null hypothesis of the absence of an auto-correlation. In the case of the first-order auto-correlation test, the p-value is fairly low and the null hypothesis is rejected; for the second-order test, the p-value is high and the null hypothesis is not rejected.

<sup>31</sup> S. R. Bond, “Dynamic panel data models: a guide to microdata methods and practices”, *Working Papers*, No. 09/02, London, Centre for Microdata Method and Practices (CEMMAP), 2002.

capture the specific features of each country. These dummy variables did not differ from zero, and the p-value of the Sargan test did not improve.

In order to correct for the effects of heteroskedasticity in the matrix of variances and co-variances of the estimators, a robust estimate of this matrix was applied in equation (2). As can be seen from column (2)-(robust estimate), the coefficients of the volatility of the real effective exchange rate and of investment in machinery and equipment were not different from zero.

Finally, equation (2) was estimated in two steps in order to heighten the efficiency of the estimate while keeping the standard errors low. Blundell and Bond (1998) stress that in spite of being asymptotically more efficient, the two-step estimates of the standard errors tend to be severely downward biased.<sup>32</sup>

### (b) Estimates for the sample excluding Mexico and Costa Rica

As shown in table VI.3, Mexico and Costa Rica performed differently from the rest of the countries of the sample. The absolute difference in XDDTP/XT between the 1970s and 2000-2003 was 40 and 50 percentage points for Mexico and Costa Rica, respectively, while the average XDDTP/XT for the region without Mexico was

Table VI.3  
RESULTS FOR THE SAMPLE WHEN MEXICO AND COSTA RICA  
ARE EXCLUDED

	Coefficient	P> z	Coefficient	P> z
	(1)		(2)	
XDDPT/XT (T-1)	0.52 (0.03)	0.00	0.52 (0.03)	0.00
Real world imports (T1)	0.37 (0.48)	0.76	0.38 (0.11)	0.00
REER (T)	0.86 (0.16)	0.00	0.86 (0.16)	0.00
Volatility of the REER over 12 months (T)	-0.12 (0.05)	0.01	-0.12 (0.05)	0.02
Imports of capital goods/GDP (T)	0.12 (0.06)	0.04	0.12 (0.06)	0.06
Constant	0.00	0.99	...	...
Sargan test	0.39		0.38	
Wald test (Chi2)	320.2		...	
1st-order auto-correlation (p-value)	0.0		0	
2nd-order auto-correlation (p-value)	0.9		0.9	

**Source:** Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of United Nations. Commodity Trade Database (COMTRADE).

eight percentage points higher. Another dimension of the atypical behaviour of these two countries is indicated by the fact that the next-largest difference is that of Brazil, with an absolute 15 percentage-point increase in the ratio. The increase for the rest of the countries of the region was far below these values.

Furthermore, the geographical proximity of the United States as a major consumer and producer market has influenced Mexico's specialization and production structure, and this factor is imperfectly captured by the lagged dependent variable in these estimates. In the case of Costa Rica, specific investments in the 1990s had a strong impact on the economy in terms of its level of activity and completely transformed this economy's export profile, as can be seen if its performance is compared with that of the region before and after that decade.

A new estimate was therefore prepared excluding Mexico and Costa Rica from the sample of countries. This new estimate is presented in table VI.3.

In equation (1) the signs are correct. The coefficients differ statistically from zero within a 10% confidence interval, with the exception of the variable of real world imports. The p-value does not allow us to reject the null hypothesis that the instruments are valid

The constant was eliminated and equation (2) was estimated. This equation yields coefficients with correct signs, and all the variables, both individually and taken together, are statistically different from zero.

Table VI.4 presents elasticities for the complete sample and the sample excluding Mexico and Costa Rica, which are not statistically different. A rise of 1% in the real effective exchange rate increases the XDDTP/XT by almost 0.9%. The weight of the structure and history of the ratio is significant. All else remaining constant, a 1% rise in the t-1 ratio increases the t ratio by 0.5%.

The volatility of the exchange rate and imports of

Table VI.4  
SUMMARY OF ELASTICITIES

Elasticities	Complete sample	Sample excluding Mexico and Costa Rica
XDDPT/XT (T-1)	0.53	0.52
World demand	0.40	0.38
REER	0.86	0.86
Volatility of REER	-0.11	-0.12
Imports of capital goods	0.13	0.12

**Source:** Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of United Nations. Commodity Trade Database (COMTRADE).

<sup>32</sup> Blundell and Bond recommend using the results of one step to make inferences about the coefficients (R. Blundell and S. R. Bond, "Initial conditions and moment restrictions in dynamic panel data models", *Journal of Econometrics*, vol. 87, 1998).

capital goods have very little effect on  $XDDTP/XT$ , but the combination of a real appreciation and sustained volatility ends up having a strong impact on the  $XDDTP/XT$  ratio.

The relevant literature and empirical evidence appear to indicate that the region's difficulty in increasing the production of tradable goods has been associated with the high degree of macroeconomic instability experienced over the last three decades, which has affected some of the determinants of the relative growth of tradables in the production structure.

The econometric analysis demonstrates that, in order to increase the proportion of durable goods and diffusers of technical progress in total exports, a high, stable real exchange rate is required along with investment in

machinery and equipment. Macroeconomic instability and other factors militated against the possibility of having real sustained devaluations, a low degree of volatility in the real exchange rate and high investment rates. Macroeconomic instability has therefore played a crucial role in limiting the diversification of exports in the sense traditionally referred to by ECLAC, namely an increase in the proportion of exports having a high technological content.

The findings of this study thus provide empirical evidence to backup two public policy recommendations for stimulating export diversification in the medium term: the achievement and maintenance of macroeconomic stability, and a gradual and sustained devaluation of the real exchange rate.





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## South America



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## Argentina

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### 1. General trends

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

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

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

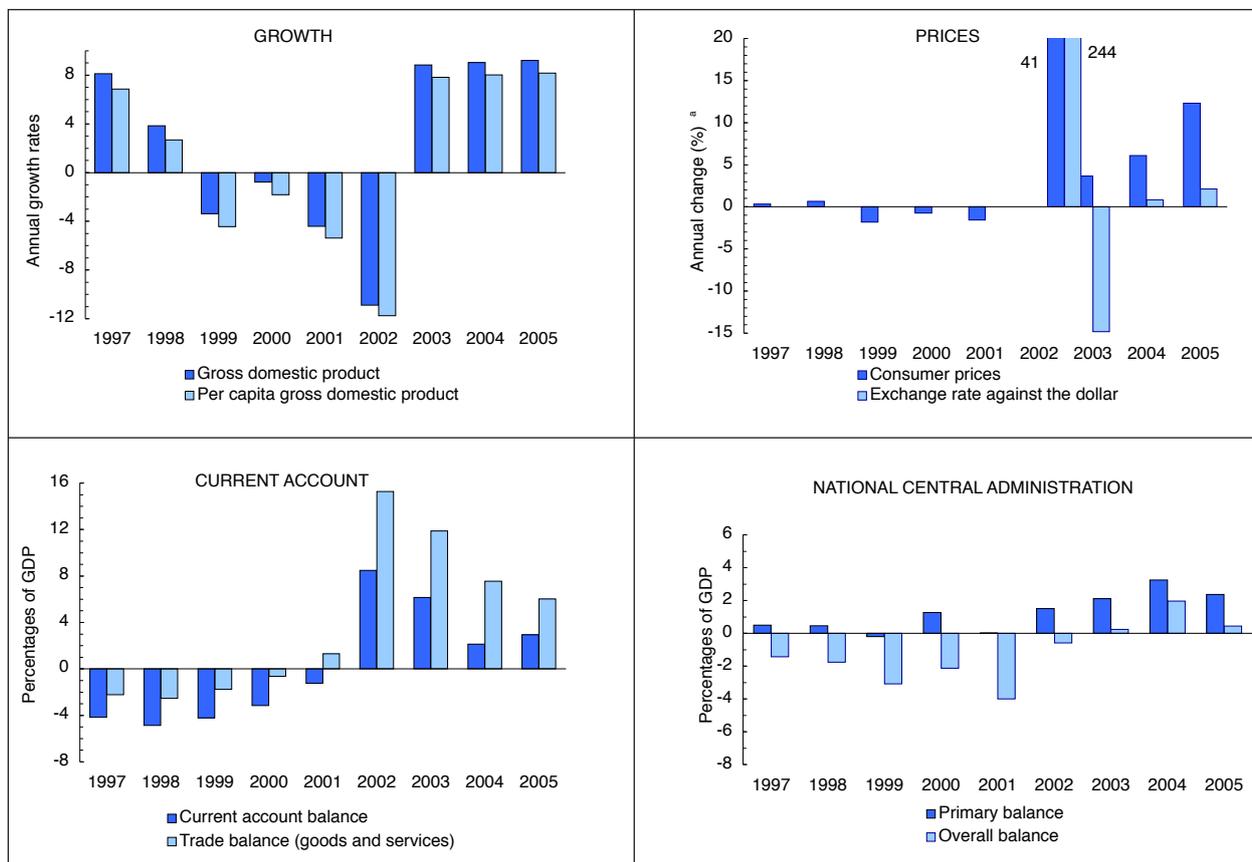
Although merchandise imports posted notable growth, the reduced elasticity of domestic absorption and a steady expansion of export volumes helped maintain a

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

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

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

Figure 1  
**ARGENTINA: MAIN ECONOMIC INDICATORS**



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

<sup>a</sup> December-December variation.

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

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

## 2. Economic policy

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

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

**(a) Fiscal policy**

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

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

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

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

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

**(b) Monetary policy**

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

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

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

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

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

Table 1  
**ARGENTINA: MAIN ECONOMIC INDICATORS**

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

Table 1 (concluded)

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

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

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

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

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

### 3. The main variables

#### (a) Economic activity

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

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

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

Table 2  
**ARGENTINA: MAIN QUARTERLY INDICATORS**

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

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

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

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

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

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

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

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

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

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

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

### **(b) Prices, wages and employment**

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

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

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

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

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

### **(c) The external sector**

In 2005, the current account surplus stood at slightly over 2.9 points of GDP. This was US\$ 2.2 billion more than in 2004, as the effects of the debt swap were taken into account from the second quarter of 2005.<sup>1</sup> The trade deficit remained about as large as it was in 2004, while the income account deficit narrowed by almost US\$ 2.6 billion, partly as a result of the reduction in interest obligations (almost US\$ 3.5 billion) and partly due to the US\$ 900 million increase in the deficit recorded under the heading of profit remittances and dividends.

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

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

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

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

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

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

## Bolivarian Republic of Venezuela

### 1. General trends

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

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

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

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

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

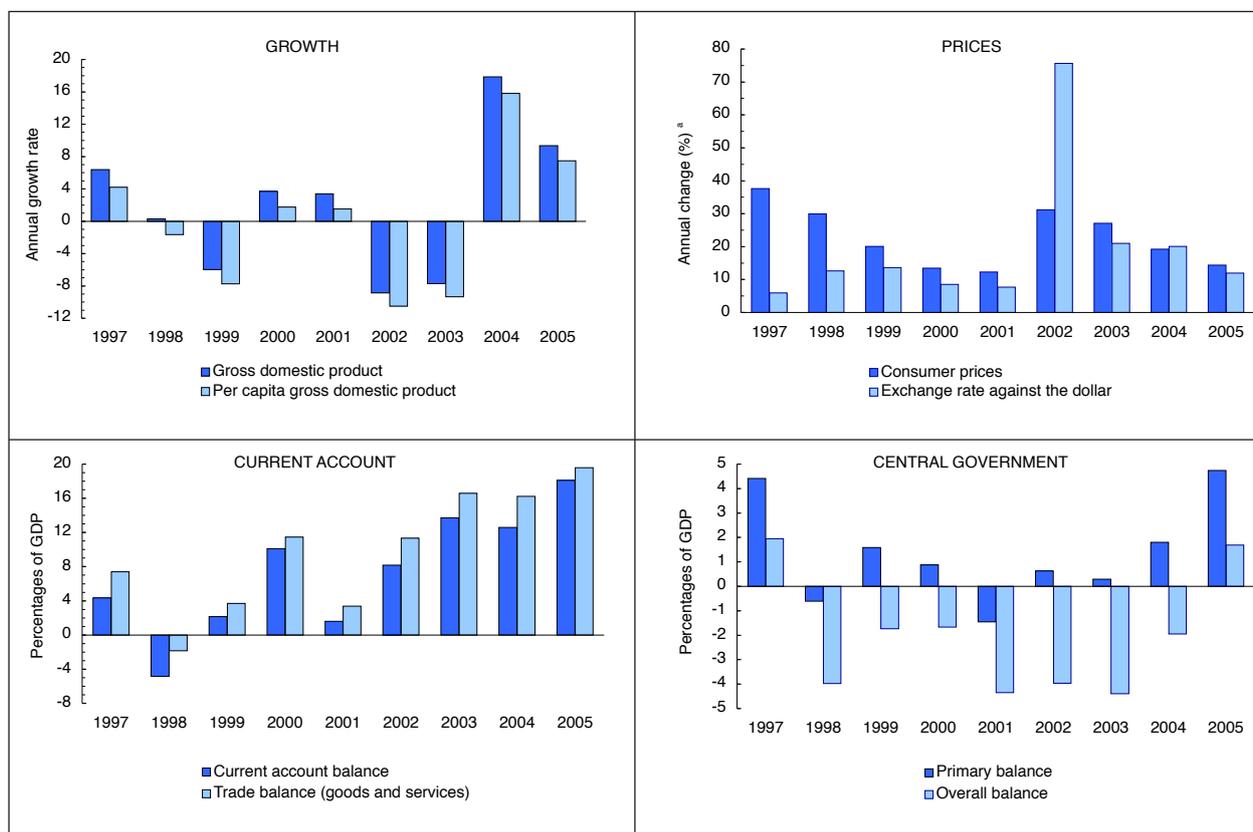
The trends observed in 2005 have continued into 2006. In the first quarter of 2006, economic activity recorded a 9.4% rise over the first quarter of 2005, and growth for the year as a whole is projected at between 7% and 8%; average annual inflation is expected to stand at 12%, and the exchange rate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

Presidential elections are scheduled for December 2006.

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

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

Figure 1  
**BOLIVARIAN REPUBLIC OF VENEZUELA: MAIN ECONOMIC INDICATORS**



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

## 2. Economic policy

### (a) Fiscal policy

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

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

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

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

In 2005 and 2006, the government has been using dollars to invest in foreign bonds<sup>3</sup> (most of which it then sells to national financial institutions), as well as setting up foreign-currency funds abroad and pursuing an ambitious programme to reschedule foreign debts with a view to obtaining longer terms and lower rates. In addition, it has restructured domestic debt so as to improve the yield curve of government bonds. During the first half of 2006, the government invested close to US\$ 4.4 billion in the repurchase of all its outstanding Brady bonds.

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

## (b) Monetary policy

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

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

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

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

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

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

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

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

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

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

Table 1  
**BOLIVARIAN REPUBLIC OF VENEZUELA: MAIN ECONOMIC INDICATORS**

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

Table 1 (concluded)

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

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

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

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

### (c) Exchange-rate policy

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

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

### (d) Other policies

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

Table 2  
BOLIVARIAN REPUBLIC OF VENEZUELA: MAIN QUARTERLY INDICATORS

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

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

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

### 3. The main variables

#### (a) Economic activity

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

#### (b) Prices, wages and employment

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

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

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

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

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

### **(c) The external sector**

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

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

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

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



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## Bolivia

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### 1. General trends

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

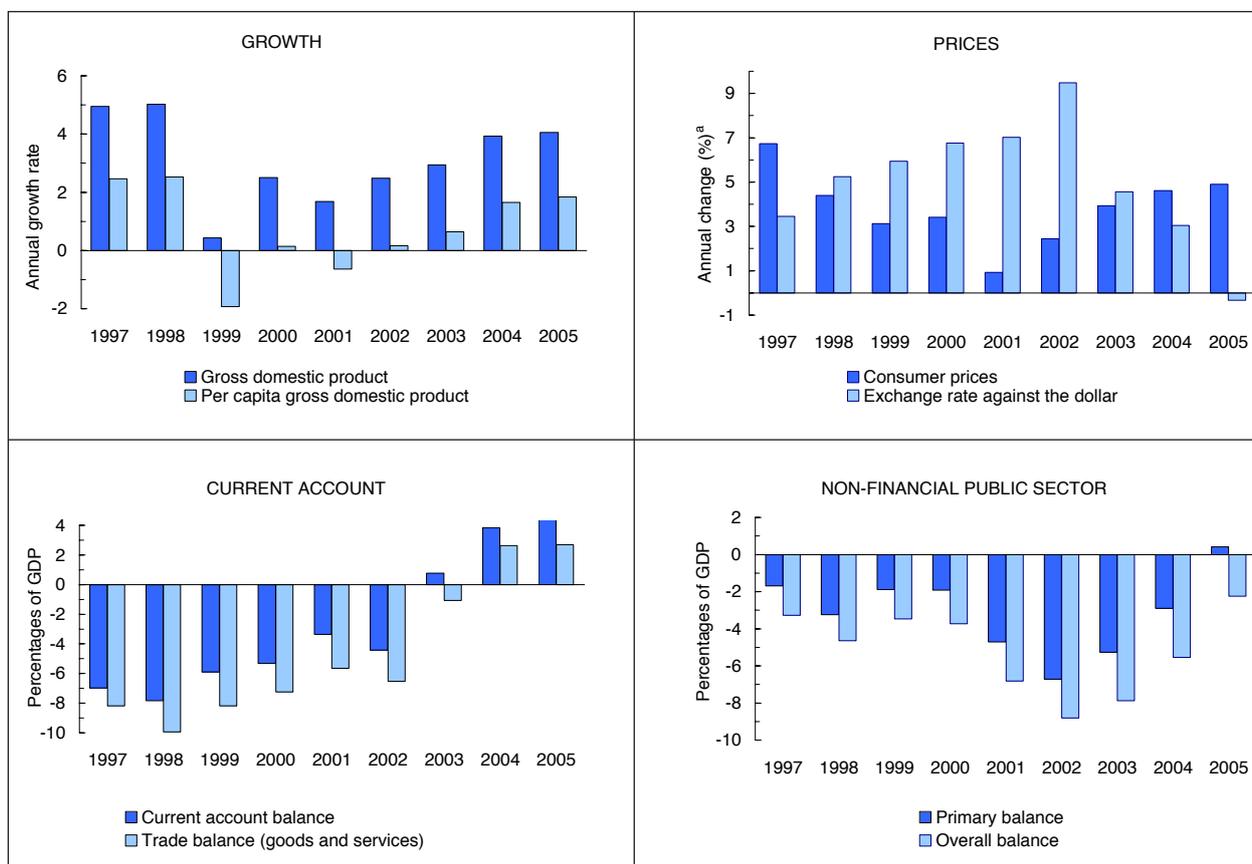
In political terms, 2005 was quite an eventful year. In the first half of the year, major social protests called for the nationalization of hydrocarbons, as Congress discussed the hydrocarbons act. These demonstrations culminated with the resignation of the President, who was replaced by a transition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

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

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

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

Figure 1  
**BOLIVIA: MAIN ECONOMIC INDICATORS**



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

<sup>a</sup> December-December variation.

## 2. Economic policy

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

### (a) Fiscal policy

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

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

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

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

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

### (b) Monetary policy

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

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

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

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

### (c) Exchange-rate policy

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

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

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

Table 1  
**BOLIVIA: MAIN ECONOMIC INDICATORS**

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

Table 1 (concluded)

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

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

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

### 3. The main variables

#### (a) Economic activity

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

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

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

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

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

Table 2  
**BOLIVIA: MAIN QUARTERLY INDICATORS**

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

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

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

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

### (b) Prices, wages and employment

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

In May 2006, the minimum monthly wage was

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

### (c) The external sector

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

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

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

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



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## Brazil

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### 1. General trends

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

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

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

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### 2. Economic policy

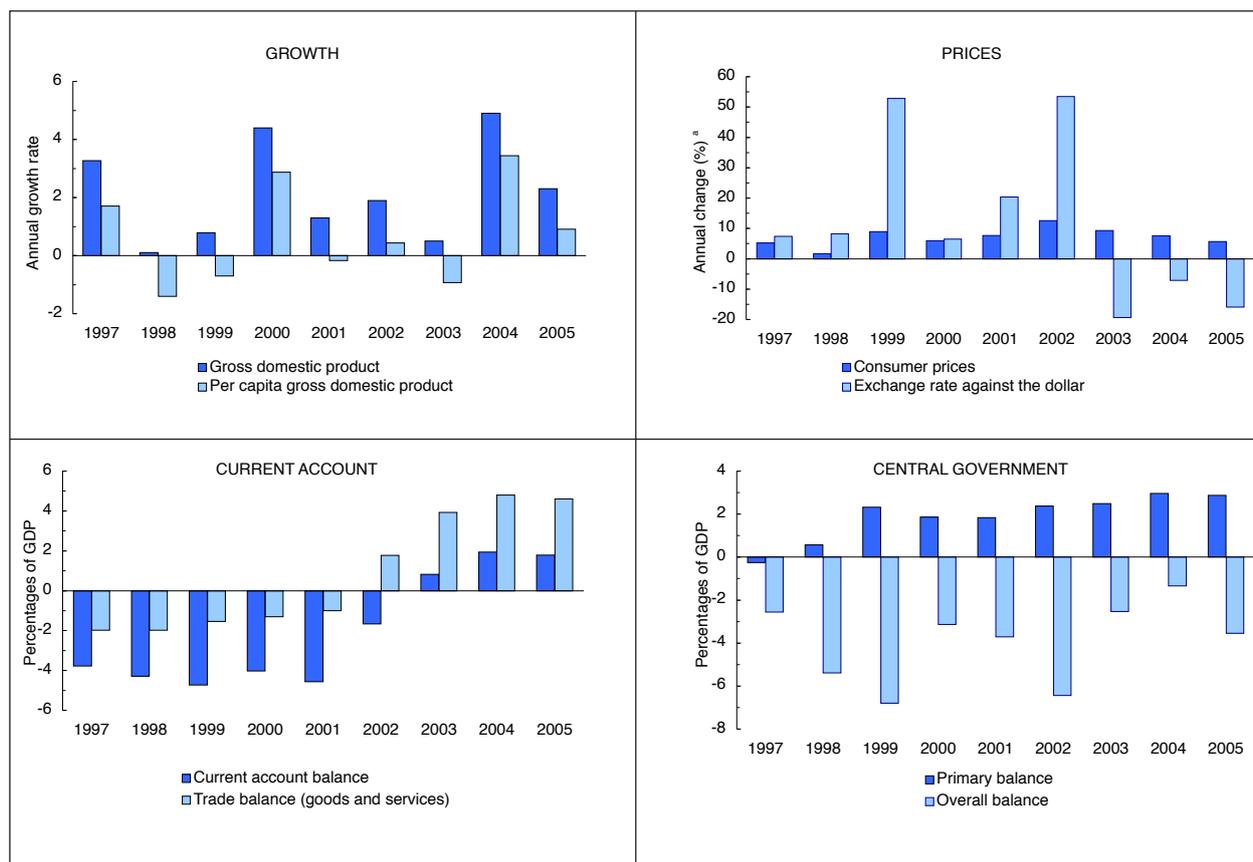
#### (a) Fiscal policy

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

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

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

Figure 1  
**BRAZIL: MAIN ECONOMIC INDICATORS**



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

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

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

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

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

### (b) Monetary and exchange-rate policy

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

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

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

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

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

### (c) Other policies

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

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## 3. The main variables

### (a) Economic activity

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

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

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

Table 1  
**BRAZIL: MAIN ECONOMIC INDICATORS**

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

Table 1 (concluded)

	1997	1998	1999	2000	2001	2002	2003	2004	2005 <sup>a</sup>
	<b>Percentages of GDP</b>								
<b>General government<sup>p</sup></b>									
Total income <sup>q</sup>	15.4	16.9	17.9	17.7	18.7	19.6	19.0	19.9	20.9
Tax revenue <sup>r</sup>	13.6	15.5	17.0	16.9	17.8	19.1	18.5	19.2	20.3
Total expenditure	17.4	22.1	25.0	20.8	22.4	26.1	21.5	21.4	24.6
Current expenditure	12.3	16.7	20.1	15.9	17.1	20.7	16.9	16.3	18.8
Interest	2.3	6.0	9.1	5.0	5.5	8.8	5.0	4.3	6.4
Capital expenditure	5.1	5.4	4.9	4.8	5.3	5.3	4.7	5.2	5.8
Primary balance	-0.3	0.6	2.3	1.9	1.8	2.4	2.5	3.0	2.9
Overall balance	-2.6	-5.4	-6.8	-3.1	-3.7	-6.4	-2.5	-1.3	-3.5
Central government debt									
Domestic	19.3	25.3	32.5	32.1	34.4	41.7	37.2	34.0	33.7
External	17.3	21.1	23.9	24.3	25.7	27.0	26.9	27.0	31.3
External	2.0	4.2	8.5	7.8	8.6	14.7	10.3	7.1	2.4
<b>Money and credit<sup>s</sup></b>									
Domestic credit <sup>t</sup>	43.6	50.8	69.4	69.5	73.4	74.6	76.3	76.5	79.4
To the public sector	13.0	17.6	35.4	36.3	38.7	40.8	43.4	43.9	43.2
To the private sector	30.7	33.1	33.5	32.8	34.3	33.6	32.7	32.5	36.2
Other	0.0	0.0	0.4	0.4	0.4	0.3	0.2	0.1	0.0
Liquidity (M3)									
Currency in circulation and local-currency deposits (M2)	23.8	26.9	26.7	24.2	24.2	25.9	25.1	24.8	26.7

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

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

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

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

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

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

## (b) Prices, wages and employment

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

Table 2  
**BRAZIL: MAIN QUARTERLY INDICATORS**

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

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

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

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

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

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

### (c) The external sector

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

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

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

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

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

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



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## Chile

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### 1. General trends

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

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

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

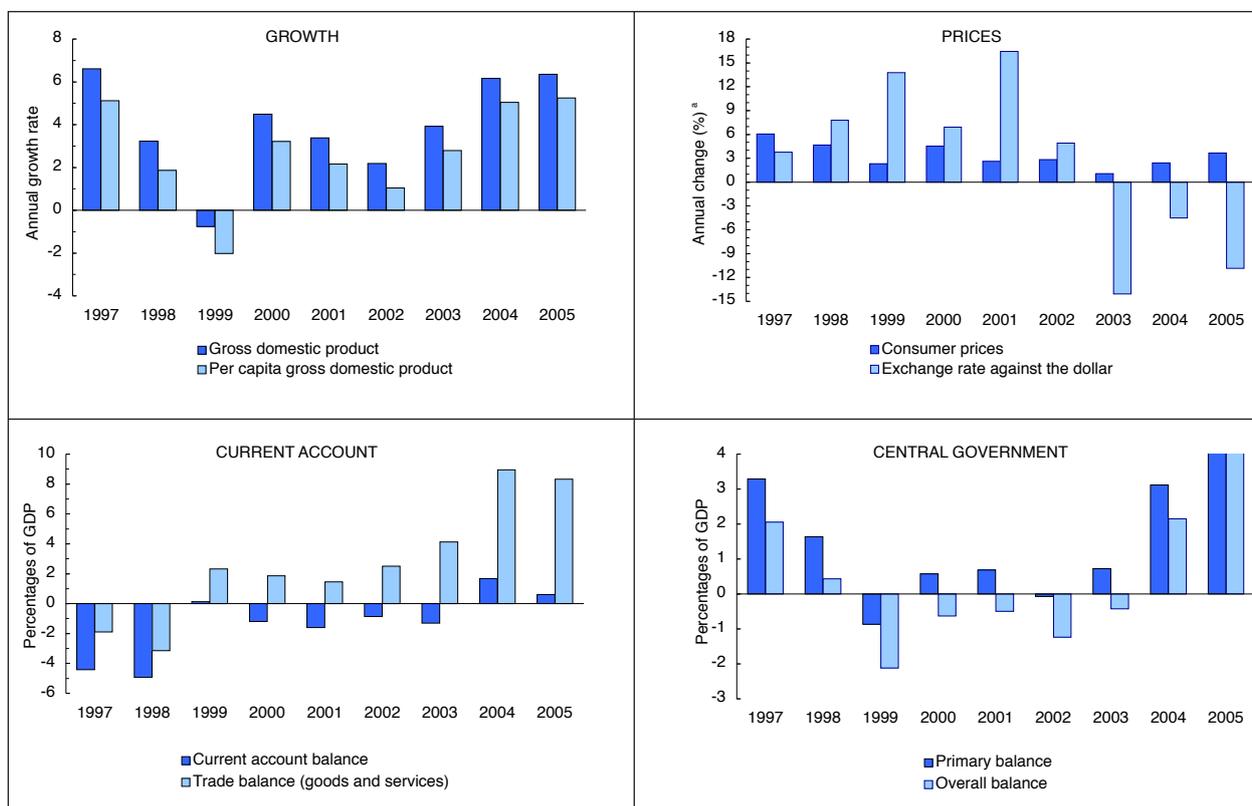
Despite the good macroeconomic situation, the short-term outlook is not risk-free. First, average oil prices are expected to be higher in 2006 than they were in 2005. As there seems to be little margin between oil production and consumption, any supply constraints could cause spikes and volatility in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

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

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

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

Figure 1  
CHILE: MAIN ECONOMIC INDICATORS



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

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

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

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

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

<sup>1</sup> See Central Bank of Chile, *Monetary Policy Report*, Santiago, Chile, May 2006.

## 2. Economic policy

### (a) Fiscal policy

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

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

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

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

### (b) Monetary and exchange-rate policy

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

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

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

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

<sup>2</sup> See Central Bank of Chile, *Monetary Policy Report*, Santiago, Chile, May 2006.

Table 1  
CHILE: MAIN ECONOMIC INDICATORS

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

Table 1 (concluded)

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

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

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

### 3. The main variables

#### (a) Economic activity

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

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

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

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

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

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

Table 2  
CHILE: MAIN QUARTERLY INDICATORS

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

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

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

## (b) Prices, wages and employment

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

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

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

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

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

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

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

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

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

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

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

### (c) The external sector

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

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

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

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

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

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



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## Colombia

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### 1. General trends

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

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

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

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

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### 2. Economic policy

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

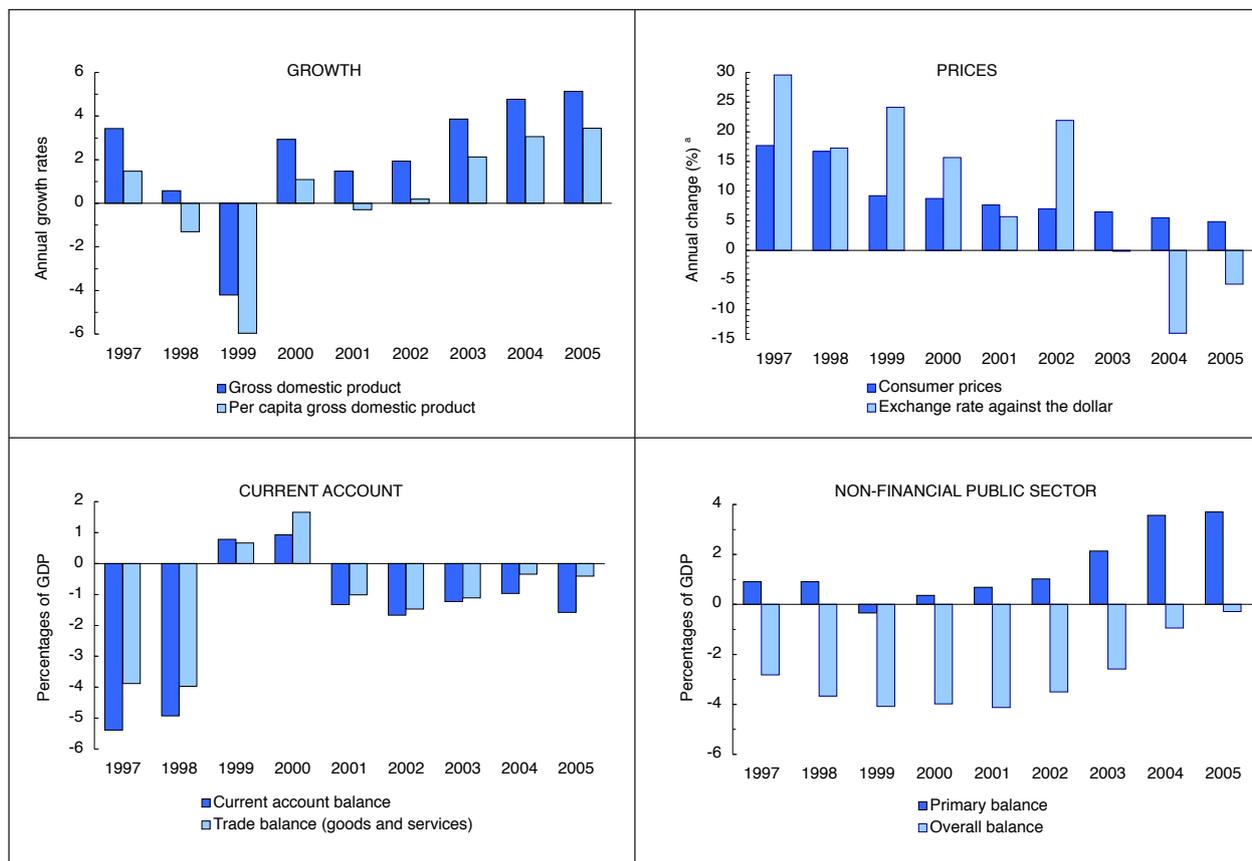
#### (a) Fiscal policy

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

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

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

Figure 1  
**COLOMBIA: MAIN ECONOMIC INDICATORS**



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

<sup>a</sup> December-December variation.

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

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

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

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

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

In the first quarter of 2006, the central government

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

### **(b) Monetary policy**

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

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

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

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

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

### **(c) Exchange-rate policy**

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

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

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

### **(d) Trade policy**

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

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

Table 1  
**COLOMBIA: MAIN ECONOMIC INDICATORS**

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

Table 1 (concluded)

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

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

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

### 3. The main variables

#### (a) Economic activity

The expansion in domestic demand became consolidated in 2005, as regards both private investment and household consumption. After growth of 4.8% in 2004, the economy accumulated an expansion of 5.1% in 2005.<sup>1</sup> Investment was substantially higher (29%), driven by tax incentives, readily available credit and low interest rates. Consumption also recorded rapid growth (4.9%) in both the private and public components (4.9% and 4.8%, respectively). In addition to the low interest rates, household consumption was stimulated by low inflation, a decrease in unemployment, increased consumer confidence and, to some extent, the wealth effect of the appreciation of shares in the stock exchange. The increase in public

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

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

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

Table 2  
COLOMBIA: MAIN QUARTERLY INDICATORS

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

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

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

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

### (b) Prices, wages and employment

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

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

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

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

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

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

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

### (c) The external sector

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

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

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

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

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

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

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

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

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

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



## Ecuador

### 1. General trends

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

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

Throughout 2005 and into early 2006 private banks

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

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

### 2. Economic policy

#### (a) Fiscal policy

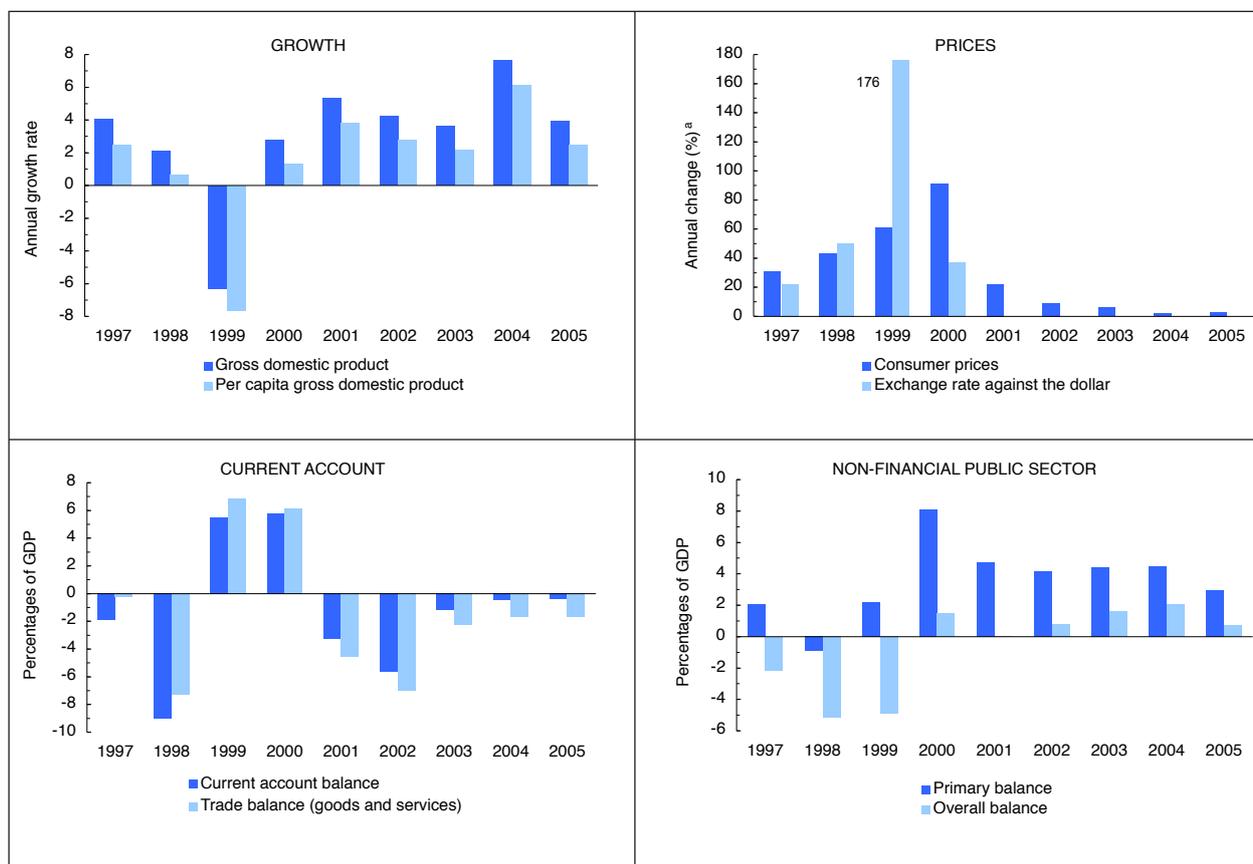
In 2005, the NFPS returned a primary surplus of 3% of GDP, while the overall surplus was 0.7%. This represented a significant decline with respect to the primary surplus of 4.5% of GDP and the global surplus of 2.1% of GDP recorded in 2004, owing to the fact that total spending grew more rapidly than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

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

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

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

Figure 1  
**ECUADOR: MAIN ECONOMIC INDICATORS**



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

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

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

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

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

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

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

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

#### (b) Monetary policy

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

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

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

#### (c) Other policies

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

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### 3. The main variables

#### (a) Economic activity

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

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

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

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

Table 1  
**ECUADOR: MAIN ECONOMIC INDICATORS**

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

Table 1 (concluded)

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

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

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

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

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

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

<sup>1</sup> The prices will be adjusted according to the United States consumer price index.

Table 2  
ECUADOR: MAIN QUARTERLY INDICATORS

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

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

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

## (b) Prices, wages and employment

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

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

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

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

## (c) The external sector

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

Ecuadorian exports performed well in 2005, growing

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

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

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

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



## Paraguay

### 1. General trends

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

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

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

with IMF, the public accounts should remain balanced.

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

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

### 2. Economic policy

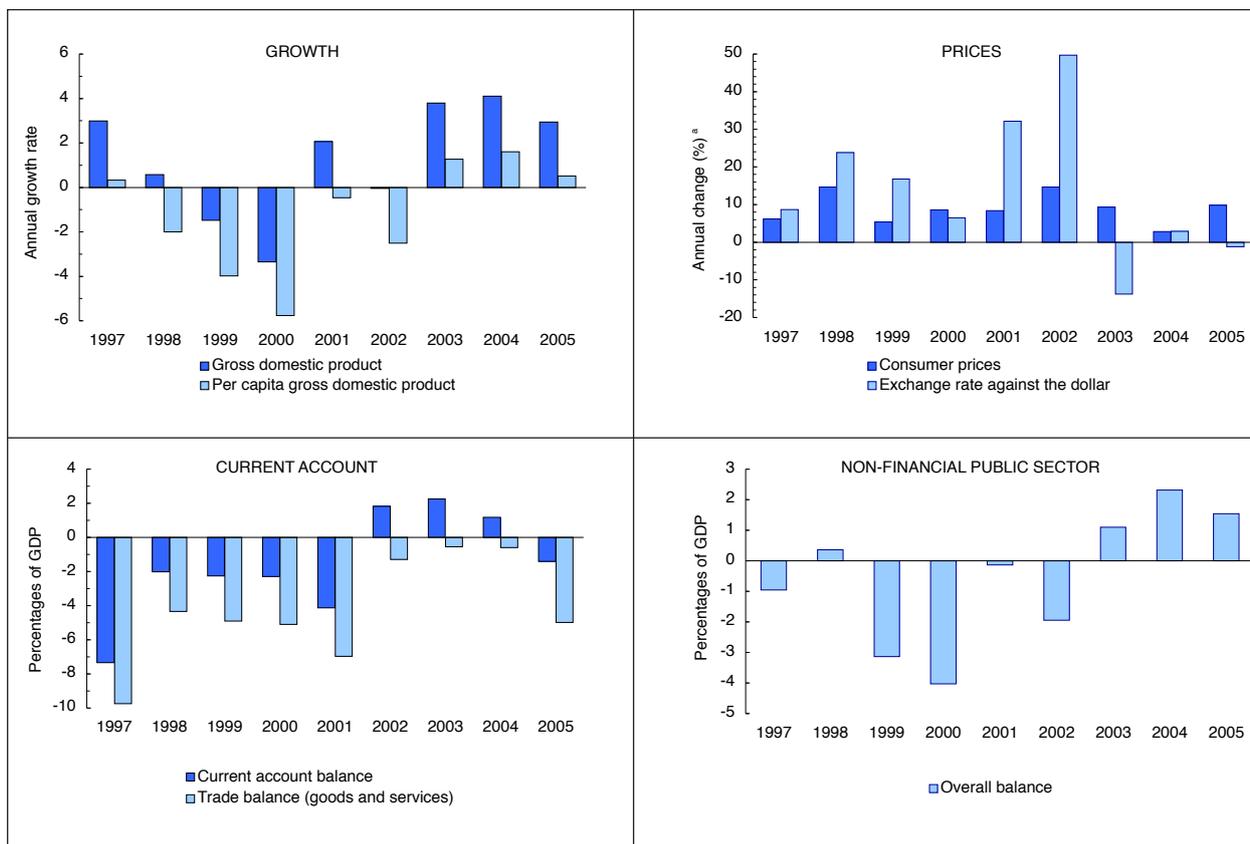
#### (a) Fiscal policy

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

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

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

Figure 1  
**PARAGUAY: MAIN ECONOMIC INDICATORS**



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

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

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

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

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

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

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

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

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

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

### (b) Monetary and exchange-rate policy

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

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

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

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

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

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

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

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

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

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

<sup>3</sup> Year-on-year nominal rates of variation.

Table 1  
**PARAGUAY: MAIN ECONOMIC INDICATORS**

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

Table 1 (concluded)

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

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

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

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

### (c) Other policies

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

The Development Finance Agency (AFD) was created

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

Table 2  
**PARAGUAY: MAIN QUARTERLY INDICATORS**

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

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

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

### 3. The main variables

#### (a) Economic activity

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

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

The livestock sector enjoyed significant growth of

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

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

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

## (b) Prices, wages and employment

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

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

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

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

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

## (c) The external sector

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

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

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

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

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

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

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



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## Peru

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### 1. General trends

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

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

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

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### 2. Economic policy

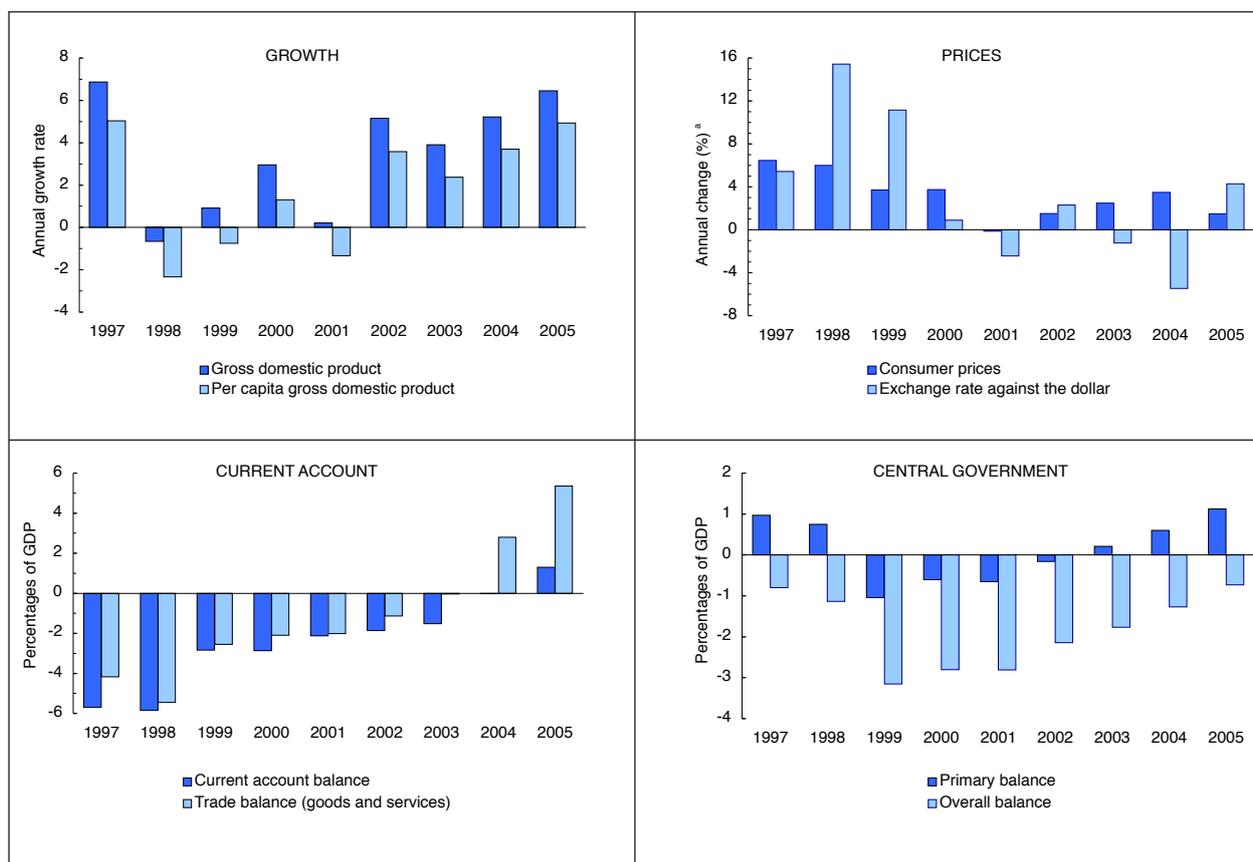
The authorities took advantage of the propitious conditions to drive ahead their strategy to reduce the Peruvian economy's vulnerability by narrowing the fiscal deficit, restructuring the public debt and reducing it in GDP terms, building up international monetary reserves and stimulating the de-dollarization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

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

#### (a) Fiscal policy

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

Figure 1  
PERU: MAIN ECONOMIC INDICATORS



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

<sup>a</sup> December-December variation.

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

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

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

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

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

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

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

### **(b) Monetary and exchange-rate policy**

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

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

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

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

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

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

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

### **(c) Other policies**

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

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

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

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

Table 1  
**PERU: MAIN ECONOMIC INDICATORS**

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

Table 1 (concluded)

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

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

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

### 3. The main variables

#### (a) Economic activity

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

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

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

Table 2  
PERU: MAIN QUARTERLY INDICATORS

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

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

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

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

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

### (b) Prices, wages and employment

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

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

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

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

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

Formal job creation continued to expand, increasing

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

### (c) The external sector

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

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

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

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

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



## Uruguay

### 1. General trends

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

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

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

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

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

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

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

### 2. Economic policy

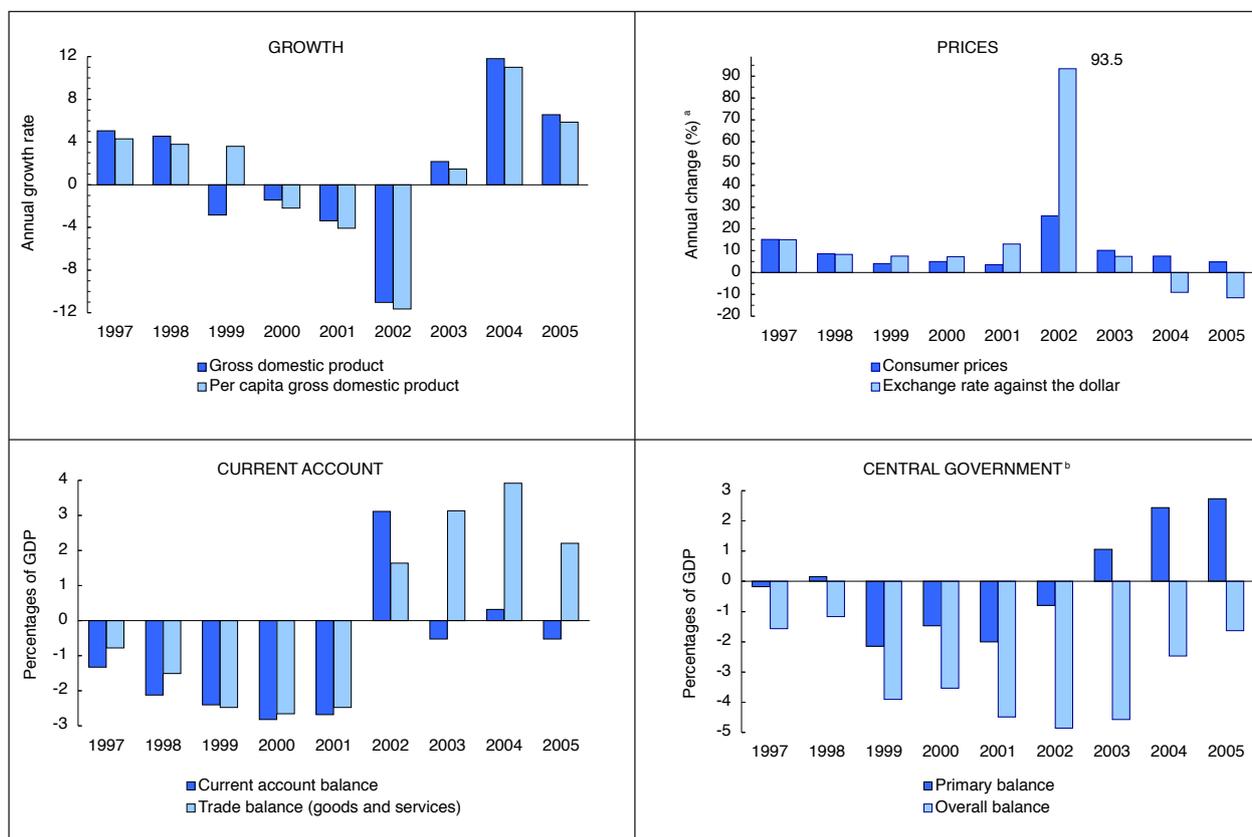
#### (a) Fiscal policy

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

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

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

Figure 1  
URUGUAY: MAIN ECONOMIC INDICATORS



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

<sup>a</sup> December-December variation.

<sup>b</sup> In 1999 the accounting methodology changed.

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

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

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

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

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

#### (b) Monetary policy

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

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

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

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

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

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

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

### (c) Exchange-rate policy

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

### (d) Other policies

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

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## 3. The main variables

### (a) Economic activity

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

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

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

### (b) Prices, wages and employment

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

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

Table 1  
URUGUAY: MAIN ECONOMIC INDICATORS

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

Table 1 (concluded)

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

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

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

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

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

### (c) The external sector

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

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

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

Table 2  
URUGUAY: MAIN QUARTERLY INDICATORS

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

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

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



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## Mexico and Central America



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## Costa Rica

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### 1. General trends

Real GDP grew by 5.9% (up from 4.1% in 2004) on the strength of export growth (12.6%), which was primarily due to the recovery of external sales of microprocessors produced by the Intel plant, as well as the buoyancy of tourism and international business services. In per capita terms, GDP rose by 4.1%, while national disposable income expanded by only 1.9% owing to losses generated by worsening terms of trade.

External factors affecting the country's economic performance included the high international prices of petroleum and some of the main raw materials imported by Costa Rica. These trends added to the exacerbation of the terms of trade, the widening of the trade gap and rising domestic prices. This situation was aggravated by the uncertainty stemming from the lack of parliamentary support for Executive-branch initiatives, particularly fiscal reform and the Dominican Republic — Central America — United States Free Trade Agreement (CAFTA-DR) and the worsening social and political climate at a juncture dominated by the elections of February 2006.

Despite rapid economic growth, the open unemployment rate rose slightly, from 6.5% to 6.6%. At the same time, real average wages in the formal sector retreated again (-1.9%), while minimum wages

increased by only 0.3% in the wake of the 1.6% dip posted in 2004. The central government was able to keep finances under control thanks to higher revenues and restraint in spending. The global deficit of the narrowly-defined public sector shrank from 3.6% of GDP to 2.3%. Faced with strong inflationary pressures (14.1%) and growing imbalances in the external sector, monetary policy was tightened during the second half of the year. The balance-of-payments current account deficit widened to 4.8% owing to a marked increase in the trade gap.

For 2006, ECLAC estimates an economic growth rate of 4.3%. According to the central bank's monetary programme for 2006-2007, inflation will fall to 11%. The consolidated public-sector deficit is expected to grow to 3.4% of GDP, while the balance-of-payments current account deficit will shrink to 4.6%.

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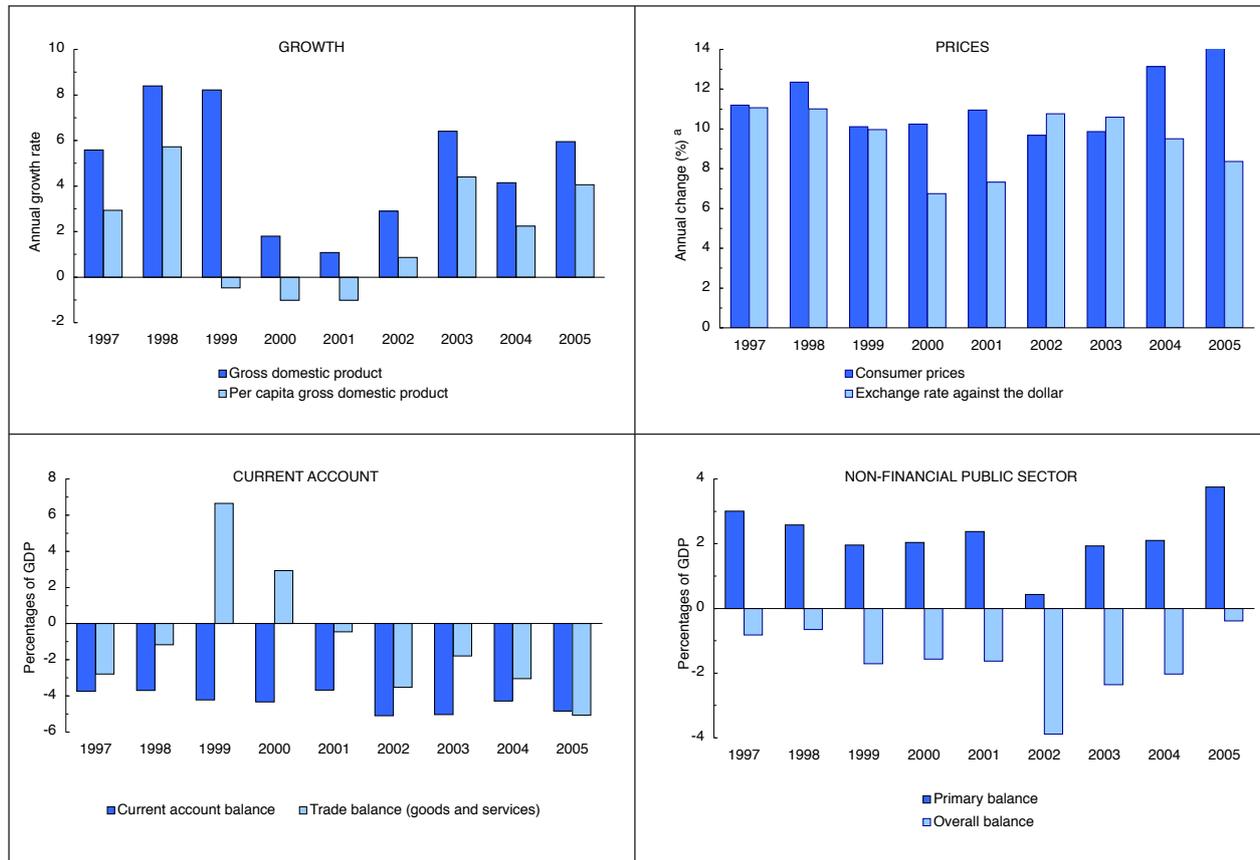
### 2. Economic policy

In 2005, various external and domestic factors encumbered the management of economic policy and prevented compliance with some of the goals of the monetary programme. Because fiscal policy had little manoeuvring room, a large part of the adjustment burden was borne by monetary policy. The economy was, however, able to absorb much of these factors' destabilizing effect.

After a hiatus of 20 years, former President Oscar Arias Sánchez was re-elected to the presidency of Costa

Rica in February 2006 and took office in May. The new government's economic policy will give priority to strengthening integration with the world economy, solving fiscal problems and effectively combating poverty and inequality. Monetary and exchange policies will gradually take on a greater role in making significant reductions in inflation and, to this end, the government plans to capitalize the central bank. Many of the relevant proposals will require congressional approval, however.

Figure 1  
**COSTA RICA: MAIN ECONOMIC INDICATORS**



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

<sup>a</sup> December-December variation.

As the government does not have a majority in Congress, it will have to seek the necessary consensus in order to achieve their implementation.

### (a) Fiscal policy

One of the primary objectives of the new government is to put public finances on a sounder footing. The fiscal deficit is one of the factors behind the fact that the country's interest rates are high relative to international levels, which encourages inflows of speculative capital, on the one hand, and raises the cost of open-market operations, on the other, thereby making monetary policy less effective. The high level of indebtedness also places a considerable burden on public finances.

The plans of the new government, which include a commitment to narrowing the fiscal deficit and raising expenditure on investment and poverty reduction,

will require an increase in tax revenues estimated at 4 percentage points of GDP. The government plans to achieve this increase by enacting progressive reforms in the tax system (particularly regarding its organization and legal framework) and combating tax evasion. Measures will also be taken to contain the growing public debt, improve its profile, and reduce its cost with a view to allowing an increase in investment spending, especially on social services.

In public spending, priority will be given to expanding comprehensive public services, particularly health and education (with the goal of increasing sectoral spending on the latter to 8% of GDP), creating jobs by developing production linkages and supporting micro-, small and medium-sized enterprises, stimulating domestic and foreign private investment that contributes to knowledge-based economic growth and developing infrastructure.

In 2005, the global deficit of the narrowly-defined public sector shrank from 3.6% of GDP to 2.3%. With the exception of the central bank, this performance was attributable to all the components of that sector, including both the central government and the rest of the non-financial public sector (NFPS).

Increased revenues and controlled spending narrowed the central government's financial imbalance from 2.7% of GDP to 2.1%. In contrast to previous years, when a significant portion of the fiscal deficit was financed by issuing bonds on international capital markets, borrowing requirements in 2005 were covered by placing debt on the local market.

Current income rose from 13.6% of GDP to 13.8%, with receipts from customs duties, income taxes and the general domestic sales tax showing the sharpest increases. Total expenditure dropped from 16.4% of GDP to 15.9% owing primarily to the use of the single Treasury account. The stagnation of wages and salaries in real terms (30% of total expenditure) contributed as well. In contrast, higher interest payments (+4.5%) had an adverse effect on government efforts to reduce spending, although interest payments on foreign debt dipped slightly in real terms.

The net result for the rest of the NFPS also improved on the preceding year, as it posted a surplus equivalent to 1.2% of GDP. This reflected a larger positive balance on the accounts of the Costa Rican Electricity Institute and the Costa Rican Social Security Fund as a result of lower capital expenditure and reduced purchases of goods and services. The improvement in the Costa Rican Petroleum Refinery's finances was largely attributable to the rise in revenues from fuel sales.

The central bank's deficit (1.4% of GDP) increased slightly. This result reflected the financial cost, in the absence of any further capitalization operations on the part of the government, of active monetary management in response to significant inflows of foreign capital.

The ratio of total public debt to GDP declined for the third consecutive year owing primarily to the shrinkage of the central government's debt and its financing strategy. Nevertheless, debt continues to be one of the most serious problems facing the Costa Rican economy, representing around 55% of domestic production.

### **(b) Monetary policy**

At the beginning of 2005, the central bank continued raising interest rates for open-market operations and announced its intention to implement a restrictive monetary policy in order to curb the upswing in inflation. It also maintained the level of the legal reserve requirement (12%) in place since October 2004 and reduced the devaluation rate to 15 centavos per day in accordance with the inflation

target (10%). However, high interest rates and the relative stability of the exchange market resulting from the policy of mini-devaluations boosted the returns on investments in colones relative to those offered by other options for financial investment in the domestic and international markets. This spurred the inflow of capital and interfered with efforts to manage the money supply, since the central bank's participation as a net buyer of foreign currency had an expansionary monetary effect that had to be sterilized to avoid domestic-spending pressures.

The central bank gradually lowered its deposit rates, raised the legal reserve requirement from 12% to 15% and stepped up its open-market operations. However, the rise in the principal monetary aggregates was greater than the increase in nominal GDP, and the expansion of credit extended to the private sector was greater than in 2004 due to the relative stability of lending rates and strategies implemented by banks to stimulate credit demand. Real borrowing rates held steady at an average of 1%, while lending rates dipped from 8.7% to 8.2%.

The primary objective of the central bank's monetary policy in 2006 has been to bring inflation down to around 10% in the next biennium. To this end, it will continue with a tight monetary policy based on open-market operations.

In order to improve the transmission mechanism for monetary policy and the efficiency of monetary policy tools, the central bank plans to introduce changes in the mechanisms it uses to obtain funds, such as the auctioning of bonds, and will use new monetary absorption instruments. These improvements are aimed at heightening the efficiency of monetary absorption without obliging the central bank to hike interest rates to any significant degree. It is hoped that these measures will influence the savings and investment decisions of economic agents by discouraging present consumption and thereby reducing inflationary pressures.

An "electronic deposit window" will also be opened for investment in monetary-stabilization bonds. This will allow the bank to provide economic agents with an instrument to replace time certificates of deposit offered by financial intermediaries. This mechanism is intended to improve the interest rate's effectiveness as a transmission mechanism for monetary policy, promote greater competition in the financial market and raise real returns for savers.

### **(c) Exchange-rate policy**

On average, the real effective exchange rate dropped by 1.5% in 2005. The central bank will continue in 2006 with its policy of daily adjustments or mini-devaluations. In order to achieve greater consistency between the inflation target and exchange-rate policy, the nominal exchange

Table 1  
**COSTA RICA: MAIN ECONOMIC INDICATORS**

	1997	1998	1999	2000	2001	2002	2003	2004	2005 <sup>a</sup>
	<b>Annual growth rates<sup>b</sup></b>								
<b>Gross domestic product</b>	5.6	8.4	8.2	1.8	1.1	2.9	6.4	4.1	5.9
<b>Per capita gross domestic product</b>	2.9	5.7	-0.5	-1.0	-1.0	0.9	4.4	2.2	4.1
<b>Gross domestic product, by sector</b>									
Agriculture, livestock, hunting, forestry and fishing	1.5	8.2	4.5	0.7	1.4	-3.3	7.4	0.1	3.3
Mining	13.0	9.2	-6.1	6.3	6.4	-3.1	4.2	7.7	-2.0
Manufacturing	7.7	11.4	24.7	-2.9	-9.1	3.4	8.4	3.6	11.8
Electricity, gas and water	5.6	8.7	6.2	6.4	45.2	-1.5	4.8	6.3	-0.2
Construction	6.1	17.4	-1.6	4.4	-18.0	5.3	5.8	4.0	4.8
Wholesale and retail commerce, restaurants and hotels	6.1	8.5	2.4	1.5	1.9	1.6	3.4	4.2	3.8
Transport, storage and communications	9.9	8.1	6.9	10.2	9.3	12.0	13.7	11.9	9.8
Financial institutions, insurance, real estate and business services	4.8	4.7	7.6	8.1	6.8	4.7	7.1	6.6	4.8
Community, social and personal services	2.6	4.6	3.0	2.6	2.0	3.0	3.0	1.3	2.2
<b>Gross domestic product, by type of expenditure</b>									
Consumption	5.1	5.0	2.1	1.1	1.4	3.0	2.8	3.0	3.6
General government	4.6	2.2	1.8	1.4	3.6	2.2	-0.2	1.3	1.2
Private	5.1	5.4	2.2	1.0	1.1	3.2	3.2	3.3	3.9
Gross domestic investment	24.9	26.3	-15.6	-1.5	31.4	8.4	-4.2	9.8	11.5
Exports (goods and services)	8.6	26.7	21.3	-0.3	-9.8	4.3	12.0	8.2	12.6
Imports (goods and services)	14.7	25.2	0.4	-2.6	1.1	6.9	1.0	9.1	11.7
	<b>Percentages of GDP</b>								
<b>Investment and saving<sup>c</sup></b>									
Gross domestic investment	18.1	20.5	17.1	16.9	20.3	22.6	20.6	22.9	25.5
National saving	14.3	16.8	12.9	12.6	16.6	17.5	15.6	18.6	20.7
External saving	3.7	3.7	4.2	4.3	3.7	5.1	5.0	4.3	4.8
	<b>Millions of dollars</b>								
<b>Balance of payments</b>									
Current account balance	-481	-521	-666	-691	-603	-857	-880	-796	-960
Merchandise trade balance	-498	-399	580	-210	-820	-1 278	-1 089	-1 421	-2 142
Exports, f.o.b.	4 221	5 538	6 576	5 813	4 923	5 270	6 163	6 370	7 100
Imports, f.o.b.	4 718	5 937	5 996	6 024	5 743	6 548	7 252	7 791	9 242
Services trade balance	140	234	471	679	746	685	776	857	1 140
Income balance	-249	-469	-1 822	-1 252	-679	-440	-776	-444	-227
Net current transfers	126	113	104	93	151	175	209	212	270
Capital and financial balance <sup>d</sup>	288	16	896	539	616	1 020	1 219	876	1 350
Net foreign direct investment	404	608	614	400	451	625	548	557	696
Financial capital <sup>e</sup>	-116	-592	282	138	165	395	671	319	655
Overall balance	-193	-504	230	-152	13	163	339	80	391
Variation in reserve assets <sup>f</sup>	-216	150	-481	152	-13	-163	-339	-80	-391
Other financing <sup>g</sup>	409	355	251	0	0	0	0	0	0
<b>Other external-sector indicators</b>									
Real effective exchange rate (index: 2000=100) <sup>h</sup>	101.1	99.8	101.8	100.0	97.0	97.4	103.4	106.8	108.4
Terms of trade for goods (index: 2000=100)	125.9	117.5	106.9	100.0	98.4	96.9	95.5	91.9	88.3
Net resource transfer (percentage of GDP)	3.5	-0.7	-4.3	-4.5	-0.4	3.4	2.5	2.3	5.7
Gross external public debt (millions of dollars)	2 640	2 872	3 057	3 151	3 175	3 281	3 733	3 884	3 626
Gross external public debt (percentage of GDP)	20.6	20.4	19.3	19.8	19.4	19.5	21.3	20.9	18.1
Net profits and interest (percentage of exports) <sup>i</sup>	-4.7	-6.8	-22.1	-16.1	-9.9	-6.2	-9.5	-5.2	-2.3
	<b>Average annual rates</b>								
<b>Employment</b>									
Labour force participation rate <sup>j</sup>	53.8	55.3	54.8	53.6	55.8	55.4	55.5	54.4	56.8
Open unemployment rate <sup>k</sup>	5.7	5.6	6.0	5.2	6.1	6.4	6.7	6.5	6.6
Visible underemployment rate <sup>k</sup>	11.0	11.7	12.0	9.7	9.5	11.2	13.2	12.5	13.0
	<b>Annual percentages</b>								
<b>Prices</b>									
Variation in consumer prices (December-December)	11.2	12.4	10.1	10.2	11.0	9.7	9.9	13.1	14.1
Variation in producer prices industrial (December-December)	10.1	8.8	11.3	10.2	8.6	8.4	11.0	17.7	12.1
Variation in nominal exchange rate (December-December)	11.1	11.0	10.0	6.8	7.3	10.8	10.6	9.5	8.4
Variation in average real wage	0.8	5.6	4.7	0.8	1.0	4.1	0.4	-2.6	-1.9
Nominal deposit rate <sup>l</sup>	12.7	13.3	14.6	12.9	11.3	11.6	10.9	10.0	10.4
Nominal lending rate <sup>m</sup>	22.7	23.0	26.0	24.0	22.2	24.2	23.4	21.2	22.0

Table 1 (concluded)

	1997	1998	1999	2000	2001	2002	2003	2004	2005 <sup>a</sup>
	<b>Percentages of GDP</b>								
<b>Central government</b>									
Total income	24.3	24.0	23.0	23.5	25.5	24.7	25.0	24.4	25.1
Current income	24.3	24.2	22.6	24.0	24.8	24.8	24.7	24.5	25.2
Tax revenue	12.8	12.8	12.2	12.6	13.5	13.6	13.9	13.9	14.1
Capital income	0.0	-0.2	0.4	-0.5	0.7	-0.1	0.4	0.0	0.0
Total expenditure <sup>n</sup>	25.1	24.6	24.7	25.0	27.1	28.6	27.4	26.5	25.5
Current expenditure	20.5	20.0	19.8	20.6	22.2	23.3	22.8	22.3	21.7
Interest	3.8	3.2	3.7	3.6	4.0	4.3	4.3	4.1	4.1
Capital expenditure	4.6	4.6	4.9	4.4	4.8	5.2	4.5	4.1	3.8
Primary balance	3.0	2.6	2.0	2.0	2.4	0.4	1.9	2.1	3.8
Overall balance	-0.8	-0.6	-1.7	-1.6	-1.6	-3.9	-2.4	-2.0	-0.4
Central government debt	...	...	...	41.8	43.5	45.4	46.3	48.3	42.7
Domestic	...	...	...	26.6	28.1	28.7	27.1	27.7	25.4
External	...	...	...	15.1	15.3	16.6	19.2	20.6	17.3
<b>Money and credit<sup>o</sup></b>									
Domestic credit <sup>p</sup>	24.7	26.4	26.2	26.7	24.7	27.0	29.3	31.7	33.1
To the public sector	11.8	11.6	10.0	8.3	3.9	3.7	5.3	7.1	7.2
To the private sector	12.9	14.8	16.2	18.3	20.7	23.1	23.8	24.3	25.4
Other	0.0	0.0	0.0	0.1	0.1	0.1	0.2	0.3	0.5
Liquidity (M3)	28.1	27.9	27.9	30.3	31.4	32.8	33.9	37.8	40.1
Currency in circulation and local-currency deposits (M2)	18.2	17.1	16.5	17.9	17.8	17.8	18.6	19.2	19.5
Foreign-currency deposits	10.0	10.9	11.4	12.3	13.6	14.9	15.4	18.6	20.5

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

<sup>a</sup> Preliminary figures. <sup>b</sup> Based on figures in local currency at constant 1991 prices. <sup>c</sup> Based on figures in local currency expressed in dollars at current prices. <sup>d</sup> Includes errors and omissions. <sup>e</sup> Refers to the capital and financial balance (including errors and omissions), minus net foreign direct investment. <sup>f</sup> A minus sign (-) denotes an increase in reserves. <sup>g</sup> Includes the use of IMF credit and loans and exceptional financing. <sup>h</sup> Annual average, weighted by the value of merchandise exports and imports. <sup>i</sup> Refers to net investment income as a percentage of exports of goods and services as shown on the balance of payments. <sup>j</sup> Economically active population as a percentage of the working-age population; nationwide total. <sup>k</sup> Unemployment and underemployment rates as percentages of the economically active population; nationwide total. <sup>l</sup> Depósitos a 90 días de bancos estatales. <sup>m</sup> Rate on loans to industry from State-owned banks. <sup>n</sup> Includes net lending. <sup>o</sup> The monetary figures are annual averages. <sup>p</sup> Refers to net credit extended to the public and private sectors by commercial banks and other financial and banking institutions.

rate will be adjusted primarily according to the inflation target and the rise in prices estimated for Costa Rica's principal trading partners, rather than past inflation.

Taking into account expectations regarding the difference between domestic and external inflation, as well as the performance of the United States dollar relative to the currencies of other trading partners, in 2006 the central bank decided to change the daily currency-adjustment rate to an annual variation of 6.6% in the price of the United States dollar in colones (8.3% in 2005).

The new Administration's plans include the adoption of a more flexible exchange-rate system. Considering the financial system's high level of dollarization, this could create problems unless this shift is coupled with measures to strengthen the financial system.

#### (d) Trade policy

In October 2005, the executive branch sent the text of the free trade agreement with the United States, Central America and the Dominican Republic (CAFTA-DR) to the legislative assembly. A free trade agreement with the countries of the Caribbean Community (CARICOM) took effect in 2005.

The new Administration has expressed its determination to strengthen the economy's export orientation. To this end, one of its main priorities is CAFTA-DR ratification. A similar agreement with the European Union (the principal market for some of Costa Rica's most successful exports) is also being considered, as are negotiations to bring Costa Rica closer to the Asia-Pacific region.

Table 2  
**COSTA RICA: MAIN QUARTERLY INDICATORS**

	2004				2005 <sup>a</sup>				2006 <sup>a</sup>	
	I	II	III	IV	I	II	III	IV	I	II
Gross domestic product (variation from same quarter of preceding year) <sup>b</sup>	4.2	5.1	4.2	3.1	2.7	5.7	9.2	6.2	7.0	...
Merchandise exports, f.o.b. (millions of dollars)	1 571	1 636	1 523	1 568	1 596	1 853	1 791	1 787	1 989	2 086
Merchandise imports, c.i.f. (millions of dollars)	2 015	2 079	2 080	2 094	2 140	2 411	2 546	2 714	2 708	2 835
International reserves (millions of dollars)	1 749	1 637	1 659	1 922	2 105	2 194	2 373	2 313	2 766	2 504 <sup>c</sup>
Real effective exchange rate (index: 2000=100) <sup>d</sup>	106.0	106.0	106.4	109.0	109.1	108.7	108.4	107.4	107.5	108.8
Consumer prices (12-month percentage variation)	11.3	11.9	13.8	13.1	13.6	13.8	13.4	14.1	12.2	12.4
Average nominal exchange rate (colones per dollar)	423	433	443	453	464	473	483	492	501	509
Average real wage (variation from same quarter of preceding year)	0.0	-3.1	-4.0	-3.6	-1.0	-2.4	-1.2	-3.1	1.3	...
Nominal interest rates (annualized percentages)										
Deposit rate <sup>e</sup>	10.1	10.0	10.0	10.0	10.1	10.5	10.6	10.4	10.7	10.0
Lending rate <sup>f</sup>	21.0	20.9	21.3	21.4	21.5	22.2	22.3	22.0	22.0	21.4
Interbank interest rate <sup>g</sup>	13.5	13.6	14.0	14.3	14.8	15.4	15.4	15.3	15.3	14.2
Domestic credit (variation from same quarter of preceding year) <sup>h</sup>	23.1	27.2	26.6	26.2	32.1	20.0	19.1	19.4	20.0	19.3
Non-performing loans as a percentage of total credit <sup>i</sup>	1.6	1.7	2.0	1.9	1.7	1.5	1.6	1.4	1.4	1.5

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

<sup>a</sup> Preliminary figures. <sup>b</sup> Based on figures in local currency at constant 1991 prices. <sup>c</sup> Data to May. <sup>d</sup> Quarterly average, weighted by the value of merchandise exports and imports. <sup>e</sup> 90-day deposits at state-owned banks. <sup>f</sup> Rate on loans to industry from State-owned banks. <sup>g</sup> Reference rate (monthly average), calculated by the Central Bank of Costa Rica. <sup>h</sup> Refers to net credit extended to the public and private sectors by commercial banks and other financial and banking institutions. <sup>i</sup> Refers to total credit extended by the banking system.

### 3. The main variables

#### (a) Economic activity

The growth rate in 2005 was 5.9%, up from 4.1% the year before. Economic activity cooled in the first five months due to worsening terms of trade, an austere fiscal policy and the effect that the prospects of a rise in interest rates had on domestic spending. Certain short-term weather factors weighed in as well, mainly affecting banana and sugar-cane production. During the rest of the year, however, economic activity rebounded on the back of buoyant exports, especially in the high-technology sector.

The expansion of economic activity was fuelled by the dynamism of external demand. Goods and services exports posted a growth rate of 12.6%, which was substantially higher than the 2004 rate of 8.2%. Domestic demand,

in contrast, slackened as a result of reduced growth in consumption, which tempered the impact of the surge in investment on domestic spending.

A strong recovery in gross fixed capital formation (7.3%) was driven by investment in capital goods, especially by companies operating under the free-zone regime. Investment in new construction slackened, however, owing largely to the reduction in public works. Private consumption (3.9%) suffered from the decline in the growth rate of disposable national income, but benefited from rising employment and an increase in bank financing for consumption and housing. Public consumption grew only slightly as a result of efforts to curb public spending.

At the sectoral level, goods production was notably buoyant (8.2%) as a result of a higher level of value added in the manufacturing sector (11.8%), thanks mainly to the

production activities of companies operating in the free zones and Costa Rican firms' exports, most of which go to other Central American countries. The agricultural sector also experienced an upswing (3.3%).

Services were up by 4.9%, largely due to transport, telecommunications (especially mobile telephones and Internet services), hotels, financial services and international business services (especially software production, call centres and business centres).

### **(b) Prices, wages and employment**

The rate of inflation, measured by the annual variation in the consumer price index, stood at 14.1%. This rate not only overshot the target set by the central bank at the beginning of 2005 by four percentage points, but also marked the highest level recorded in the last 10 years.

This development was largely attributable to external shocks that boosted the prices of tradable goods. The price index for tradables showed an annual variation of 18%. This mainly reflected rising international hydrocarbon, coffee and beef prices, much of whose effect was passed on to domestic prices. Even though such external shocks are transitory, in this case their magnitude and duration appear to have heightened inflationary expectations. In addition, efforts to hold down price levels have been hindered by the strong inertial component of inflation in the Costa Rican economy.

Economic growth translated into a considerable upturn in employment, especially in the formal sector. However, as a consequence of the expansion of the labour supply, the national open unemployment rate edged up from 6.5% to 6.6%. At the same time, real average wages in the formal

sector retreated by 1.9%, while nominal minimum wage adjustments barely compensated for price increases.

### **(c) The external sector**

The balance-of-payments current account deficit widened to the equivalent of 4.8% of GDP (in 2004 it amounted to 4.3%). The narrowing of the deficit on the income account (thanks to decreased repatriation of profits and dividends from foreign direct investment (FDI)) was more than offset by the surge in of the trade deficit, which jumped from 3.0% to 5.0% of GDP. The inflow of foreign financial capital caused international assets to swell by US\$ 391 million.

In 2005, FDI inflows reached US\$ 696 million, equivalent to 3.5% of GDP. Among the most significant investments were those linked to the expansion of companies located in the country's free trade zones, such as Intel, as well as the establishment of new industrial and services companies. New acquisitions and reinvestments by large retailers were also a significant factor.

Goods exports grew by 11.4%. Products showing particularly high growth included coffee (due to rebounding international prices) and non-traditional agricultural goods such as pineapples, melons, flowers, foliage and household plants. Industrial goods for export showing notable increases included microprocessors, sound amplification equipment, dental equipment, integrated circuits, electrical conductors, refrigerators and medicine. The expansion of imports (18.6%) was concentrated in raw materials and intermediate goods, largely because of the country's rising oil bill and external purchases by companies located in its free zones.



## El Salvador

### 1. General trends

In 2005, GDP in El Salvador grew by 2.8%, resulting in the largest increase in per capita GDP (1%) for six years. The increase in agricultural production and the improved performance of the construction sector offset the lower growth of previous years. Nevertheless, this growth rate was lower than in the other Central American countries and below the average for Latin America. Increased public investment (24.9%) had a significant multiplying effect on consumption, and family remittance income was equivalent to 16.7% of GDP.

Economic activity was held back by higher international oil prices and, to a lesser extent, by the hike in international interest rates which resulted in a slight increase in debt servicing. Annual inflation stood at 4.3% and the current account deficit was 4.6% of GDP. The floods caused by tropical storm Stan, and the eruption of the Ilamatepec volcano in October 2005, caused damage and losses estimated at US\$ 355

million, but this did not affect the main macroeconomic balances.<sup>1</sup>

The economy is expected to grow by 3.5% in 2006, driven by reconstruction works, the buoyant growth of world markets, and improved results for agriculture and tourism. The main planks of economic policy are to maintain fiscal discipline and encourage production, especially in manufacturing and agriculture, as well as tourism activities.

### 2. Economic policy

In view of the absence of monetary and exchange-rate policy, economic policy was focused on fiscal policy, the main feature in 2005 being the successful implementation of the tax reform.

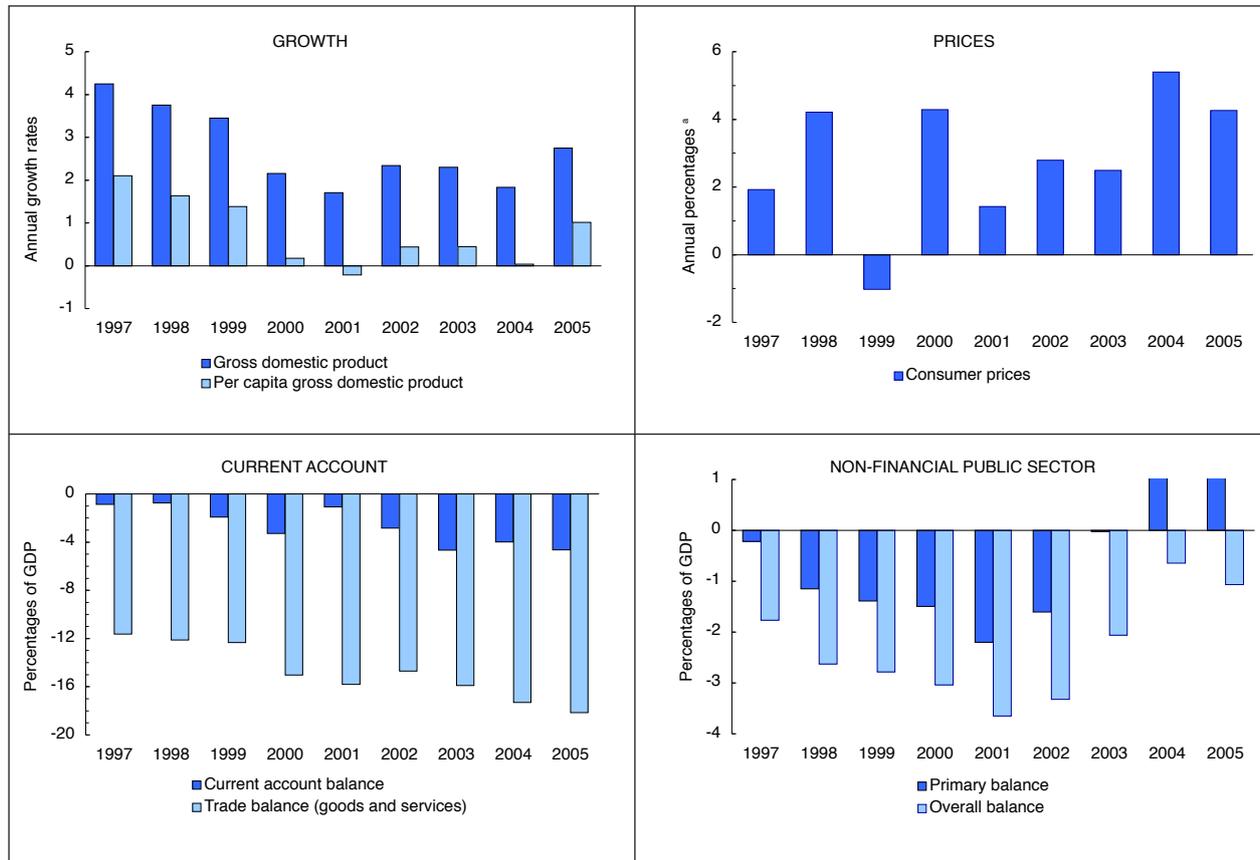
#### (a) Fiscal policy

The goal of fiscal policy in 2005 was to improve results through fiscal reform. Although this reform's positive effects were offset by the costs of reconstruction work following the natural disasters, the central government

deficit dropped from 1.1% of GDP in 2004 to 1.0% in 2005. The tax reform generated additional income of US\$ 170 million, owing to amendments to the tax code and the laws governing pensions, banking and income tax. The tax burden was 12.6% of GDP, which was one percentage point higher than in the previous year and was also the target amount. The taxes showing the highest real growth were the tax on consumption of goods and services (22.8%), income tax (19.6%), VAT (10.7%) and property and other taxes (2.3%). Meanwhile, non-tax revenue fell by 49.7%.

<sup>1</sup> See Economic Commission for Latin America and the Caribbean (ECLAC), *Efectos en El Salvador de las lluvias torrenciales, tormenta tropical Stan y erupción del volcán Ilamatepec (Santa Ana)*, October 2005 (LC/MEX/R.892), and *Perfiles de proyecto* (LC/MEX/R.892/Add.1), Mexico City, ECLAC subregional headquarters in Mexico, November 2005.

Figure 1  
EL SALVADOR: MAIN ECONOMIC INDICATORS



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

<sup>a</sup> December-December variation.

Current expenditure rose by 3% in real terms, mainly because of the increase in debt servicing and the burden of the pension system (US\$ 327.1 million). It is estimated that pension costs will rise by 22% in 2006, judging by the recent trend in pension system transition costs. Investment expenditure grew by 25%, after two years of sharp contraction. As a result of these different trends, total expenditure was 6% higher.

In order to attenuate the impact of rising oil prices and protect low-income families, subsidies were introduced for public transport (US\$ 8.9 million) and for consumption of electricity (US\$ 33.4 million) and liquefied petroleum gas (LPG) (US\$ 55.6 million). These measures, together with reconstruction expenditure and pension costs, resulted in a non-financial public sector (NFPS) deficit equivalent to 3% of GDP, one half of a percentage point more than in 2004. If pension payments are excluded, the deficit rose from 0.6% of GDP in 2004 to 1.1% of GDP in 2005. In view of the upward trend in fossil fuel prices, it is expected that the subsidies

will continue in 2006 and the NFPS deficit will remain at the same levels.

The successful adoption of the budget led to a recovery in public-sector investment (24.9%), after a fall of 43.2% in 2004. Growth is expected to be even higher in 2006, owing to infrastructure investments in the La Unión and Acajutla ports, which are 50% completed.

Public external debt (US\$ 4.976 billion dollars) rose by 4%. Bonds worth US\$ 401.8 million were issued in 2005, of which US\$ 375 million were on the international market. In 2006 a bond issue for US\$ 663.7 million is expected, which would include US\$ 563.7 million on the international market (US\$ 400 million had been placed by April 2006) and US\$ 100 million on the national market, to meet financing needs (capital expenditure, debt servicing and pension costs). The pension debt will be covered by 60% of this bond issue. Internal public debt increased by 8.9% in relation to 2004 and reached US\$ 2,727,600,000, while total public debt amounted to 45% of GDP.

In 2006 the government plans not to increase taxes but to make efforts to combat evasion and smuggling and to encourage compliance with tax obligations. Judging by the general budget allocations to each area, the government's priorities for 2006 are spending on social development (37.4%), repayment of public debt (18.8%) and compliance with general obligations (11.4%).

#### **(b) Monetary policy**

The hike in international interest rates in 2005 resulted in a slight increase in nominal interest rates in El Salvador, which has not yet been reflected in real deposit rates, as the rates for 180-day deposits were close to those in 2004 (-1.1%), standing at -1.2% in 2005. The interest rates for one-year loans rose from 1.8% in 2004 to 2.1% in 2005. Domestic credit to the public sector grew by 44.5% and to the private sector by 7.7%.

In December 2005, banking indicators improved slightly compared with the same month in the previous year. In 2005 the Central Reserve Bank held net international reserves of US\$ 1.83 billion (3.1% less than in the previous year), equivalent to three months' goods and services imports.

#### **(c) Other policies**

2005 saw the adoption of the consumer protection law, providing greater security to the population in the purchase of goods and services.

Despite the fact that the government of President Antonio Saca has launched a number of crime reduction programmes, National Police statistics indicate that violence increased by almost 33% in 2005. The National Institute of Forensic Medicine reported 3,697 homicides (54 homicides for every 100,000 inhabitants), a rise of 26% compared with 2004. The United Nations Development Programme (UNDP) estimated that the cost of violence in El Salvador was equivalent to 11.5% of GDP.

The authorities sought to boost tourism, with the adoption of a general tourism law and the identification of immediate measures to improve infrastructure in the ten major areas of tourism development in the country. This led to the design and construction of the first stage of the tourism complex "La Libertad" and the granting of facilities for private investment in various tourism enterprises.

Developments expected in 2006 include an increased number of tourists (over one million), the implementation of the National Tourism Plan 2014, the application of the implementing regulations of the legislation on tourism and the creation of an inter-agency commission for tourism development.

In March 2006 the Dominican Republic-Central America-United States Free Trade Agreement (CAFTA-DR) came into force, and El Salvador was the first country in the region to approve the set of reforms needed for its implementation. The treaty is expected to offer greater incentives and facilities for exports and foreign direct investment (FDI), especially in non-traditional and ethnic products.

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### **3. The main variables**

#### **(a) Economic activity**

Economic activity in 2005 showed the highest growth for six years (2.8%), driven by favourable export prices for some agricultural goods and the recovery of gross fixed investment (5.7%), which compensated for the previous year's 5% fall. A significant contribution was made by the increase in public spending (24.9%), compared to private investment which expanded by only 3.6%. Investment in machinery and construction grew at similar rates, close to 6%. Remittances have had an impact on domestic demand and have boosted private consumption (2.6%). In 2005, exports of goods and services rose very slowly (0.4%), while on the supply side, goods and services imports increased by 0.8%.

The agricultural sector experienced growth of 5.8% in 2005, owing to the rise in basic grains production and the hike in international coffee and sugar prices. The basic services sector (electricity, gas, water, transport, storage and communications) expanded by 4.2%, while the construction sector, after a fall of 11.4% in 2004, posted an increase of 3.4%, owing to higher levels of public and private investment in the works at the La Unión and Acajutla ports, and to the expenditure on reconstruction work in the aftermath of the natural disasters of October 2005 (which will have a greater impact in 2006). Financial services grew by 2.9% and the manufacturing sector expanded by 1.4% despite the exit of some maquila companies.

The decline in maquila production, which accounts

Table 1  
EL SALVADOR: MAIN ECONOMIC INDICATORS

	1997	1998	1999	2000	2001	2002	2003	2004	2005 <sup>a</sup>
	<b>Annual growth rates<sup>b</sup></b>								
<b>Gross domestic product</b>	4.2	3.7	3.4	2.2	1.7	2.3	2.3	1.8	2.8
<b>Per capita gross domestic product</b>	2.1	1.6	1.4	0.2	-0.2	0.4	0.4	0.0	1.0
<b>Gross domestic product, by sector</b>									
Agriculture, livestock, hunting, forestry and fishing	0.4	-0.7	7.7	-3.1	-2.6	0.4	0.9	3.0	5.8
Mining	6.5	5.3	0.4	-4.7	11.7	5.5	3.5	-16.0	3.5
Manufacturing	8.0	6.6	3.7	4.1	4.0	2.9	2.2	0.9	1.4
Electricity, gas and water	4.2	6.1	2.7	-2.3	4.7	7.3	4.4	3.3	3.1
Construction	6.2	8.5	-1.8	-3.4	9.6	6.7	3.2	-11.4	3.4
Wholesale and retail commerce, restaurants and hotels	2.9	4.0	2.0	3.6	1.9	1.5	2.7	2.4	1.6
Transport, storage and communications	7.7	4.2	9.5	6.1	4.3	5.0	3.4	5.4	4.3
Financial institutions, insurance, real estate and business services	4.4	3.7	3.0	3.0	-0.8	2.7	2.6	2.5	2.9
Community, social and personal services	3.4	1.2	1.0	1.1	-0.3	-0.6	0.5	1.8	1.7
<b>Gross domestic product, by type of expenditure</b>									
Consumption	3.0	2.4	3.4	3.7	3.2	1.5	1.9	2.7	2.5
General government	2.8	2.5	0.4	0.9	4.6	0.1	-0.3	1.9	1.7
Private	3.0	2.4	3.7	3.9	3.1	1.6	2.1	2.8	2.6
Gross domestic investment	6.5	22.8	-4.0	2.7	5.1	-2.7	7.8	-4.5	2.6
Exports (goods and services)	30.2	6.2	7.1	16.8	-0.2	6.0	4.7	6.6	0.4
Imports (goods and services)	16.8	9.2	2.7	14.5	4.2	1.5	4.8	4.3	0.8
	<b>Percentages of GDP</b>								
<b>Investment and saving<sup>c</sup></b>									
Gross domestic investment	15.1	17.6	16.4	16.9	16.7	16.4	17.0	16.0	15.4
National saving	14.2	16.8	14.5	13.6	15.6	13.6	12.3	12.0	10.8
External saving	0.9	0.8	1.9	3.3	1.1	2.8	4.7	4.0	4.6
	<b>Millions of dollars</b>								
<b>Balance of payments</b>									
Current account balance	-98	-91	-239	-431	-150	-405	-702	-632	-786
Merchandise trade balance	-1 143	-1 306	-1 356	-1 740	-1 933	-1 865	-2 287	-2 662	-3 008
Exports, f.o.b.	2 437	2 460	2 534	2 963	2 892	3 020	3 153	3 337	3 432
Imports, f.o.b.	3 580	3 765	3 890	4 703	4 824	4 885	5 439	5 999	6 440
Services trade balance	-152	-149	-183	-235	-250	-240	-107	-78	-72
Income balance	-163	-163	-282	-253	-266	-323	-423	-460	-571
Net current transfers	1 361	1 527	1 582	1 797	2 298	2 023	2 114	2 568	2 865
Capital and financial balance <sup>d</sup>	460	394	447	385	-27	282	1 019	579	728
Net foreign direct investment	59	1 103	162	178	289	496	123	430	300
Financial capital <sup>e</sup>	401	-709	285	207	-316	-214	895	150	427
Overall balance	363	303	208	-46	-178	-124	316	-52	-59
Variation in reserve assets <sup>f</sup>	-363	-303	-208	46	178	124	-316	53	59
<b>Other external-sector indicators</b>									
Real effective exchange rate (index: 2000=100) <sup>g</sup>	104.0	101.9	100.4	100.0	99.6	99.6	100.1	100.3	101.7
Terms of trade for goods (index: 2000=100)	95.0	95.8	99.6	100.0	102.5	101.6	97.7	96.8	96.8
Net resource transfer (percentage of GDP)	2.7	1.9	1.3	1.0	-2.1	-0.3	4.0	0.8	0.9
Gross external public debt (millions of dollars)	2 689	2 646	2 789	2 831	3 148	3 987	4 717	4 778	4 976
Gross external public debt (percentage of GDP)	24.1	22.0	22.4	21.6	22.8	27.9	31.3	30.2	29.3
Net profits and interest (percentage of exports) <sup>h</sup>	-5.6	-5.3	-8.9	-6.9	-7.4	-8.5	-10.3	-10.4	-12.5
	<b>Average annual rates</b>								
<b>Employment</b>									
Labour force participation rate <sup>i</sup>	50.9	53.5	52.6	52.2	53.3	51.2	53.4	51.7	52.4
Open unemployment rate <sup>j</sup>	8.0	7.5	7.0	6.7	7.0	6.2	6.9	6.8	7.8
Visible underemployment rate <sup>k</sup>	...	3.2	3.5	3.4	3.4	4.1	4.5	4.5	5.8
	<b>Annual percentages</b>								
<b>Prices</b>									
Variation in consumer prices (December-December)	1.9	4.2	-1.0	4.3	1.4	2.8	2.5	5.4	4.3
Variation in real minimum wage	-4.3	3.3	2.4	-2.2	-3.6	-1.8	2.1	-1.4	-4.5
Nominal deposit rate <sup>l</sup>	...	...	...	6.5	5.5	3.4	3.4	3.3	3.4
Nominal lending rate <sup>m</sup>	...	...	...	10.7	9.6	7.1	6.6	6.3	6.9

Table 1 (concluded)

	1997	1998	1999	2000	2001	2002	2003	2004	2005 <sup>a</sup>
	<b>Percentages of GDP</b>								
<b>Non-financial public sector</b>									
Total income <sup>n</sup>	15.3	14.9	15.0	15.8	14.9	15.5	16.2	16.2	16.4
Current income	15.1	14.8	14.7	14.9	14.4	14.7	15.7	15.9	16.1
Tax revenue	10.3	10.2	10.2	10.2	10.5	11.1	11.5	11.5	12.6
Capital income	...	...	...	...	0.0	0.5	0.0	0.0	0.0
Total expenditure <sup>o</sup>	17.1	17.6	17.8	18.8	18.5	18.8	18.3	16.9	17.5
Current expenditure	13.2	13.8	14.5	15.5	14.0	13.9	14.6	14.6	14.7
Interest	1.6	1.5	1.4	1.5	1.4	1.7	2.0	2.1	2.3
Capital expenditure	4.0	3.8	3.2	3.3	4.5	4.9	3.7	2.3	2.8
Primary balance	-0.2	-1.2	-1.4	-1.5	-2.2	-1.6	-0.0	1.5	1.2
Overall balance	-1.8	-2.6	-2.8	-3.0	-3.6	-3.3	-2.1	-0.6	-1.1
<b>Central government debt</b>									
Domestic	12.0	11.2	7.2	9.6	11.7	11.1	11.0	11.8	12.7
External	24.1	22.0	18.0	17.5	19.1	24.2	26.2	26.2	25.1
<b>Money and credit<sup>p</sup></b>									
Domestic credit <sup>q</sup>	...	...	...	...	...	37.5	37.9	38.7	36.5
To the public sector	...	...	...	...	...	-1.1	-0.5	1.0	0.8
To the private sector	...	...	...	...	...	40.2	40.5	40.2	39.5
Liquidity (M3)	42.0	44.3	44.7	45.1	43.9	41.9	39.9	38.4	36.2

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

<sup>a</sup> Preliminary figures. <sup>b</sup> Based on figures in local currency at constant 1990 prices. <sup>c</sup> Based on figures in local currency expressed in dollars at current prices. <sup>d</sup> Includes errors and omissions. <sup>e</sup> Refers to the capital and financial balance (including errors and omissions), minus net foreign direct investment. <sup>f</sup> A minus sign (-) denotes an increase in reserves. <sup>g</sup> Annual average, weighted by the value of merchandise exports and imports. <sup>h</sup> Refers to net investment income as a percentage of exports of goods and services as shown on the balance of payments. <sup>i</sup> Economically active population as a percentage of the working-age population; nationwide total. <sup>j</sup> Unemployment rate as a percentage of the economically active population, nationwide total. <sup>k</sup> Underemployment rate as a percentage of the economically active population; urban total. <sup>l</sup> Reference rate for deposits of up to 180 days in the financial system. <sup>m</sup> Reference rate for 1-year loans in the financial system. <sup>n</sup> Includes grants. <sup>o</sup> Includes net lending. <sup>p</sup> The monetary figures are annual averages. <sup>q</sup> Refers to net credit extended to the public and private sectors by commercial banks and other financial and banking institutions.

for 12% of the manufacturing sector (-3.3% in 2004 and -6% in 2005), together with the loss of competitiveness in a number of productive sectors and continuing insecurity in the country led the Government of El Salvador to design an economic programme to boost the productive sectors.

In September 2005, the government announced an industrial policy proposal (implementation will begin in 2006) which is intended to strengthen the competitiveness of the manufacturing sector, promote economic diversification and eliminate coordination and information failures. This policy has a reactivation fund of US\$ 30 million which will be managed by the Multisectoral Investment Bank and will be used to support strategic projects and sectoral studies. The sector is expected to post growth rates of 7% over the next five years and contribute up to 30% of national GDP, starting from a base level of 24%.

In 2006 a series of measures will be implemented in the agricultural sector to increase productive capacity and efficiency. In addition, the government plans to encourage

other key areas of national development. To help to open up external markets, treaty administration will be strengthened and a National Management Commission for Trade Treaties (Conatco) will be established, while trade negotiations will be concluded with Canada and initiated with the European Union, Taiwan province of China and CARICOM. As for competitiveness and productivity, efforts will be made to improve the business climate and attract new investments. Lastly, the government will launch a national energy policy to encourage an expansion of electricity generating capacity using renewable resources. The financing of this policy, however, requires urgent attention.

The country's economic activity as measured by the economic activity index (IVAE)<sup>2</sup> (trend cycle) posted an annual increase of 5.6% in the first quarter of 2006. This expansion of economic activity was due to the rapid growth in the sectors of electricity, gas and water, transport, storage and communications, financial services, agricultural activities and commerce. Economic activity was also supported by a higher growth rate for exports.

<sup>2</sup> The IVAE includes eleven of the twelve activities that make up GDP, with coverage of 84.5%. The activities added in 2006 are: fishing, cotton production, mining and quarries, water supply services, communications, restaurants and hotels, business services, and community, social and personal services. The number of establishments surveyed in the trade and industry sector has been expanded and the number of products has been increased.

Table 2  
EL SALVADOR: MAIN QUARTERLY INDICATORS

	2004				2005 <sup>a</sup>				2006 <sup>a</sup>	
	I	II	III	IV	I	II	III	IV	I	II
Gross domestic product (variation from same quarter of preceding year) <sup>b</sup>	1.9	1.8	1.8	1.9	1.7	3.1	3.3	2.9	3.2	...
Merchandise exports, f.o.b. (millions of dollars)	815	807	844	829	821	919	865	784	909	...
Merchandise imports, c.i.f. (millions of dollars)	1 462	1 542	1 535	1 730	1 542	1 759	2 327	1 696	1 777	...
International reserves (millions of dollars)	1 787	1 689	1 768	1 754	1 587	1 928	1 643	1 723	1 681	2 034 <sup>c</sup>
Real effective exchange rate (index: 2000=100) <sup>d</sup>	100.7	99.5	99.7	101.3	101.6	101.7	102.1	101.5	102.3	102.4
Consumer prices (12-month percentage variation)	3.0	4.6	5.3	5.4	4.7	4.3	4.4	4.3	4.0	4.4
Average nominal exchange rate (colones per dollar)	8.75	8.75	8.75	8.75	8.75	8.75	8.75	8.75	8.75	8.75
Nominal interest rates (annualized percentages)										
Deposit rate <sup>e</sup>	3.4	3.4	3.3	3.3	3.2	3.4	3.4	3.7	4.1	4.2
Lending rate <sup>f</sup>	6.6	6.2	6.3	6.1	6.9	6.8	6.9	6.9	7.6	7.4
Interbank interest rate	...	...	...	...	...	5.8	4.5	5.3	...	6.0 <sup>c</sup>
Domestic credit (variation from same quarter of preceding year) <sup>g</sup>	9.0	9.5	6.2	3.2	3.6	-4.7	0.1	5.2	7.2	2.4 <sup>c</sup>
Non-performing loans as a percentage of total credit <sup>h</sup>	2.7	2.6	2.7	2.4	2.5	2.1	2.2	2.0	1.9	2.1 <sup>c</sup>

Source: Comisión Económica para América Latina y el Caribe, sobre la base de cifras oficiales.

<sup>a</sup> Preliminary figures. <sup>b</sup> Based on figures in local currency at constant 1990 prices. <sup>c</sup> Data to May. <sup>d</sup> Quarterly average, weighted by the value of merchandise exports and imports. <sup>e</sup> Reference rate for deposits of up to 180 days in the financial system. <sup>f</sup> Reference rate for 1-year loans in the financial system. <sup>g</sup> Refers to net credit extended to the public and private sectors by commercial banks and other financial and banking institutions. <sup>h</sup> Refers to total credit extended by the banking system.

## (b) Prices, wages and employment

Annual inflation of 4.3%, exceeding the target range of between 3% and 4%, was attributable to price rises caused by temporary food shortages resulting from the floods and high oil prices, which in turn increased transport costs and led to higher prices for pulses, vegetables and electric power. The sectors which had inflation equal to or higher than the average were alcohol, tobacco and narcotics (16.6%), transport (8.1%), foodstuffs and non-alcoholic beverages (4.7%) and housing, water, electricity, gas and other fuels (4.3%).

In April 2006 twelve-month inflation was at 4.2%. For the rest of 2006 price rises are expected to fall back to the 3%-4% range, despite wage increases for public officials and rising oil prices. The industrial price index in 2005 was 6.9%, almost half the 2004 level (13%), and in April 2006 it went up again, to 9.6%.

In 2005, the fifth consecutive year, there was no increase in the minimum wage and families' purchasing power diminished. This was partially mitigated by the subsidy programme to help low-income groups. Despite economic growth, job losses in the maquila sector caused the unemployment rate to rise by one percentage point, to 7.8%.

The wage increases for public employees in 2006 were the first since 1998, and the total cost was US\$ 40 million. Salaries of up to US\$ 400 per month will increase by 10%, those between US\$ 401 and US\$ 700 by 8%, those between US\$ 701 and US\$ 1,000 by 6% and those of US\$ 1,001 and above by 3%. In addition, staffing in the health and education sector will be expanded to 23,227 employees, costing nearly US\$ 12.5 million.

## (c) The external sector

In 2005, exports of goods increased only slightly (2.7%), as a result of the fall in maquila exports (5.4%), which accounted for 54% of total exports. This was offset by the improvement in the prices of some agricultural products, including coffee and sugar. CAFTA-DR will benefit sugar exports in 2006 in view of the doubling of the import quota for the United States market. There was a 10.1% rise in exports of non-traditional goods and growth of 40.6% in exports of traditional goods, but the latter represented only 6.9% of total goods exports. The export sector is expected to improve its performance in 2006. In the first quarter of 2006 it posted growth of 10.8%.

Meanwhile, goods imports increased by 6.9%. Almost

50% were purchases of intermediate and capital goods, 30% were consumer goods and the remaining 20% were maquila inputs. Imports of consumer goods (13.2%) and intermediate goods (11%) were the most buoyant. In the case of intermediate goods this was due to the high prices of oil and petroleum products. In March 2006 the growth rate for imports reached 13.8%, and the current account deficit is expected to increase in 2006.

In 2005 income from tourism was US\$ 629 million, owing to promotional activities conducted abroad by the newly-created Ministry of Tourism.

The economy received a significant external boost from increased family remittances (11.1%), associated with efforts to counteract the impact of natural disasters and with the strong performance of the United States economy. Remittances (US\$ 2.83 billion) sustained private consumption and covered almost 94% of the trade gap,

but the terms of trade worsened for the third consecutive year (-2.3%). These trends led to a balance-of-payments current account deficit of 4.6% of GDP.

The financial account showed a positive balance of US\$ 722.9 million, an increase of over US\$ 600 million compared to 2004. This was due to the 37.5% rise in the net inflow of foreign direct investment, which amounted to US\$ 517 million. One of the contributing factors was non-recurring receipts from the sale of bank assets, although there was a drop in assets under the heading of “other investment”. Portfolio investments grew by US\$ 93.6 million, reversing a six-year downward trend.

In May 2006 the three main international rating agencies did not alter their risk ratings for El Salvador’s long-term debt instruments. Among the Central American countries, it is the only holder of the “investment grade” rating awarded by Moody’s Investors Service.



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## Guatemala

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### 1. General trends

The Guatemalan economy grew by 3.2%, the best performance of the past five years. GNP growth was driven by private consumption and inflation was at 8.6%, a moderate reduction from the 2004 level of 9.2%. No unemployment survey was carried out in 2005, but the economic growth would be consistent with an unemployment rate similar to that of 2004, while the underemployment rate would be almost 30%.

The current account deficit of 4.1% of GDP was due to a negative balance on the goods and services account equivalent to 14% of GDP, mitigated by current transfer income equivalent to 10.9% of GDP, consisting mainly of family remittances from the United States. The negative current-account balance was more than offset by capital flows, which increased international reserves by US\$ 250 million. The terms of trade continued to deteriorate and despite improved export prices, the price rises for oil and other raw material imports were even higher.

Economic performance in 2005 reflected efforts by the monetary authorities to moderate the impact on inflation of higher fuel prices and measures taken in connection with the foreign-exchange market, such as the introduction of an explicit intervention rule to prevent

any sudden appreciation of the national currency, a policy strongly supported by the fiscal authorities. In September, the government deficit was 0.6% of GDP, and by the end of the year it had risen to 1.5% of GDP, owing to the increase in spending in the fourth quarter, especially capital spending.

If the Banco de Guatemala's growth projection of 4.4% for 2006 is accurate, it will be the first time in this decade that growth is higher than the average rate recorded in the 1990s; the projections call for inflation of between 5% and 7%, a fiscal deficit of 2.5% of GDP, owing to the process of reconstruction after the damage caused by tropical storm Stan, and a current account deficit of 3.8% of GDP. Risk factors include the sustained increase in oil and petroleum product prices and their impact on domestic and global inflation.

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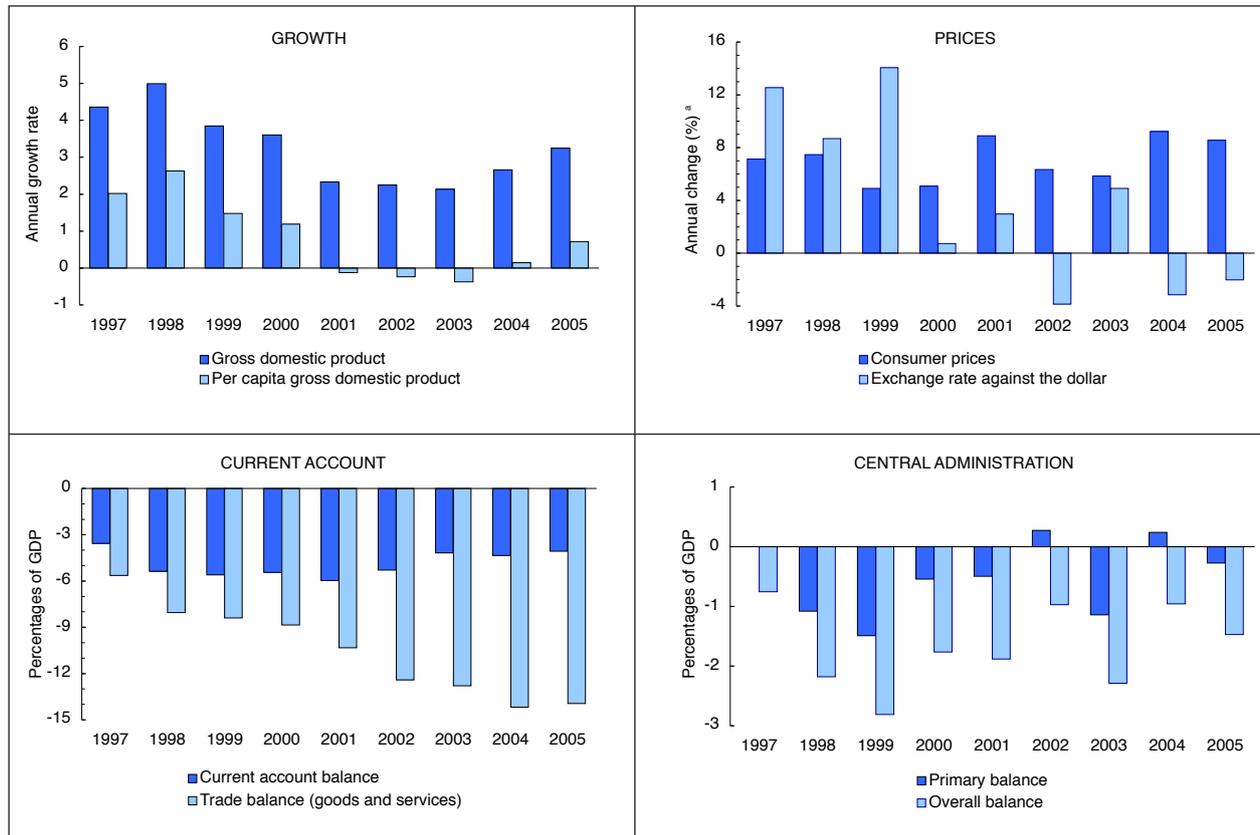
### 2. Economic policy

The monetary authorities tried to establish a balance between boosting the economy and ensuring stable domestic prices in view of the high oil prices. Prudent fiscal policies contributed to achieving this goal and exchange-rate policy moderated the appreciating trend caused by growing remittance and capital flows.

#### (a) Fiscal policy

Total revenue in real terms was down by 2.2% despite efforts by the Office of the Superintendent of Tax Administration to increase collection. Tax revenue diminished by 2.3%, although direct tax receipts grew by

Figure 1  
**GUATEMALA: MAIN ECONOMIC INDICATORS**



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

3.7%, mainly owing to increased income tax revenues. The take from indirect taxes contracted by 4.3%, and from VAT by 5.5%. As a result, the tax burden declined from 10.1% to 9.5% of GDP. September saw the restoration of the fuel distribution tax, after its suspension by the Constitutional Court at the end of 2004. A special tariff had been applied to fuels between January and August in order to compensate for this suspension.

Total expenditure grew by 2.7% and current expenditure was down by 0.4%. There were savings in public debt servicing, thanks to improvements in interest rates and terms for domestic borrowing, and this contributed to the growth of 9.6% in capital expenditure. It was also possible to assign resources according to the priorities established in the peace agreements. Social spending rose by an estimated 11.8% in real terms compared to 2004, mostly benefiting the education and health sectors.

The fiscal deficit of 1.5% of GDP was financed entirely by domestic borrowing, and domestic debt rose from 12.84 billion quetzales in 2004 to 16.425 billion in

2005, which is equivalent to 6.7% of GDP and the highest figure since 1992.

The law against tax evasion was passed in mid-2006. If collection does not improve in the second half of the year, some budgetary spending items may have to be cut.

#### (b) Monetary policy

The central bank authorities made progress toward the adoption of a comprehensive inflation target system, which includes measures such as the adoption of a flexible exchange-rate regime and monetary stabilization operations. The inflation rate of 8.6% in 2005 was much higher than the annual target of 4%-6%.

The Government sought to moderate the monetary base by keeping central bank deposits above the planned level (in September they exceeded the original target by 1.265 billion quetzales); in addition, 2005 saw a 15% increase in the placement of monetary regulation instruments. These movements only partially countered the monetization resulting from the monetary authority's

purchases of foreign currency. M1 expanded by 8.5% in real terms (17.7% in nominal terms) while liquidity in national currency (M2) and broad liquidity (M3) grew at a slower rate (5.5%). The abundant liquidity in the economy was reflected in a substantial increase in credit to the private sector (11.8%).

At the beginning of the year the central bank announced that the interest rate for seven-day deposit certificates would be the benchmark rate for short-term monetary stabilization operations. In view of the persistence of inflationary pressures, the monetary authority gradually increased that rate from 2.6% at the beginning of 2005 to 4.0% by the end of the year. The weighted average interest rate of all monetary stabilization operations rose from 6.3% at the beginning of 2005 to 6.5% in November. Despite these increases, however, both rates remained negative in real terms.

In 2005 the banking system benefited from stable interest rates. There was substantial credit expansion, together with improvements in portfolio quality and a reduction in non-performing assets. The banking system showed moderate levels of liquidity in national and foreign currency and channelled more resources towards the private sector. Non-performing loans remained at about 6% of the total portfolio.

The legal instruments adopted in 2005 included a law to prevent and counteract the financing of terrorism, which complemented the regulations against the laundering of money and other assets and the investment rules for banks in relation to securities issued by private entities.

In order to counteract the inflationary pressures of the “second round”,<sup>1</sup> the monetary policy interest rate

was increased by 0.5% in the first few months of 2006, and in May it stood at 4.5%. In 2006 the actual inflation rate will probably be close to the upper limit of the annual inflation target (7%).

### (c) Exchange-rate policy

The monetary authorities continued to face the appreciation of the national currency that was caused by the easy availability of foreign currency in the Guatemalan economy, fuelled by massive inflows of financial capital and family remittances (13.9% of GDP).

Exchange-rate policy in 2005 sought to hold back any sudden appreciation and minimize exchange-rate volatility. The central bank bought US\$ 467 million in 2005, and the annual average real appreciation was 7.1%. In the first half of 2006 the value of the quetzal remained stable at 7.6 quetzales to the dollar, and with lower domestic inflation, real appreciation was reduced.

### (d) Other policies

In 2005 the Congress of the Republic approved the Dominican Republic-Central America-United States Free Trade Treaty (CAFTA-DR), which was due to enter into force on 1 January 2006. Owing to delays in the approval of some of the regulations, it actually entered into force on 3 July 2006. The treaty opens up opportunities for more rapid growth of non-traditional exports and an influx of new foreign investment over the next few years.

## 3. The main variables

### (a) Economic activity

GDP grew by 3.2%, which was higher than the 2.7% recorded in 2004.<sup>2</sup> Per capita GDP growth was up (0.7%) for the first time since the year 2000. In a context of macroeconomic stability, the factor which most contributed to growth was the increase in domestic demand (3.7%), driven by family remittances.

In the public sector, consumption was 5.3% higher owing to increased health and education spending, which offset the 10.1% drop in 2004. Private spending grew by 4.6%, mainly owing to family remittances, while gross fixed investment expanded by 11%, driven by construction and rising purchases of capital goods. In contrast, external demand was only 0.2% higher.

In October 2005, Guatemala was ravaged by tropical

<sup>1</sup> The expression “second round” refers to the increase in prices of those goods and services which do not include petroleum products in their cost structure, but which are affected indirectly by the increase in transport, electricity and other prices.

<sup>2</sup> The estimates of the system of national accounts (SNA) and the balance of payments are being updated. The current series in constant 1958 quetzales (compiled according to 1953 SNA) will be replaced in 2006 by series in constant 2001 quetzales (compiled according to 1993 SNA). In addition, the new balance of payments series will be compiled in accordance with the fifth manual of the International Monetary Fund. The new statistics will be submitted to the Monetary Board of the Bank of Guatemala in June 2006.

Table 1  
**GUATEMALA: MAIN ECONOMIC INDICATORS**

	1997	1998	1999	2000	2001	2002	2003	2004	2005 <sup>a</sup>
	<b>Annual growth rates<sup>b</sup></b>								
<b>Gross domestic product</b>	4.4	5.0	3.8	3.6	2.3	2.2	2.1	2.7	3.2
<b>Per capita gross domestic product</b>	2.0	2.6	1.5	1.2	-0.1	-0.2	-0.4	0.1	0.7
<b>Gross domestic product, by sector</b>									
Agriculture, livestock, hunting, forestry and fishing	2.9	3.7	2.1	2.6	1.2	1.8	3.1	3.7	2.3
Mining	24.6	21.0	-1.9	-8.5	0.8	9.8	4.1	-8.2	-1.1
Manufacturing	2.7	3.6	2.5	1.9	1.1	0.8	1.0	2.3	2.7
Electricity, gas and water	14.7	5.8	11.0	17.4	-3.0	9.1	4.4	6.0	3.5
Construction	10.0	9.3	7.8	-18.3	12.2	-15.3	-3.3	-19.6	3.0
Wholesale and retail commerce, restaurants and hotels	3.7	5.3	3.2	4.1	2.7	2.8	1.9	3.2	2.6
Transport, storage and communications	5.9	7.5	6.8	7.6	6.8	5.7	4.8	9.2	8.4
Financial institutions, insurance, real estate and business services	4.7	5.9	4.6	3.1	0.3	2.2	2.2	2.5	2.3
Community, social and personal services	4.7	4.1	4.7	4.6	3.5	1.2	-0.2	-2.8	2.9
<b>Gross domestic product, by type of expenditure</b>									
Consumption	4.2	5.1	3.7	4.2	4.0	3.0	2.9	2.3	4.7
General government	6.2	9.7	5.2	10.4	5.4	-2.1	-0.6	-10.1	5.3
Private	4.0	4.6	3.6	3.5	3.8	3.6	3.3	3.7	4.6
Gross domestic investment	20.1	36.3	-0.4	2.5	6.4	14.3	4.0	7.0	-1.4
Exports (goods and services)	8.1	2.4	4.6	3.8	-4.0	-6.7	-0.2	6.6	0.2
Imports (goods and services)	19.5	24.5	0.7	6.0	6.9	6.6	5.3	7.2	3.5
	<b>Percentages of GDP</b>								
<b>Investment and saving<sup>c</sup></b>									
Gross domestic investment	13.7	17.4	17.4	17.8	17.8	19.1	18.8	19.8	18.4
National saving	10.1	12.0	11.8	12.4	11.8	13.8	14.6	15.5	14.3
External saving	3.6	5.4	5.6	5.4	6.0	5.3	4.2	4.4	4.1
	<b>Millions of dollars</b>								
<b>Balance of payments</b>									
Current account balance	-634	-1 039	-1 026	-1 049	-1 253	-1 235	-1 039	-1 188	-1 303
Merchandise trade balance	-940	-1 409	-1 445	-1 660	-2 282	-2 972	-3 116	-3 760	-4 272
Exports, f.o.b.	2 603	2 847	2 781	3 082	2 860	2 819	3 060	3 430	3 855
Imports, f.o.b.	3 543	4 256	4 226	4 742	5 142	5 791	6 176	7 189	8 127
Services trade balance	-62	-152	-91	-48	117	79	-68	-115	-194
Income balance	-239	-184	-205	-209	-84	-318	-318	-319	-329
Net current transfers	607	705	715	868	997	1 976	2 462	3 006	3 492
Capital and financial balance <sup>d</sup>	863	1 275	901	1 703	1 727	1 257	1 589	1 797	1 553
Net foreign direct investment	84	673	155	230	456	111	131	155	198
Financial capital <sup>e</sup>	779	602	746	1 474	1 271	1 146	1 458	1 642	1 355
Overall balance	230	235	-125	654	474	22	550	609	250
Variation in reserve assets <sup>f</sup>	-258	-263	125	-654	-474	-22	-550	-609	-250
Other financing <sup>g</sup>	28	28	0	0	0	0	0	0	0
<b>Other external-sector indicators</b>									
Real effective exchange rate (index: 2000=100) <sup>h</sup>	88.3	88.1	98.7	100.0	95.7	88.5	88.6	86.0	79.9
Terms of trade for goods (index: 2000=100)	97.9	115.3	101.9	100.0	96.7	95.8	93.0	92.1	91.3
Net resource transfer (percentage of GDP)	3.7	5.8	3.8	7.7	7.8	4.0	5.1	5.4	3.8
Gross external public debt (millions of dollars)	2 135	2 368	2 631	2 644	2 925	3 119	3 467	3 844	3 723
Gross external public debt (percentage of GDP)	12.0	12.2	14.4	13.7	13.9	13.4	13.9	14.1	11.6
Net profits and interest (percentage of exports) <sup>i</sup>	-7.5	-5.3	-5.9	-5.4	-2.2	-8.0	-7.7	-6.9	-6.4
	<b>Average annual rates</b>								
<b>Employment</b>									
Labour force participation rate <sup>j</sup>	54.4	54.7	55.0	56.3	56.9	61.4	60.9	56.1	...
Open unemployment rate <sup>k</sup>	5.1	3.8	...	...	...	3.1	3.4	3.1	...
	<b>Annual percentages</b>								
<b>Prices</b>									
Variation in consumer prices (December-December)	7.1	7.5	4.9	5.1	8.9	6.3	5.9	9.2	8.6
Variation in nominal exchange rate (December-December)	12.5	8.7	14.1	0.7	3.0	-3.9	4.9	-3.2	-2.0
Variation in average real wage	2.8	3.6	5.8	3.8	0.5	-0.9	0.4	-2.4	...
Nominal deposit rate <sup>l</sup>	5.8	5.4	7.9	10.2	8.8	7.1	5.2	4.5	4.6
Nominal lending rate <sup>m</sup>	18.7	16.5	19.4	20.9	19.0	16.9	15.0	13.8	13.0

Table 1 (concluded)

	1997	1998	1999	2000	2001	2002	2003	2004	2005 <sup>a</sup>
	<b>Percentages of GDP</b>								
<b>Central Administration</b>									
Total income	9.9	10.3	11.0	11.0	11.1	11.4	11.0	10.8	10.2
Current income	9.9	10.3	11.0	11.0	11.0	11.4	11.0	10.8	10.2
Tax revenue	9.4	9.3	9.9	10.0	9.7	10.6	10.3	10.1	9.5
Capital income	0.0	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Total expenditure	10.7	12.5	13.8	12.8	12.9	12.4	13.3	11.8	11.7
Current expenditure	6.7	7.9	8.6	9.1	9.2	8.6	8.9	8.0	7.7
Interest	0.8	1.1	1.3	1.2	1.4	1.2	1.1	1.2	1.2
Capital expenditure	3.9	4.6	5.2	3.7	3.7	3.8	4.5	3.7	3.9
Primary balance	-0.0	-1.1	-1.5	-0.5	-0.5	0.3	-1.1	0.2	-0.3
Overall balance	-0.8	-2.2	-2.8	-1.8	-1.9	-1.0	-2.3	-1.0	-1.5
Debt of the central administration	14.0	14.6	17.5	16.9	18.0	16.4	18.4	18.8	17.6
Domestic	5.4	5.0	5.8	5.8	5.6	4.5	5.6	5.9	6.7
External	8.5	9.6	11.8	11.2	12.4	11.9	12.8	12.9	10.9
<b>Money and credit<sup>n</sup></b>									
Domestic credit <sup>o</sup>	...	...	...	15.8	16.2	15.5	15.0	14.7	15.2
To the public sector	...	...	...	-2.2	-2.0	-2.7	-2.9	-2.8	-3.0
To the private sector	...	...	...	16.7	16.9	17.1	17.1	17.0	17.7
Other	...	...	...	1.3	1.3	1.1	0.8	0.6	0.5
Liquidity (M3)	...	...	...	...	26.5	26.6	27.4	27.7	27.9
Currency in circulation and local-currency deposits (M2)	22.4	23.0	23.1	23.8	25.1	25.1	25.2	24.8	24.8
Foreign-currency deposits	...	...	...	...	1.4	1.5	2.1	2.9	3.2

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

<sup>a</sup> Preliminary figures. <sup>b</sup> Based on figures in local currency at constant 1958 prices. <sup>c</sup> Based on figures in local currency expressed in dollars at current prices. <sup>d</sup> Includes errors and omissions. <sup>e</sup> Refers to the capital and financial balance (including errors and omissions), minus net foreign direct investment. <sup>f</sup> A minus sign (-) denotes an increase in reserves. <sup>g</sup> Includes the use of IMF credit and loans and exceptional financing. <sup>h</sup> Annual average, weighted by the value of merchandise exports and imports. <sup>i</sup> Refers to net investment income as a percentage of exports of goods and services as shown on the balance of payments. <sup>j</sup> Economically active population as a percentage of the working-age population; nationwide total. <sup>k</sup> Unemployment and underemployment rates as percentages of the economically active population; nationwide total. <sup>l</sup> Average rate for deposits in the banking system. <sup>m</sup> Average rate for loans in the banking system. <sup>n</sup> The monetary figures are annual averages. <sup>o</sup> Refers to net credit extended to the public and private sectors by commercial banks and other financial and banking institutions.

storm Stan, which caused the death of 669 persons, the disappearance of another 884, and material damage and losses estimated at 7.473 billion quetzales, equivalent to US\$ 983 million (3.4% of GDP). The agricultural sector was one of the worst affected, as the tropical storm caused damage to approximately 61,000 hectares of crops, mainly white corn, sesame, bananas and various non-traditional export products, including mini-vegetables, snow peas and ornamental products.<sup>3</sup>

Despite the material damage, all productive sectors posted positive growth except for mining (-1.1%). Agriculture grew by 2.3% (3.7% in 2004); in 2005 sugar cane and cardamom production was down, but countered by the increase in banana production and the improvement in basic grains (excluding corn), pulses and vegetables; there was no change in coffee production.

Manufacturing industry grew by 2.7%, the best result of the last seven years, owing to the recovery in exports of industrial products; the increase in investment brought higher demand for industrial products as well as cement and iron. Trade slowed its growth from 3.2% in 2004 to

2.6%, reflecting the downturn in agriculture and slower growth in foreign purchases. The construction subsector showed signs of recovery (3%) following its 20% fall in 2004, owing to the boom in private construction. That boom compensated for the drop in public works, which consisted only of highway maintenance activities. The transport and communications sector continued its rapid expansion (8.4%).

### (b) Prices, wages and employment

The twelve-month variation of consumer prices in 2005 was 8.6%, slightly less than in 2004 (9.2%). The rise in international prices for oil and petroleum products contributed to the rise, as did temporary shortages of some products caused by tropical storm Stan. In 2005, according to the central bank, imported inflation accounted for 2.5 percentage points of annual inflation. Year-on-year inflation stood at 7.5% in April 2006.

By sector of activity, the annual price rises were significant for foods, non-alcoholic beverages and

<sup>3</sup> See Economic Commission for Latin America and the Caribbean (ECLAC), *Efectos en Guatemala de las lluvias torrenciales y la tormenta tropical Stan, octubre de 2005 (LC/MEX/R.895)*, Mexico City, ECLAC subregional headquarters in Mexico, November 2005.

Table 2  
**GUATEMALA: MAIN QUARTERLY INDICATORS**

	2004				2005 <sup>a</sup>				2006 <sup>a</sup>	
	I	II	III	IV	I	II	III	IV	I	II
Merchandise exports, f.o.b. (millions of dollars)	1 174	1 257	1 344	1 262	1 293	1 455	1 392	1 241	1 385	...
Merchandise imports, c.i.f. (millions of dollars)	2 194	2 374	2 358	2 549	1 971	2 249	2 223	2 369	2 734	...
International reserves (millions of dollars)	2 862	2 872	2 896	3 426	3 563	3 636	3 706	3 664	3 982	4 061 <sup>b</sup>
Real effective exchange rate (index: 2000=100) <sup>c</sup>	89.0	86.3	85.0	83.7	81.7	80.2	79.3	78.2	78.0	77.4
Consumer prices (12-month percentage variation)	5.8	7.4	8.0	9.2	9.5	8.8	9.4	8.6	7.3	7.6
Average nominal exchange rate (quetzales per dollar)	8.10	7.99	7.90	7.79	7.71	7.61	7.61	7.64	7.62	7.60
Nominal interest rates (annualized percentages)										
Deposit rate <sup>d</sup>	4.4	4.4	4.5	4.5	4.6	4.6	4.6	4.6	4.6	4.7
Lending rate <sup>e</sup>	13.9	13.9	13.8	13.6	13.5	13.0	12.9	12.7	12.7	12.7
Interbank interest rate	1.9	2.0	2.4	2.4	2.3	2.0	2.3	3.5	4.2	4.4
Domestic credit (variation from same quarter of preceding year) <sup>f</sup>	9.8	5.4	9.1	5.2	12.3	16.3	21.2	32.1	...	...
Non-performing loans as a percentage of total credit <sup>g</sup>	7.0	7.0	7.5	5.9	6.9	6.5	6.1	5.1	6.1	6.3 <sup>b</sup>

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

<sup>a</sup> Preliminary figures. <sup>b</sup> Data to May. <sup>c</sup> Quarterly average, weighted by the value of merchandise exports and imports. <sup>d</sup> Average rate for deposits in the banking system. <sup>e</sup> Average rate for loans by the banking system. <sup>f</sup> Refers to net credit extended to the public and private sectors by commercial banks and other financial and banking institutions. <sup>g</sup> Refers to total credit extended by the banking system.

meals outside the home (12.4%) and for transport and communications (7.9%), while gasoline prices were up by about 30%, and urban transport prices by only 5.6%. All other items were below the annual 7% rate, with the lowest increases in clothing and footwear prices (3.5%).

There was no adjustment to the minimum wage in 2005, but there was a 10% raise in January 2006. There were also no unemployment surveys in 2005. In 2004 the national open unemployment rate was estimated at 3.1% and the equivalent unemployment rate (which includes visible underemployment) was 29% of the economically active population (EAP).

### (c) The external sector

The deficit in goods and services was around US\$ 4.5 billion, reflecting the upward trend in foreign purchases that began in 1997. In 2005, as in 2004, large purchases of oil and fuels contributed to a goods deficit of US\$ 4.27 billion.

The deficit of around US\$ 200 million on the non-factor services account was small thanks to the growing foreign-currency income from tourism, which amounted to US\$ 864 million, despite the problems caused by tropical storm Stan. The current transfer balance was

US\$ 3.5 billion, which included family remittances estimated at US\$ 2.9 billion.

Income from family remittances and donations counteracted the deficit in non-factor goods and services, so that the balance-of-payments current account deficit was US\$ 1.3 billion. This was financed with room to spare by income on the capital and financial accounts, leaving an overall balance of US\$ 250 million. This improvement boosted international reserves to US\$ 3.782 billion, which covers five months of imports of goods and services.

In 2005, exports of goods expanded to US\$ 3.85 billion, an increase of 12.4%, similar to that in 2004. Traditional exports (20%) contributed strongly to this growth, boosted by the recovery of prices, especially for foreign sales of coffee, whose export value increased by 43.5%, and of petroleum (26%). In contrast, the growth of non-traditional exports (12%) was reduced almost by half. The external sales which generated the greatest amounts of foreign currency were rubber articles (19%), clothing (18%) and chemical products (17%). Although fruit exports recovered by 50%, the amount exported was the same as the 2000 level, while there was a drop in exports of food products and, in particular, tobacco.

With few exceptions, it was the recovery in the prices of exported goods that contributed the most to total exports in 2005. The fastest growth in export volume was for cardamom (21%) and bananas (8%), while exports were down for oil (7%) and sugar (4%).

The growth of exports to Central American countries slowed to 12% (15% in 2004). Maquila value added fell by 1.2% compared to the increase of 14.6% in 2004. External sales were affected by Asian competition in the textiles sector and the closure of some maquila enterprises.

Goods imports maintained the upward trend observed since 2000 (13% in 2005). As in 2004, this was due to the significant hike in the oil bill (44%), which jumped from US\$ 1.09 billion in 2004 to US\$ 1.57 billion in

2005. Purchases of intermediate goods for industry grew by 9% and for construction by 22%, but those for agriculture were down (-26%). Purchases of capital goods declined once again (18%), although those for the industrial sector continued their rapid growth (15%). The expansion in consumer goods imports slowed from 13% to 8%, and what growth there was in 2005 was entirely due to purchases of non-durable goods.

Guatemala's external public debt burden (11.6% of GDP) continued to be one of the lowest in Latin America and the Caribbean, and remained below critical levels; the external debt stood at US\$ 3.723 billion, a nominal reduction of 3%; between 2004 and 2005, it diminished from 83% to 73% as a proportion of exports of goods and services.



## Honduras

### 1. General trends

Stimulated by a generally favourable external environment, the Honduran economy recorded 4.1% growth (compared with 5.0% in 2004). GDP growth was led by domestic demand, especially private consumption (7.9%), and by significant inflows of family remittances. Notwithstanding the high cost of fuel, annual inflation stood at 7.7% (down from 9.2% in 2004). National open unemployment diminished from 5.9% to 4.1%. The balance-of-payments current-account deficit hit a record low of 0.5% of GDP, owing to copious inflows of current transfers, which offset the chronic trade deficit.

In April, following several years of negotiations and reforms, Honduras reached the completion point for the Heavily Indebted Poor Countries (HIPC) Debt Initiative. This achievement brought relief in the service of external debt owed to various creditors.

In January 2006, Manuel Zelaya took office as president of the country. The new government's priority objectives were to promote public sector transparency, reduce poverty and combat corruption. Projections for 2006 are for 4.8% GDP growth, an inflation target of between 5.5% and 6.5%, a fiscal deficit equivalent to

2.5% of GDP and a balance-of-payments current-account deficit of 0.2% of GDP. Continued growth is expected in remittances and exports, especially the value added of the maquila industry, in a year marked by the entry into force in April of the Dominican Republic-Central America-United States Free-Trade Agreement (DR-CAFTA). Potential risk factors are high prices for oil and petroleum products and their implications for domestic and world inflation, more intense pressure for a nominal appreciation of the Honduran currency and demands for wage hikes in the public sector.

### 2. Economic policy

The Honduran authorities continued to develop their economic policy in accordance with the IMF Poverty Reduction and Growth Facility (PRGF) arrangement. In the fiscal area, there was no significant progress in reducing expenditure on wages and allocating additional resources to public investments. The monetary policy modernization programme adopted in 2004 as part of the reform plan is now being implemented.

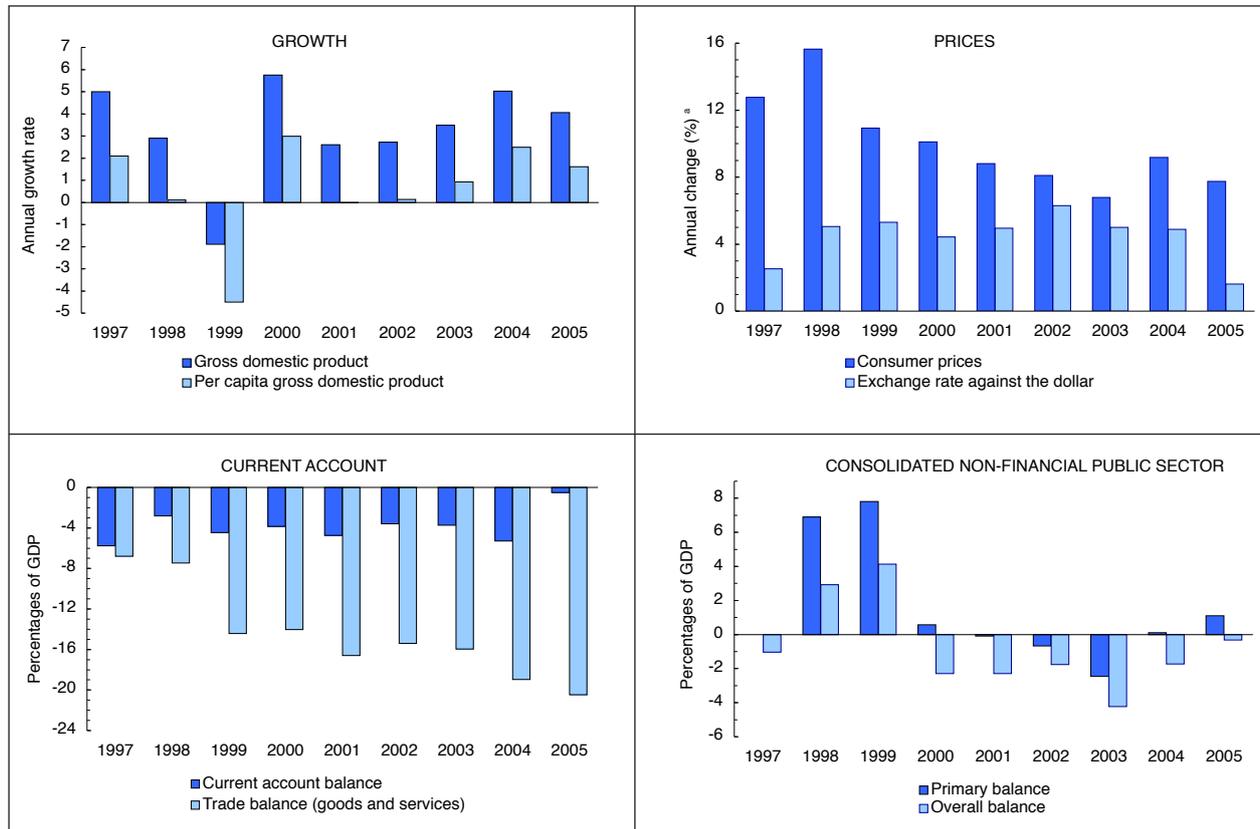
#### (a) Fiscal policy

The fall in the government deficit as a percentage of GDP from 3.1% in 2004 to 2.4% in 2005 was a positive

development for an electoral year, although it was due to a reduction in capital expenditure.

Total revenues in real terms increased by 7.9%. Tax revenue rose by 5.8%; proceeds from direct taxation were up by 13.8%, owing to higher receipts from income tax and the tax on property and net assets, and revenue from indirect taxes grew by 3.1%. Receipts from the general sales tax picked up by 6.9%, but proceeds from the taxes on petroleum products and beer production and consumption, and those from the tax on the production and consumption of cigarettes declined by 13%. The tax on foreign trade brought in 3.5% more. These figures were unimpressive in a year of economic expansion. Non-tax

Figure 1  
**HONDURAS: MAIN ECONOMIC INDICATORS**



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

revenues showed a 4.8% rise, while grants increased by more than 50%.

Total expenditure grew by 4.4% in real terms. Current expenditure increased by 8.5%; interest payments on public external debt diminished by 5%, reflecting lower overall external debt payments, compared with a sharp increase in domestic debt servicing. Payroll expenditures rose by 1.6%, while procurement of goods and services expanded substantially (35%). Capital expenditure declined by 8.5% mainly owing to a contraction in physical investment (17%). As much as 73% of the fiscal deficit was covered through external sources.

A fiscal deficit equivalent to 2.5% of GDP is projected for 2006 and will be financed essentially with external resources. The financial constraints affecting some non-financial public sector (NFPS) corporations and some local governments deserve special attention. The gradual phasing out of tariffs under DR-CAFTA is likely to result in a decline in tax revenues, which could be mitigated by higher revenues if the projected increase in economic activity materializes.

## (b) Monetary policy

In May 2005, the monetary policy modernization programme began to be applied. Its objective is to make economic agents more aware of monetary policy and to regulate the financial sector's short-term liquidity. Short-term open-market operations (weekly auctions) were separated from medium and long-term operations (fortnightly auctions).

A seven-day interest rate was established as the monetary policy reference rate and a methodology was put in place for forecasting the financial system's liquidity requirements. This rate remained at 7% from May 2005, then was cut to 6.75% in March 2006 and to 6.5% in April.

The build-up of international reserves (US\$ 355 million) caused a flurry of open-market operations designed to sterilize the increased liquidity; placements of monetary absorption certificates increased by 15% and the average weighted yield in December was 9.2%.

Notwithstanding these measures by the monetary authority, there was strong real growth of the monetary aggregates: M1 and M3 expanded by 11% and M2 by 15%. This was due in part to confidence among economic agents. Credit in the financial system grew by 10%, reflecting a more proactive credit policy in a context of falling interest rates. The real average lending rate stood at 9.2% (10.9% in 2004) and the deposit rate was -0.65% (0.04% in 2004).

In February 2005, the central bank approved regulations for last-resort loans to resolve temporary liquidity problems. This system provides for financial institutions whose solvency is good to receive short-term help when they have temporary cash-flow difficulties.

In May 2006, the central bank presented its first of its six-monthly monetary programmes, the purpose of which is to reduce uncertainty for economic agents in the medium term. The bank set its inflation target at between

5.5% and 6.5% for 2006 and 2007 and gave priority to stabilization of interest rates for deposits and loans at positive real values.

### (c) Exchange-rate policy

The lempira recorded a nominal average annual depreciation of 3%, which occurred mainly in the first half-year, since from mid-2005 to mid-2006, the nominal rate of exchange remained stable at 19 lempiras to the dollar. As a result, there was a slight real appreciation (1%) in 2005.

Thanks to the massive remittance and capital inflows, the results were positive. It may be difficult to avoid a more significant real appreciation of the lempira in the coming months, owing to the continually growing amounts of remittances. In the first four months, these totalled US\$ 680 million, a 30% increase over the same period in 2005.

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## 3. The main variables

### (a) Economic activity

GDP grew by 4.1% in 2005, down from 5% in 2004. However, with this trend, per capita GDP increased substantially for the second consecutive year (1.6% in 2005, 2.5% in 2004). GDP growth was driven by external and domestic demand; one of the significant components of the latter was private consumption (7.9%), boosted by the massive inflow of remittances. Public consumption was also robust at 9.3%.

Domestic investment fell (2.8%) after expanding in 2004 (13.2%). This was due to the decline in gross fixed capital investment (8%) following a reduction in private-sector investment (12.7%). Investment in construction, especially for commercial and industrial premises suffered the sharpest contraction. Public sector investment grew by 7.8%, however.

External demand grew by 6% (down from 9.7% in 2004). This result reflects weak growth in traditional exports, especially bananas and coffee.

All productive sectors performed well, although growth in the agricultural sector was minimal (0.5%). Among the crops geared mainly to the export market, coffee recorded a 16% decline in production; banana production contracted by 5% compared with a 19% expansion in 2004. Conversely, sugar cane was up by 2.7%, continuing the positive trend of recent years.

With respect to production for the domestic market, the African palm performed remarkably well (18%), following a decade of sustained growth. Basic grains rallied (after a contraction in the previous year): corn expanded by 18.2% and beans, by 9.7%. Fishery output increased by 1.2%, with tilapia and shrimp performing particularly well, but lobster production was down by 16%.

The transport and communications subsectors were also buoyant (6.3%), with strong results in communications and manufacturing (5.1%), which benefited from 11.7% growth in the textile industry (including maquila operations); the other branches of industry were below average, although construction expanded by 3%, making up for the previous year's decline.

### (b) Prices, wages and employment

Twelve-month inflation to December was 7.7% (9.2% in 2004), partly owing to rising prices for oil and petroleum products, although strong domestic demand also played a part. However, the appreciation of the lempira mitigated the rise in the prices of imported goods. In April 2006, year-on-year inflation was down to 5.8%, almost two percentage points less than at the end of 2005.

The consumer price index (CPI) components that contributed most to inflation were education (11.6%), housing, water, electricity and gas (8%) and above all

Table 1  
**HONDURAS: MAIN ECONOMIC INDICATORS**

	1997	1998	1999	2000	2001	2002	2003	2004	2005 <sup>a</sup>
	<b>Annual growth rates<sup>b</sup></b>								
<b>Gross domestic product</b>	5.0	2.9	-1.9	5.7	2.6	2.7	3.5	5.0	4.1
<b>Per capita gross domestic product</b>	2.1	0.1	-4.5	3.0	-0.0	0.1	0.9	2.5	1.6
<b>Gross domestic product, by sector</b>									
Agriculture, livestock, hunting, forestry and fishing	4.3	-1.9	-8.5	11.7	-0.5	4.9	2.6	7.0	0.5
Mining	4.9	3.7	5.4	1.7	-0.8	4.2	3.2	-2.3	4.0
Manufacturing	6.1	3.4	2.6	5.5	5.2	3.8	3.7	4.1	5.1
Electricity, gas and water	7.6	4.9	2.1	10.6	-1.8	5.6	10.1	6.4	12.8
Construction	-3.0	5.3	10.5	1.5	-5.2	-14.2	13.8	-1.2	3.0
Wholesale and retail commerce, restaurants and hotels	3.5	3.1	0.7	3.7	3.0	2.9	3.1	4.7	4.9
Transport, storage and communications	4.4	2.7	1.7	5.0	5.3	3.5	3.7	5.3	6.3
Financial institutions, insurance, real estate and business services	7.8	7.2	0.8	2.6	3.4	2.8	2.7	3.7	5.6
Community, social and personal services	5.1	3.4	-0.9	10.5	11.0	6.9	1.3	6.2	5.3
<b>Gross domestic product, by type of expenditure</b>									
Consumption	2.7	5.7	0.4	7.9	5.3	4.8	3.4	4.5	8.1
General government	-1.0	15.4	9.8	15.7	12.1	0.5	0.8	3.4	9.3
Private	3.1	4.5	-0.9	6.8	4.3	5.5	3.8	4.7	7.9
Gross domestic investment	7.9	1.9	8.1	-2.8	-3.8	-5.8	6.7	13.2	-2.8
Exports (goods and services)	1.3	1.6	-11.2	7.3	3.2	4.9	5.3	9.7	6.0
Imports (goods and services)	-1.4	7.5	4.3	3.8	4.0	2.4	7.3	14.0	9.3
	<b>Percentages of GDP</b>								
<b>Investment and saving<sup>c</sup></b>									
Gross domestic investment	32.2	30.9	34.7	30.7	29.6	25.6	26.6	30.4	29.9
National saving	26.4	28.1	30.2	26.9	24.8	22.0	22.9	25.1	29.4
External saving	5.8	2.8	4.4	3.9	4.7	3.6	3.7	5.3	0.5
	<b>Millions of dollars</b>								
<b>Balance of payments</b>									
Current account balance	-272	-148	-241	-232	-303	-237	-260	-399	-42
Merchandise trade balance	-294	-323	-753	-658	-834	-829	-945	-1 278	-1 536
Exports, f.o.b.	1 857	2 048	1 756	2 012	1 935	1 977	2 090	2 398	2 652
Imports, f.o.b.	2 150	2 371	2 510	2 670	2 769	2 806	3 035	3 677	4 188
Services trade balance	-26	-70	-28	-188	-228	-184	-163	-150	-176
Income balance	-212	-204	-155	-133	-170	-193	-258	-359	-314
Net current transfers	260	449	696	747	929	969	1 106	1 388	1 984
Capital and financial balance <sup>d</sup>	454	-8	53	178	302	301	33	772	259
Net foreign direct investment	122	99	237	282	193	176	247	325	272
Financial capital <sup>e</sup>	333	-107	-185	-104	109	125	-214	448	-13
Overall balance	182	-155	-188	-54	-1	64	-227	373	216
Variation in reserve assets <sup>f</sup>	-308	-230	-442	-119	-147	-214	88	-504	-372
Other financing <sup>g</sup>	126	385	630	173	148	150	139	131	156
<b>Other external-sector indicators</b>									
Real effective exchange rate (index: 2000=100) <sup>h</sup>	119.0	108.8	104.5	100.0	97.1	96.9	98.4	100.0	100.1
Terms of trade for goods (index: 2000=100)	125.5	108.9	107.5	100.0	94.8	92.0	88.0	87.2	87.2
Net resource transfer (percentage of GDP)	7.8	3.3	9.7	3.6	4.4	3.9	-1.2	7.2	1.2
Gross external debt (millions of dollars)	4 073	4 369	4 691	4 711	4 757	4 922	5 242	5 912	5 223
Gross external debt (percentage of GDP)	86.4	83.0	86.5	78.2	74.3	74.8	75.5	78.4	62.4
Net profits and interest (percentage of exports) <sup>i</sup>	-9.7	-8.4	-7.0	-5.3	-7.0	-7.7	-9.6	-11.5	-9.2
	<b>Average annual rates</b>								
<b>Employment</b>									
Labour force participation rate <sup>j</sup>	53.1	52.9	55.7	...	52.5	51.7	50.0	50.6	50.9
Open unemployment rate <sup>k</sup>	3.6	3.5	3.5	...	4.1	3.9	5.3	5.9	4.5
Visible underemployment rate <sup>k</sup>	3.0	2.1	2.7	...	4.4	3.9	6.4	6.9	8.1
	<b>Annual percentages</b>								
<b>Prices</b>									
Variation in consumer prices (December-December)	12.8	15.7	10.9	10.1	8.8	8.1	6.8	9.2	7.7
Variation in nominal exchange rate (December-December)	2.5	5.1	5.3	4.4	5.0	6.3	5.0	4.9	1.6
Variation in real minimum wage	6.3	1.8	-3.0	3.1	2.5	2.1	8.6	0.8	5.8
Nominal deposit rate <sup>l</sup>	21.3	18.6	19.4	15.9	14.5	13.7	11.5	11.1	10.9
Nominal lending rate <sup>m</sup>	32.1	30.6	30.2	26.8	23.8	22.7	20.8	19.9	18.8

Table 1 (concluded)

	1997	1998	1999	2000	2001	2002	2003	2004	2005 <sup>a</sup>
	<b>Percentages of GDP</b>								
<b>Consolidated non-financial public sector</b>									
Total income <sup>n</sup>	29.7	32.2	34.7	30.8	34.0	32.3	33.2	34.4	33.8
Current income	29.4	31.4	33.7	29.7	31.9	30.8	31.9	33.1	32.0
Capital income	0.4	0.1	0.3	0.0	0.0	0.2	0.1	0.3	0.5
Total expenditure <sup>o</sup>	30.8	29.3	30.6	33.1	36.3	34.0	37.4	36.1	34.1
Current expenditure	22.8	21.9	24.1	24.4	27.1	26.6	29.0	27.8	27.1
Interest	0.0	4.0	3.7	2.9	2.2	1.1	1.8	1.8	1.4
Capital expenditure	7.6	7.2	5.8	7.7	8.1	6.3	7.4	7.7	6.8
Primary balance	...	6.9	7.8	0.6	-0.1	-0.7	-2.5	0.1	1.1
Overall balance	-1.0	2.9	4.1	-2.3	-2.3	-1.8	-4.2	-1.7	-0.3
Public sector debt	45.3	41.1	42.7	49.1	50.7	66.5	63.5	51.1	50.4
Domestic	11.7	11.0	12.0	13.5	14.7	17.3	17.3	14.7	19.2
External	33.6	30.1	30.7	35.6	36.0	49.1	46.2	36.4	31.3
<b>Money and credit<sup>p</sup></b>									
Domestic credit <sup>q</sup>	23.5	27.6	25.6	24.6	27.7	27.0	28.7	30.5	29.6
To the public sector	-3.1	-6.2	-13.0	-13.7	-11.3	-11.8	-9.9	-8.0	-9.1
To the private sector	26.6	33.8	38.6	38.3	39.0	38.8	38.6	38.5	38.7
Liquidity (M3)	35.0	40.8	43.3	45.3	46.7	48.6	49.3	50.5	52.6
Currency in circulation and local-currency deposits (M2)	27.2	32.2	33.2	34.7	34.7	34.6	34.7	35.3	37.4
Foreign-currency deposits	7.8	8.6	10.1	10.6	12.0	14.0	14.6	15.2	15.2

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

<sup>a</sup> Preliminary figures. <sup>b</sup> Based on figures in local currency at constant 1978 prices. <sup>c</sup> Based on figures in local currency expressed in dollars at current prices. <sup>d</sup> Includes errors and omissions. <sup>e</sup> Refers to the capital and financial balance (including errors and omissions), minus net foreign direct investment. <sup>f</sup> A minus sign (-) denotes an increase in reserves. <sup>g</sup> Includes the use of IMF credit and loans and exceptional financing. <sup>h</sup> Annual average, weighted by the value of merchandise exports and imports. <sup>i</sup> Refers to net investment income as a percentage of exports of goods and services as shown on the balance of payments. <sup>j</sup> Economically active population as a percentage of the working-age population; nationwide total. <sup>k</sup> Unemployment and underemployment rates as percentages of the economically active population; nationwide total. <sup>l</sup> Weighted average rate on time deposits. <sup>m</sup> Weighted average rate on loans. <sup>n</sup> Includes grants. <sup>o</sup> Includes net lending. <sup>p</sup> The monetary figures are annual averages. <sup>q</sup> Refers to net credit extended to the public and private sectors by commercial banks and other financial and banking institutions.

transport (14%), which was affected by rising prices for fuels and national and international transport services. By mid-year, food prices had increased by 12%, but they later subsided.

Wholesale prices increased by 10.2% in twelve months. Among the factors that had the strongest impact on inflation in 2005 were the steep rise in the cost of construction materials (18.4%) caused by the sector's remarkable recovery, and price increases in the agricultural sector (13%).

The nationwide open unemployment rate declined from 5.9% in May 2004 to 4.1% in September 2005, with improvements in both urban and rural areas. However, this lower unemployment went hand in hand with a reduction in workers' income, since the rate of visible underemployment<sup>1</sup> increased from 29.5% in May 2004 to 33.9% in September 2005.

As from 2005, the average nominal daily minimum wage increased by 9.7%, and real wages grew by only

1%. On 1 January 2006, minimum wages were raised by 9.2%, which could mean a higher real increase this year if the inflation target is met.

### (c) The external sector

The non-factor goods and services deficit continued to widen; it stood at US\$ 1.71 billion in 2005, while the factor goods and services income balance diminished slightly to US\$ 315 million. These deficits were offset by current transfers so that the non-factor and factor goods and services deficit, which was equivalent to 25% of GDP, was offset by the positive transfer balance of 24.5% of GDP. As a result, the balance of payments current-account deficit amounted to only 0.5% of GDP, a figure unprecedented in the last twenty-five years.

The small current-account deficit meant that a major part of the capital inflows were used to swell international reserves, which expanded from US\$ 1.657 billion to

<sup>1</sup> This concept refers to those persons who work 36 hours per week or more, but whose monthly income is below the monthly minimum wage.

Table 2  
**HONDURAS: MAIN QUARTERLY INDICATORS**

	2004				2005 <sup>a</sup>				2006 <sup>a</sup>	
	I	II	III	IV	I	II	III	IV	I	II
Merchandise exports, f.o.b. (millions of dollars) <sup>b</sup>	408	415	369	349	475	488	367	368	520	...
Merchandise imports, c.i.f. (millions of dollars)	920	935	984	1 078	999	1 133	1 135	1 217	1 157	...
International reserves (millions of dollars)	1 501	1 625	1 695	1 970	2 068	2 160	2 177	2 327	2 565	2 669 <sup>c</sup>
Real effective exchange rate (index: 2000=100) <sup>d</sup>	100.1	99.5	99.5	101.1	101.3	100.5	99.3	99.1	99.1	...
Consumer prices (12-month percentage variation)	6.7	8.3	8.4	9.2	9.5	9.0	9.3	7.7	6.2	5.7
Average nominal exchange rate (lempiras per dollar)	17.86	18.10	18.33	18.54	18.71	18.84	18.86	18.88	18.89	18.90
Nominal interest rates (annualized percentages)										
Deposit rate <sup>e</sup>	11.3	11.2	11.0	10.9	11.0	11.0	10.9	10.8	10.6	10.0 <sup>c</sup>
Lending rate <sup>f</sup>	20.1	20.0	19.7	19.6	19.3	19.0	18.6	18.5	18.3	17.8 <sup>c</sup>
Interbank interest rate	8.3	7.5	7.5	7.7	7.5	7.5	7.5	7.2	6.9	5.5
Domestic credit (variation from same quarter of preceding year) <sup>g</sup>	23.8	21.2	19.7	9.0	9.3	9.9	13.5	21.2	22.9	25.5 <sup>h</sup>
Non-performing loans as a percentage of total credit <sup>i</sup>	3.5	3.3	3.5	2.6	2.7	2.5	2.3	2.2	2.2	2.2 <sup>h</sup>

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

<sup>a</sup> Preliminary figures. <sup>b</sup> Does not include maquila activities. <sup>c</sup> Data to May. <sup>d</sup> Quarterly average, weighted by the value of merchandise exports and imports. <sup>e</sup> Weighted average rate on time deposits. <sup>f</sup> Weighted average rate on loans. <sup>g</sup> Refers to net credit extended to the public and private sectors by commercial banks and other financial and banking institutions. <sup>h</sup> Data to April. <sup>i</sup> Refers to total credit extended by the banking system.

US\$ 2.012 billion. Thus, by the end of 2005, international reserves were equivalent to five months' goods and services imports.

The value of merchandise exports (including the net value added of the maquila industry) increased by 10.6%. This was due to the expansion of traditional exports (25%), including the substantial increase in earnings from coffee and bananas (which together account for 82% of this category), thanks to strong prices on international markets, although the volumes exported actually declined. Sugar sales recovered (82%) and timber exports were up (26%), reflecting volume and price increases, although they are still short of the 2001 figures. Exports of ores, especially gold and silver, showed a lacklustre performance.

Non-traditional exports grew by 0.8% in value terms, accounting for earnings of the order of US\$ 1 billion, export volumes having increased although prices deteriorated. This category includes shrimp, lobster, tilapia, melon and pineapple. The value added recorded by the maquila industry grew by 10%, despite competition from the Asian countries.

The value of imports continued to follow the sustained upward trend begun in 1990 (14.5%). This reflected the increasingly hefty bill for oil and petroleum products. Other imports rose by only 9% (20% in 2004).

In 2005, the oil bill amounted to US\$ 904 million (a 42% increase), almost doubling the figure for 2003.

Imports of consumer goods (especially non-durable goods) also increased substantially (21%); meanwhile raw material imports grew by 24%. Conversely, imports of capital goods slumped by 17%, mainly because of declining purchases for the industry sector. It should be borne in mind, however, that this is being measured against 2004, when extraordinary purchases were made by electric power generating companies.

Net non-factor services amounted to US\$ 177 million. The deterioration in this account was partly due to higher transport costs abroad in the 2004-2005 biennium. It was offset, however, by increasing inflows from tourism, which stood at US\$ 500 million in 2005, double the amount recorded in 2000.

In 2005, current transfers, which include family remittances from the United States (US\$ 1.763 billion) and non-refundable official development assistance (US\$ 221 million) totalled US\$ 1.984 billion, an unprecedented amount, 43% above the 2004 figure.

The factor income balance amounted to US\$ 315 million (US\$ 359 million in 2004); there were falls in net profit remittances and net interest payments, which was a result of higher revenues, since payments remained practically unchanged.

Net capital inflows (including errors and omissions) fell sharply, from US\$ 770 million in 2004 to US\$ 258 million in 2005. Foreign investment stood at US\$ 272 million, while net outflows of other capital

totalled US\$ 14 million, reflecting clearly the reduction in public external debt arising from the HIPC initiative.

In April 2005, following several years of negotiations, Honduras reached its completion point under the Heavily Indebted Poor Countries (HIPC) Debt Initiative,<sup>2</sup> enabling the member countries of the Paris Club to forgive US\$ 1.061 billion in external public debt. In December 2005, IMF cancelled the Honduran government's debt with the Fund. By mid-2006, the World Bank is expected to ratify this offer of debt relief; steps have been taken towards achieving a similar objective with the Inter-American Development Bank. Total relief (including the debts

written off by the Paris Club, IMF and the World Bank) is estimated at US\$ 2.875 billion, almost 60% of the external public debt, and will be implemented over a period of 15 years.

Honduras's external debt diminished for the first time since 1997, falling from US\$ 5.912 billion in 2004 to US\$ 5.170 billion in 2005 thanks to the reduction in public liabilities, while private debt continued to grow. In terms of GDP, the external public debt contracted from 70% in 2004 to 53.3% in 2005. As a percentage of goods and services exports, it diminished from 190% in 2004 to 150% in 2005.

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<sup>2</sup> The completion point is the point at which the country has satisfied all the conditions relating to policy measures required under the Heavily Indebted Poor Countries (HIPC) Debt Initiative.



## Mexico

### 1. General trends

The growth rate of the Mexican economy fell from 4.2% in 2004 to 3.0% in 2005. Economic policy continued to be guided by the principle of fiscal and monetary prudence and this contributed to market stability: interest rates trended downwards in the second half of the year and the exchange rate appreciated slightly in real terms, which helped to lower inflation.

The balance-of-payments current account deficit narrowed for the fifth year in a row to 0.6% of GDP, mainly thanks to oil revenues and a 20% increase in family remittances (which exceeded US\$ 20.0 billion). Inflows of foreign direct investment amounted to over US\$ 18.0 billion, while Mexican investment abroad has increased five-fold in the last three years and represented over US\$ 6.0 billion in 2005.

Private consumption remained buoyant on the back of increases in credit and remittances. Following a three-year period of decline, capital formation rose for the second consecutive year (7.6%) thanks to greater investment in machinery and equipment and a moderate upturn in construction driven by mortgage lending. Economic growth fuelled employment, while real wages held steady.

In the second half of 2006, the United States economy is expected to slow slightly, which would take some of the wind out of Mexico's export performance. GDP should grow by 4%, driven mainly by domestic demand, which will continue to draw strength from the expansion of private-sector credit and a low inflation rate (of around 3.5%). Monetary, foreign-exchange and fiscal policy stances will remain unchanged and the fiscal surplus is expected to weigh in at 0.2% of GDP. The presidential and legislative elections to be held in July 2006 are expected to be closely contested and the post-election climate may entail some financial volatility, but the transition is not expected to bring any great commotion on the economic front.

### 2. Economic policy

The overarching objective of economic policy was to reduce inflation. In a context of fiscal and monetary austerity and a floating exchange rate, windfall oil revenues afforded a degree of freedom that enabled the authorities to meet the fiscal deficit target comfortably and pay down public debt. Monetary policy remained tight in the early part of 2005 until inflation showed signs of abating then, in the second half of the year, interest rates came down in a trend that continued into the first few months of 2006.

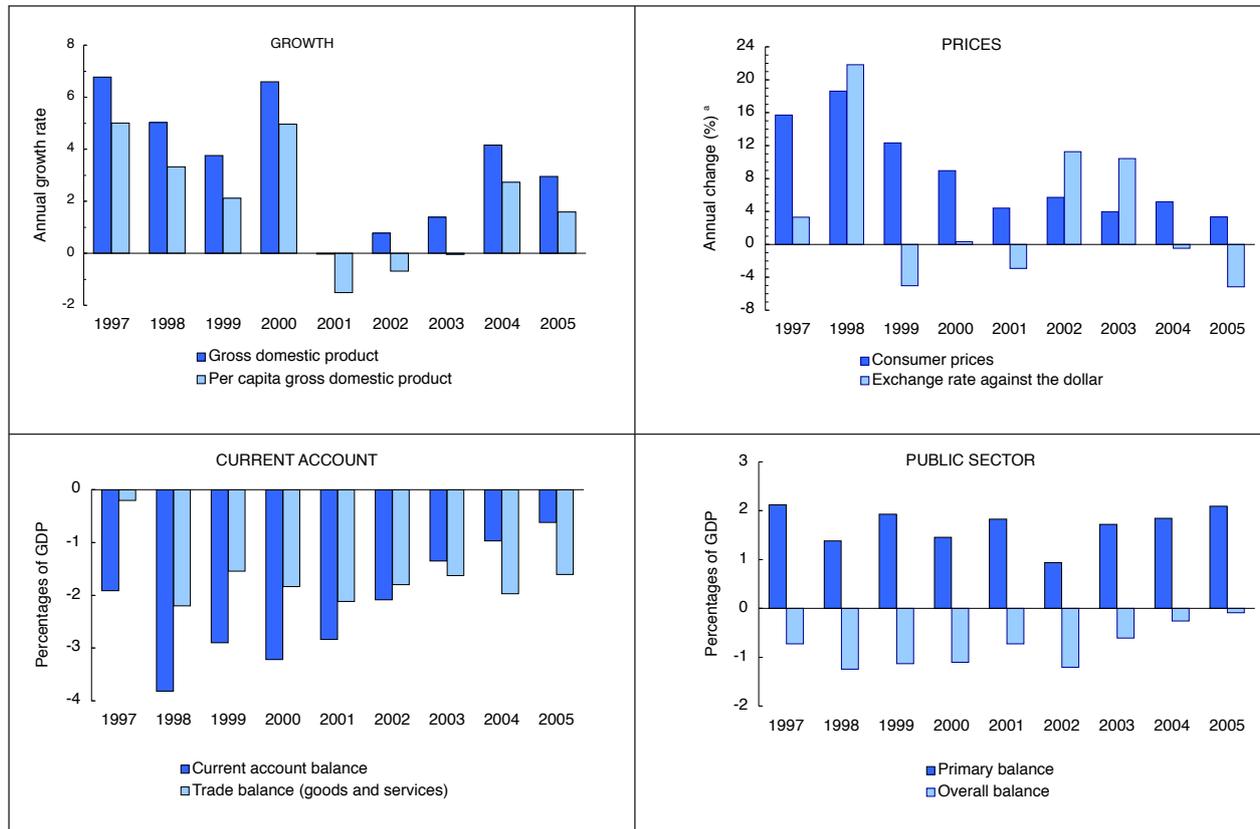
#### (a) Fiscal policy

Fiscal policy remained austere, amidst abundant oil revenues that were up by 9.6% in real terms and represented

37% of the total income of public-sector institutions included in the federal budget. These revenues facilitated the achievement of the target for the fiscal deficit, which at 0.1% of GDP was 0.13 percentage points smaller than predicted by the federal government at the beginning of 2005. Non-oil revenues expanded by 3.6%, with tax income growing strongly (6.4%) thanks to improved collection. Expenditure has remained almost constant in relation to GDP since 2003 (23.3% of GDP).

The public-sector borrowing requirement (PSBR), encompassing all public-sector activities (whether implemented by public or private entities), continued to trend downwards in 2005 and stood at 1.63% of GDP, not including excluding exceptional income from Banco de

Figure 1  
**MEXICO: MAIN ECONOMIC INDICATORS**



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

México (central bank) profits or from privatizations. In 2006, PSBR is expected to come to 1.5% of GDP.

As a result of amortization and prepayment of external obligations, external public debt dropped from 9.8% of GDP in 2004 to 7.7% in 2005, around which figure it is expected to remain in 2006. The domestic debt ratio remained unchanged, and total public sector debt fell to 31.6% of GDP.<sup>1</sup>

In 2006, a lower take is expected from income tax (as a result of legislative reform) and from tax on non-recurrent income. Expenditure will therefore need to be adjusted in order to achieve the fiscal target. Outstanding tasks in the areas of public finances include the need to increase the tax burden, which fell from 10.0% of GDP in 2004 to 9.7% in 2005.

## (b) Monetary policy

Monetary policy was directed towards keeping inflation within a range of one percentage point on either side of the target of 3%. One of the two main instruments of monetary policy is the “corto” (a compulsory level of commercial bank balances in the central bank), which was last raised to 79 million pesos per day in March 2005. The other instrument is the setting of minimum rates of interest, which the Banco de México uses to send clear signals to the markets on its desired monetary position. The tight monetary stance was in keeping with monetary policy in the United States, although expectations that inflation would remain under control gradually brought the benchmark interest rate (28-day

<sup>1</sup> Total public sector debt includes the balance of items included in the public-sector borrowing requirement (PSBR) and not included in the definition of traditional debt, such as the Bank Savings Protection Institute (IPAB), the Toll Road Rescue Trust for bailing out highway concessions (FARAC), the programme to restructure debts in inflation-indexed investment units (UDIs), Projects with a Deferred Impact on Public Expenditure Recording (PIDIREGAS) and bank debtor support programmes, which represented 14.8% of GDP in 2005. See Banco de México, *Informe anual 2005*, p. 87.

equilibrium interbank rate) down from 10.0% in the second quarter of 2005 to 8.7% at the year's end and 7.3% in mid-2006.

The nominal lending rate<sup>2</sup> followed the same trend, dropping from almost 10% in late 2005 to around 7.5% in the first half of 2006. The decline in interest rates is expected to tail off during the rest of the year, in line with the thrust of monetary policy.

The money supply swelled by 7.9% in real terms in 2005, while narrow money expanded by 7.1% (11.1% of GDP), which is evidence of the gradualness of the remonetization process. The decline in interest rates starting in the second half of 2005 helped to fuel expansion of M1 and other monetary aggregates, and this effect continued into the first few months of 2006. The growth of local-currency-denominated deposits slowed from a rate of 18% in November 2005 to 14% in March 2006. Rates of growth in foreign-currency deposits (a component of M3) went from 59% to 47% in the same period.

In a context of expanding credit supply, households absorbed 80% of total commercial bank lending in 2005 (with a 15% increase in the lending balance of this banking sector in 2005). Consumer credit, from both commercial banks and other sources of financing, was the most buoyant. Consumer credit from bank and non-bank institutions grew by 41% in real terms in 2005 and has kept up that rate in 2006. Mortgage lending is also continuing to expand in 2006 after having grown by 6.7% in 2005, driven by housing loans extended by non-bank intermediaries such as limited purpose financial institutions (SOFOLÉS). Corporate borrowing, on the other hand, contracted by 0.4% in 2005.

### (c) Exchange-rate policy

Mexico's foreign-exchange policy has been based on a floating exchange-rate regime since the end of 1994. In 2005, the peso tended to appreciate slightly in the foreign-exchange market, especially in the second half of the year, when inflows of foreign exchange from FDI and exports firmed up. The average nominal exchange rate in 2005 was 10.9 pesos to one United States dollar, with real appreciation of 4% for the year as a whole.<sup>3</sup>

The foreign-exchange market experienced short-lived periods of volatility in 2006, caused by the prospect of an international liquidity squeeze and as a result of the domestic political context. On average, the exchange rate has fluctuated around 11 pesos to the dollar, and it is expected to stabilize and continue to record moderate real appreciation following the presidential elections. One contributing factor in this has been the weakening of the dollar in relation to several other currencies in the first half of 2006.

In response to the expansion of international reserves triggered by rising petroleum prices and increases in both exports and direct and portfolio investment, the Banco de México continued to hold foreign exchange auctions — the mechanism it has been using since March 2003 to slow the build-up of reserves. An average of US\$ 19 million was auctioned daily in 2005 and the picture was similar in 2006. In 2005 international reserves were up by US\$ 7.164 billion over the 2004 figure and the balance stood at US\$ 74.11 billion at the end of December. In May 2006, international reserves amounted to US\$ 75.0 billion, with growth expected to slow during the second half of the year.

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## 3. The main variables

### (a) Economic activity

Economic performance was notable for the slowdown seen in external demand and for rising domestic expenditure led by private consumption and investment. This rising expenditure, however, was not enough to prevent a fall in the GDP growth rate, from 4.2% in 2004 to 3.0% in 2005. Gross fixed capital formation swelled by 7.6%,

driven by the private sector component, which represented 80% of the total. This performance was largely thanks to purchases of machinery and equipment, especially from abroad, which were up by 15%. Public investment continued to decline (-0.5%), owing to declining purchases of machinery and equipment (-4.3%). Domestic demand continues to expand and exports again posted high growth rates in the last quarter of 2005 and the first few months

<sup>2</sup> The nominal lending rate refers to the cost of lending to companies, which is calculated approximately as the yield on the commercial paper they issue on the money market.

<sup>3</sup> Appreciation was 3.4% on the basis of unit labour costs from the non-maquila manufacturing sector. See Banco de México, *Informe anual 2005*, p. 108.

Table 1  
**MEXICO: MAIN ECONOMIC INDICATORS**

	1997	1998	1999	2000	2001	2002	2003	2004	2005 <sup>a</sup>
	<b>Annual growth rates<sup>b</sup></b>								
<b>Gross domestic product</b>	6.8	5.0	3.8	6.6	-0.0	0.8	1.4	4.2	3.0
<b>Per capita gross domestic product</b>	5.0	3.3	2.1	5.0	-1.5	-0.7	-0.0	2.7	1.6
<b>Gross domestic product, by sector</b>									
Agriculture, livestock, hunting, forestry and fishing	0.2	3.0	1.5	0.4	5.9	-0.9	3.8	3.2	-1.5
Mining	4.5	2.7	-2.1	3.8	1.5	0.4	3.7	3.4	1.2
Manufacturing	9.9	7.4	4.2	6.9	-3.8	-0.7	-1.3	4.0	1.2
Electricity, gas and water	5.2	1.9	15.8	3.0	2.3	1.0	1.5	2.8	1.4
Construction	9.3	4.2	5.0	4.2	-5.7	2.1	3.3	6.1	3.3
Wholesale and retail commerce, restaurants and hotels	10.7	5.6	3.1	12.2	-1.2	0.0	1.5	5.5	3.1
Transport, storage and communications	9.9	6.7	7.8	9.1	3.8	1.8	5.0	9.2	7.1
Financial institutions, insurance, real estate and business services	3.7	4.6	3.6	5.5	4.5	4.2	3.9	3.9	5.8
Community, social and personal services	3.3	2.9	2.1	2.9	-0.3	0.9	-0.6	0.6	2.1
<b>Gross domestic product, by type of expenditure</b>									
Consumption	6.0	5.0	4.4	7.4	1.9	1.4	2.1	3.6	4.8
General government	2.9	2.3	4.7	2.4	-2.0	-0.3	0.8	-0.4	0.5
Private	6.5	5.4	4.3	8.2	2.5	1.6	2.2	4.1	5.4
Gross domestic investment	24.8	10.5	4.0	11.7	-3.8	-1.1	-4.1	7.3	-0.2
Exports (goods and services)	10.7	12.1	12.4	16.3	-3.6	1.4	2.7	11.6	6.9
Imports (goods and services)	22.7	16.6	14.1	21.5	-1.6	1.5	0.7	11.6	8.7
	<b>Percentages of GDP</b>								
<b>Investment and saving<sup>c</sup></b>									
Gross domestic investment	25.9	24.3	23.5	23.8	20.8	20.6	20.5	22.0	21.8
National saving	24.0	20.5	20.6	20.6	18.0	18.5	19.1	21.1	21.2
External saving	1.9	3.8	2.9	3.2	2.8	2.1	1.4	1.0	0.6
	<b>Millions of dollars</b>								
<b>Balance of payments</b>									
Current account balance	-7 666	-16 073	-13 929	-18 683	-17 651	-13 528	-8 625	-6 616	-4 789
Merchandise trade balance	623	-7 915	-5 613	-8 337	-9 617	-7 633	-5 779	-8 811	-7 587
Exports, f.o.b.	110 431	117 459	136 362	166 121	158 780	161 046	164 766	187 999	214 233
Imports, f.o.b.	109 808	125 374	141 975	174 458	168 396	168 679	170 546	196 810	221 820
Services trade balance	-1 433	-1 350	-1 799	-2 323	-3 558	-4 048	-4 601	-4 649	-4 768
Income balance	-12 106	-12 820	-12 830	-15 017	-13 814	-12 116	-12 103	-10 200	-12 919
Net current transfers	5 250	6 012	6 313	6 994	9 338	10 268	13 858	17 044	20 484
Capital and financial balance <sup>d</sup>	28 126	12 572	18 206	25 793	24 976	20 618	18 063	10 674	11 953
Net foreign direct investment	12 831	11 897	13 631	17 588	22 747	17 384	12 930	14 242	11 884
Financial capital <sup>e</sup>	15 295	675	4 574	8 205	2 229	3 234	5 132	-3 568	69
Overall balance	20 460	-3 501	4 277	7 110	7 325	7 090	9 438	4 058	7 164
Variation in reserve assets <sup>f</sup>	-10 513	-2 118	-592	-2 824	-7 325	-7 090	-9 438	-4 058	-7 164
Other financing <sup>g</sup>	-9 948	5 619	-3 685	-4 286	0	0	0	0	0
<b>Other external-sector indicators</b>									
Real effective exchange rate (index: 2000=100) <sup>h</sup>	119.9	119.0	108.8	100.0	93.4	92.9	104.5	109.5	106.1
Terms of trade for goods (index: 2000=100)	89.5	90.6	99.3	100.0	97.4	97.9	98.8	101.6	103.6
Net resource transfer (percentage of GDP)	1.5	1.3	0.4	1.1	1.8	1.3	0.9	0.1	-0.1
Total gross external debt (billions of dollars)	149	160	166	149	145	135	132	131	127
Total gross external debt (percentage of GDP)	37.2	38.1	34.6	25.6	23.2	20.8	20.7	19.2	16.5
Net profits and interest (percentage of exports) <sup>i</sup>	-10.0	-9.9	-8.7	-8.4	-8.1	-7.0	-6.8	-5.1	-5.6
	<b>Average annual rates</b>								
<b>Employment</b>									
Labour force participation rate <sup>j</sup>	58.9	59.1	58.3	58.7	58.1	57.8	58.3	58.9	59.5
Open unemployment rate <sup>k</sup>	5.4	4.7	3.7	3.4	3.6	3.9	4.6	5.3	4.7
Visible underemployment rate <sup>k</sup>	14.8	12.2	11.3	11.7	11.1	10.0	10.5	11.6	...
	<b>Annual percentages</b>								
<b>Prices</b>									
Variation in consumer prices (December-December)	15.7	18.6	12.3	9.0	4.4	5.7	4.0	5.2	3.3
Variation in the national producer price index (December-December)	10.5	17.5	12.5	6.4	1.3	9.2	6.8	8.0	3.4
Variation in nominal exchange rate (December-December)	3.3	21.8	-5.0	0.3	-2.9	11.2	10.4	-0.5	-5.2
Variation in average real wage	-0.6	2.8	1.5	6.0	6.7	1.9	1.3	0.2	-0.1
Nominal deposit rate <sup>l</sup>	20.0	22.4	20.9	14.6	11.0	6.2	5.1	5.4	7.6
Nominal lending rate <sup>m</sup>	22.1	26.4	23.7	16.9	12.8	8.2	6.9	7.2	9.9

Table 1 (concluded)

	1997	1998	1999	2000	2001	2002	2003	2004	2005 <sup>a</sup>
	<b>Percentages of GDP</b>								
<b>Public sector</b>									
Total income	23.1	20.4	20.8	21.6	21.8	22.2	23.2	23.0	23.3
Tax revenue	9.8	10.5	11.4	10.6	11.3	11.6	11.1	10.0	9.7
Total expenditure <sup>n</sup>	23.7	21.6	22.0	22.7	22.5	23.3	23.9	23.3	23.3
Current expenditure	12.8	12.4	12.5	13.0	13.3	13.8	14.6	13.6	14.0
Interest	2.8	2.6	3.1	2.6	2.6	2.1	2.3	2.1	2.2
Capital expenditure	3.5	3.1	2.8	2.7	2.6	3.2	2.9	3.5	3.4
Primary balance <sup>o</sup>	2.1	1.4	1.9	1.5	1.8	0.9	1.7	1.8	2.1
Overall balance <sup>o</sup>	-0.7	-1.2	-1.1	-1.1	-0.7	-1.2	-0.6	-0.3	-0.1
<b>Public sector debt</b>	31.1	33.5	30.1	27.0	25.8	27.5	27.6	25.8	24.1
Domestic	8.6	9.8	11.0	12.3	13.1	14.5	14.7	14.3	14.8
External	22.5	23.7	19.1	14.7	12.6	13.0	12.9	11.6	9.2
<b>Money and credit<sup>p</sup></b>									
Domestic credit <sup>q</sup>	35.6	36.8	33.1	30.2	29.1	28.3	28.1	26.2	26.6
To the public sector	12.7	12.5	11.6	11.3	11.3	10.7	11.4	10.3	10.2
To the private sector	20.7	22.2	19.0	16.7	16.3	15.7	15.1	14.0	14.8
Other	2.2	2.2	2.5	2.1	1.5	1.9	1.5	1.9	1.6
Liquidity (M3)	36.3	38.1	40.2	40.1	43.4	45.4	46.1	46.4	49.0
Currency in circulation and local-currency deposits (M2)	35.1	36.8	38.8	38.7	42.0	43.8	44.7	45.0	47.6
Foreign-currency deposits	1.3	1.3	1.4	1.4	1.5	1.6	1.4	1.4	1.5

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

<sup>a</sup> Preliminary figures. <sup>b</sup> Based on figures in local currency at constant 1993 prices. <sup>c</sup> Based on figures in local currency expressed in dollars at current prices. <sup>d</sup> Includes errors and omissions. <sup>e</sup> Refers to the capital and financial balance (including errors and omissions), minus net foreign direct investment. <sup>f</sup> A minus sign (-) denotes an increase in reserves. <sup>g</sup> Includes the use of IMF credit and loans and exceptional financing. <sup>h</sup> Annual average, weighted by the value of merchandise exports and imports. <sup>i</sup> Refers to net investment income as a percentage of exports of goods and services as shown on the balance of payments. <sup>j</sup> Economically active population as a percentage of the working-age population, urban areas. <sup>k</sup> Unemployment and underemployment rates as percentages of the economically active population, urban areas. <sup>l</sup> Cost of term deposits in local currency in the multibanking system. <sup>m</sup> Lending rate published by IMF. <sup>n</sup> Includes non-budgeted expenditure. <sup>o</sup> Includes the non-budgetary balance. <sup>p</sup> The monetary figures are annual averages. <sup>q</sup> Refers to net credit extended to the public and private sectors by commercial banks and other financial and banking institutions.

of 2006. This was reflected in a first-quarter GDP growth rate of 5.5%: the highest in six years.

Private consumption was up by 5.4% in 2005, fuelled by remittances and increased employment. Another factor was the downward trend in interest rates in the second half of 2005 and the first few months of 2006; this also gave impetus to fixed investment, which rose by 7.6% (similar to the 7.5% recorded in 2004) and continued buoyant into 2006.

Albeit at a lower rate than in 2004, in 2005 production expanded across all branches of activity except agriculture, which declined by 1.5% owing to poor weather conditions, including the drought in the first semester and Hurricanes Stan and Wilma at the year's end.<sup>4</sup> In the first quarter of 2006, manufacturing and construction performed very well, with growth rates of 7.1% and 8.3%, respectively. Services, which account for 65.7% of GDP, maintained a steady pace of growth during 2005 (6.4% for basic services and 3.5% for other services) and, like the other branches of the economy, have remained buoyant in 2006.

In the manufacturing sector, good performances were

turned in by the metal products and machinery and equipment segments. The latter includes the automobile industry, which has succeeded in repositioning in the United States market. In the light of changes in world competitiveness and demand, the manufacturing industry is shifting its production platform towards luxury automobiles for export. As a result, and thanks to increased demand from the United States (the main export market), the automobile industry's production rose by 6.6% in 2005, with 74% of output destined for the external market. This trend has strengthened in 2006, with production up by more than 35% in January-April. Japanese companies with operations in Mexico have stepped up production, encouraged by the benefits of the Economic Complementarity Agreement in place between the two countries since April 2005.

With readily available financing, construction continued to expand, although less vigorously than in 2004. Residential construction (48% of the total) fared particularly well, while infrastructure work slowed slightly. In 2006, construction in the petroleum and petrochemical sectors picked up as oil-industry surpluses were put to use, which

<sup>4</sup> According to data from the Secretariat of Agriculture, Livestock, Rural Development, Fisheries and Food (SAGARPA), 1.6 million hectares were affected by drought and 254,000 hectares by hurricanes.

Table 2  
**MEXICO: MAIN QUARTERLY INDICATORS**

	2004				2005 <sup>a</sup>				2006 <sup>a</sup>	
	I	II	III	IV	I	II	III	IV	I	II
Gross domestic product (variation from same quarter of preceding year) <sup>b</sup>	3.6	3.7	4.5	4.8	2.4	3.3	3.4	2.7	5.5	...
Merchandise exports, f.o.b. (millions of dollars)	43 193	47 388	47 874	49 543	46 895	53 977	54 183	59 178	58 879	...
Merchandise imports, f.o.b. (millions of dollars)	43 717	48 507	49 822	54 764	48 772	54 655	55 871	62 521	58 119	...
International reserves (millions of dollars)	61 591	60 409	62 209	64 141	64 054	65 551	69 930	74 054	75 950	81 383 <sup>c</sup>
Real effective exchange rate (index: 2000=100) <sup>d</sup>	106.5	110.5	111.0	109.9	108.9	106.9	104.7	103.7	102.4	110.2
Unemployment rate	5.4	5.1	5.8	4.8	5.1	4.7	5.1	4.1	4.5	...
Consumer prices (12-month percentage variation)	4.2	4.4	5.1	5.2	4.4	4.3	3.5	3.3	3.4	3.2
Average nominal exchange rate (pesos per dollar)	10.98	11.38	11.45	11.33	11.18	10.96	10.72	10.71	10.60	11.18
Average real wage (variation from same quarter of preceding year)	1.5	0.6	0.1	-0.9	-0.1	-0.1	-0.7	0.3	0.5	...
Nominal interest rates (annualized percentages)										
Deposit rate <sup>e</sup>	4.5	5.0	5.6	6.5	7.2	7.9	8.0	7.4	6.6	6.1
Lending rate <sup>f</sup>	6.0	6.7	7.5	8.6	9.4	10.0	10.1	10.1	7.9	7.3 <sup>c</sup>
Interbank interest rate	5.9	6.7	7.5	8.5	9.4	10.0	9.9	9.1	8.0	7.4
Sovereign bond spread (basis points)	183	215	188	166	180	168	136	126	127	138
Stock price index (in dollars, December 2000=100)	148	141	149	183	178	198	238	263	281	269
Domestic credit (variation from same quarter of preceding year) <sup>g</sup>	1.6	6.4	3.9	7.3	8.5	10.8	8.8	6.9	14.9	8.7 <sup>h</sup>
Non-performing loans as a percentage of total credit <sup>i</sup>	3.2	3.0	2.7	2.5	2.4	2.3	2.0	1.8	1.7	...

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

<sup>a</sup> Preliminary figures. <sup>b</sup> Based on figures in local currency at constant 1993 prices. <sup>c</sup> Data to May. <sup>d</sup> Quarterly average, weighted by the value of merchandise exports and imports. <sup>e</sup> Cost of term deposits in local currency in the multibanking system. <sup>f</sup> Lending rate published by IMF. <sup>g</sup> Refers to net credit extended to the public and private sectors by commercial banks and other financial and banking institutions. <sup>h</sup> Data to April. <sup>i</sup> Refers to total credit extended by full-service banks.

suggests that public investment will be higher this year.

Services benefited from steady demand for traditional and mobile telephones, courier services and air transport. This was reflected in a 7.1% increase in the transport, storage and communications sector in 2005, which is expected to continue in 2006. Commerce, restaurants and hotels slowed to 3.1% in 2005 (down from 5.5% in 2004) as result of the damage wreaked by Hurricane Wilma in one of the tourist areas of Quintana Roo, although this activity is now picking up (5.3% in the first quarter of 2006) thanks to reconstruction efforts in the area. Financial services climbed 5.8% in 2005 and community, social and personal services by 2.1%.

## (b) Prices, wages and employment

December-to-December inflation fell from 5.2% in 2004 to 3.3% in 2005, which was the lowest rate seen in decades. Contributing factors included the peso's nominal stability and trend towards real appreciation, less buoyant economic activity and the Banco de México's aforementioned efforts to neutralize domestic inflationary pressure. Core inflation<sup>5</sup> stood at 3.12%, owing to smaller rises in prices for processed food and housing thanks, in turn, to the easing of international price volatility in raw materials, particularly steel, which boosted residential construction.

<sup>5</sup> Core inflation covers merchandise (processed food, beverages and tobacco) and services (housing and others).

Non-core inflation<sup>6</sup> was the determinant of the decline in overall inflation, dropping by more than four percentage points to stand at 3.76% at the end of 2005, mainly because the agricultural price index went from 10.1% growth in 2004 to a -0.2% decline in 2005.

In 2006, both components displayed similar patterns to the previous year, with moderate variations in the prices of fruit and vegetables and adjustments of controlled prices in the early months. If this trend continues, overall inflation is expected to end the year at around the 3.5% mark.

Despite the economy's lower growth, the open unemployment rate dipped from 3.9% in 2004 to 3.6% in 2005 and to 3.5% in the first quarter of 2006. This reflected the absorption of labour by the informal sector and, to a lesser extent, increased employment in labour-intensive activities such as construction. In 2005, 11.8 million people, representing over 28% of the employed population, were in informal employment. The average rate of underemployment<sup>7</sup> was 7.5% of the employed population in 2005, retreating to 6.2% in the first quarter of 2006 in keeping with the economic buoyancy seen in that period.

As regards formal employment, the number of workers affiliated to the Mexican Social Security Institute swelled to 12.9 million in 2005, exceeding for the first time the previous record of 12.6 million recorded in 2000. This uptrend has continued into 2006 on the back of strong economic growth and the number of affiliates came to 13.5 million in March. One trend to be noted is the growing proportion of temporary workers, who represented 15.6% of the total in 2005 and 17.4% in March 2006 (compared with 6.9% 10 years earlier).

The services sector consolidated its position as the main generator of formal employment (45% of the total) and the largest absorber of labour in recent years. Manufacturing, which is the second largest employment generator (22.5% of the total), has recorded negative performances since 2001, although 2005 saw growth of 1.3% over 2004. This upswing is continuing in 2006 thanks to expanding external demand. The number of people employed by the maquila industry grew by 4.7% in 2005, which was similar to the 5% rate recorded in 2004. However, the number of jobs is still 10% below the peak registered in 2000. Employment in construction expanded by 6.5%, although this largely reflected the hiring of temporary workers.

Labour productivity in the manufacturing industry edged up by 2% in 2005 (compared with 7.1% in 2004), while real average wages declined (-0.1%), as did unit labour costs (-2.1%). Commerce recorded a 2.8% rise in productivity and a fall in both wages (-0.4%) and unit labour costs (-3.1%) over the same period.

### (c) The external sector

The balance-of-payments current account deficit has been narrowing since 2001, due both to rising migrant remittances and to the fact that export growth has exceeded import growth. The current account deficit stood at 0.62% of GDP in 2005 (0.97% in 2004), or US\$ 4.789 billion. Unlike what occurred in 2001-2003, however, growth was strong in both exports (14%) and imports (13%) — and that trend has continued into 2006 as a result of rising external demand for automobiles and high petroleum prices. The merchandise trade deficit shrank from US\$ 8.811 billion to US\$ 7.587 billion in 2005. The goods and services trade deficit stood at US\$ 12.354 billion.

The year's most robust growth in trade occurred in the final quarter of 2005 and continued into the first quarter of 2006 (in which sales of land vehicles and fuels and minerals stood out with rates of 51% and 54%, respectively), far outstripping import growth.

High petroleum prices during 2005 (an average of US\$ 43 per barrel of Mexican mix) pushed up the value of oil sales by more than 33%. Rising world demand, tighter international supply and the geopolitical risk in the Islamic Republic of Iran and in Iraq seem to be driving this upward trend: by April 2006, the average price of Mexican mix had risen above US\$ 50 per barrel. Agricultural exports also expanded in 2005 (5.7%), since the fall in production did not affect export supply. Manufacturing exports were up by 11%, with decreases observed only in textiles and office equipment.

Worthy of note in relation to imports is the gradual growth in consumer goods purchases, which have exceeded those of capital goods since 2002. Consumer goods imports now represent 14.2% of total imports (11.7% in 2001), compared with 11.9% for capital goods (13.4% in 2001). This pattern is associated with more readily available consumer credit and with inflows of remittances. Growth in purchases of intermediate goods, which are closely linked to maquila plant imports, has risen to two-digit figures thanks to the upswing in the maquila industry.

<sup>6</sup> Non-core inflation covers agricultural products (fruits and vegetables, meat and eggs); controlled goods and services; and education.

<sup>7</sup> The underemployed are those who are willing and need to work more hours than their current employment permits.

The income account deficit widened slightly to stand at US\$ 12.919 billion, mainly as a result of interest payments on debt and profit remittances. The deficit on the trade and income accounts (US\$ 25.273 billion) was largely offset by the surplus on transfers. Transfers consist almost entirely of remittances from Mexicans living abroad, which accounted for US\$ 20.034 billion (20.6% more than in 2004; 2.6% of GDP; and 111% of foreign direct investment). Up to April 2006, remittances grew by 25%. If this trend continues, remittances will total US\$ 25.0 billion by the end of the year.

The financial account posted a surplus of US\$ 12.758 billion, which was the net outcome of the reduction in government debt (US\$ 10.165 billion), higher inflows of foreign direct investment (US\$ 18.055 billion gross, US\$ 13.0 billion net) and portfolio investment (US\$ 10.188 billion). Portfolio investment benefited from the interest rates prevailing in the first half of 2005 and from the country's

financial stability. In 2006, capital inflows continue to rise, partly due to the increased non-financial public sector borrowing being recorded since the last quarter of 2005.

Mexico's exports continued to lose competitiveness. Despite high economic growth in the United States, that country's demand for Mexican manufactures slackened in the face of competition from Asian countries, especially China, which has replaced Mexico as the second largest exporter to the United States after Canada. In the first few months of 2006, however, Mexican products seemed to be regaining market share from competitors such as China, Japan and Germany. In 2005, Mexico accounted for 10.2% of total United States imports (4% down on 2004), some way below Canada's 17.2% and China's 14.6%. Mexico's imports from China are also on the rise (23% more than in 2004) and represent 8% of the market, while imports from the United States edged up only slightly (7%) and their market share dropped to 53.4% (2.9 percentage points down on 2004).

## Nicaragua

### 1. General trends

Real GDP grew by 4% in 2005, reflecting a loss of momentum of almost one percentage point with respect to 2004 and corresponding to per capita GDP of 1.9%. The open unemployment rate at the national level declined for the third consecutive year, from 6.5% to 5.6% national, while urban open unemployment stood at 7.0%. The real average wage increased significantly in the central government but remained unchanged for formal private-sector wage-earners. Official minimum wages were adjusted in May, when a nominal 16.5% increase was awarded for construction and financial sectors and 15% for other economic activities.

Although the expansion of the world economy and global trade favoured exports from the country, the surge in international prices for oil and some other industrial commodities led to a deterioration in the terms of trade, a slight rise in inflation (from 8.9% in 2004 to 9.6% in 2005), a real exchange rate appreciation against the United States dollar and a widening of the trade deficit.

Lack of parliamentary support for the projects of the Executive and mounting political tensions in the run-up to the November 2006 elections have generated a climate of uncertainty that is putting a damper on the economy. At the same time, the increase in the public budget in 2005 (beyond the figure originally agreed) and the meagre advances in the area of structural reform resulted in the suspension of the three-year programme signed with the International Monetary Fund (IMF) in December 2002; this led to a reduction in disbursements for budget and balance-of-payments support. Following negotiations during the year, however, the Fund, convinced of the government's commitment to achieving quantitative goals and conscious of its efforts to achieve a national consensus in order to fulfil the agenda of structural reforms before the year is out, decided to extend the programme to December 2006.

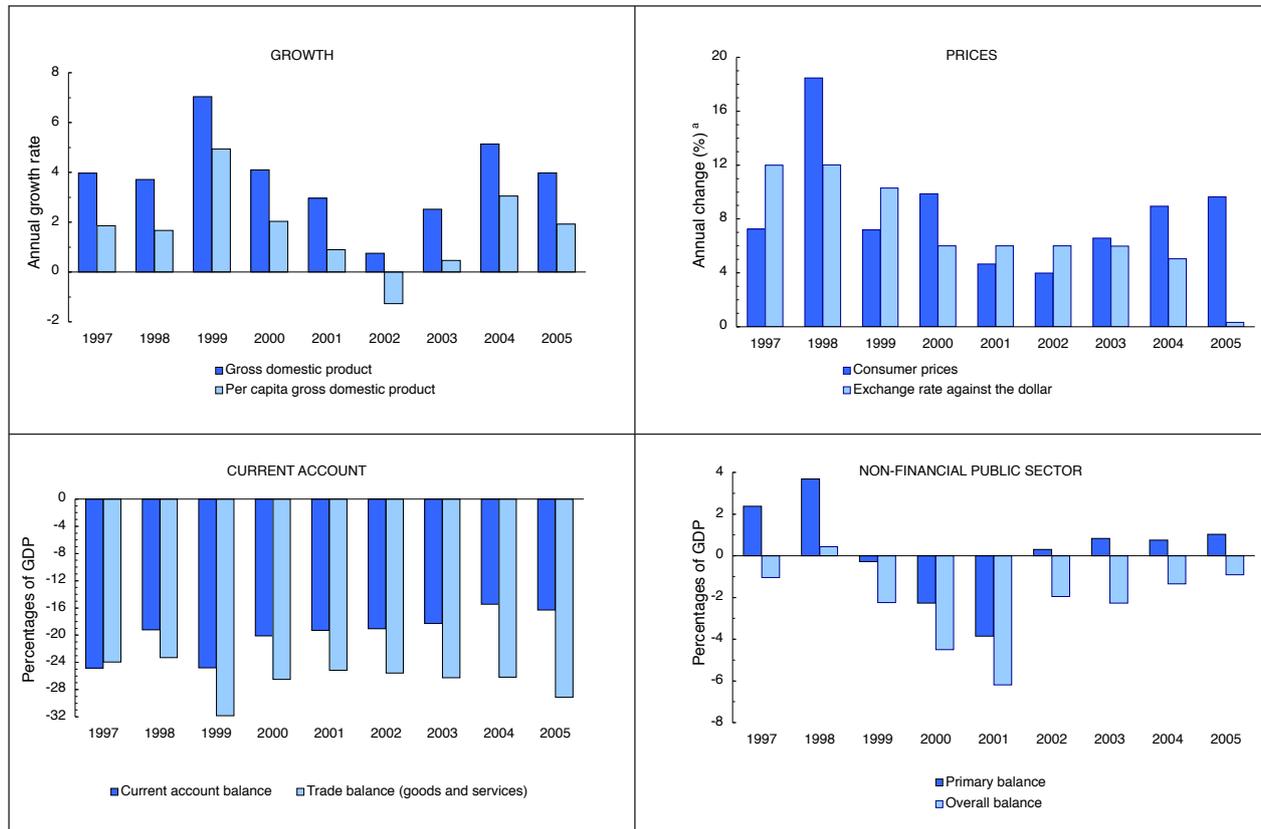
The fiscal discipline of the previous years was maintained, resulting in a reduction in the non-financial public sector deficit (before grants) from 5.8% to 4.3% of GDP, but without resorting to the cut in public spending, especially spending on the poverty reduction strategy.

Thus, public financing management also facilitated the fulfilment of the main monetary policy goals.

Notwithstanding the suspension of the IMF programme, the debt relief provided for under the heavily indebted poor countries initiative (HIPC) was not affected. At the end of December 2005, Nicaragua became eligible for external debt relief programmes that will cancel US\$ 3.761 billion of a total scheduled debt of US\$ 6,328 billion. As a result of the negotiations carried out during the year, the external debt balance was one of the lowest in the last 20 years. In addition, the Group of eight added Nicaragua to its list of countries for consideration under the debt-forgiveness plan for countries included in the HIPC initiative with IMF, the World Bank and the African Development Fund. This will imply a further external-debt reduction of approximately US\$ 800 million. In this political and economic context, Nicaragua ratified the Dominican Republic - Central America - United States Free Trade Agreement (DR-CAFTA), which entered into force in April 2006.

The trend towards a slowdown in the economy, noted in the last quarter of 2005, is expected to continue in 2006. Exports will continue to expand, but uncertainty surrounding the electoral process is expected to curb domestic demand and especially private investment. The economy is expected to grow by an estimated 3.5%. Nevertheless, a continued rise in international prices for oil and some industrial raw materials could cause economic activity to slow more than predicted, restricting GDP growth to between 3.2% and 3.4%.

Figure 1  
NICARAGUA: MAIN ECONOMIC INDICATORS



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

In terms of price trends, an increase of 7.3% is expected, but imported inflation could push up domestic inflation to between 8% and 10%. The central bank estimated that a 10% increase in the price of oil would translate into a 0.7 percentage-point increase in the inflation rate.

As regards monetary policy, one of the main objectives of the central bank is to build up international reserves. These are expected to stand at 15.2% of GDP, which will

bolster domestic stability and the exchange-rate, and improve vulnerability indicators, such as coverage of the monetary base (1.98 times) and of imports (3.2 months). Fiscal policy will be adjusted with a view to attaining this goal. The primary balance deficit of the public sector is expected to diminish, while the fiscal balance after grants should remain constant. In the external sector, the balance-of-payments current-account deficit will amount to 17% of GDP.

## 2. Economic policy

No significant changes are foreseen with respect to economic policy management in 2006. Monetary policy will continue to be oriented towards curbing inflation, countering the external vulnerability of the economy, and further strengthening net external assets and reducing central bank debt, provided that this does not have an adverse effect on economic activity. Despite the estimated

expenditure (1% of GDP) that the electoral process will entail, fiscal discipline is expected to be maintained. This will give the monetary authority more leeway in achieving its policy objectives.

Unlike the situation in previous elections, there is consensus among the contenders in the present electoral process on the need to preserve the existing macroeconomic

stability so that at the start of its mandate, the next administration does not have to correct huge imbalances. The extension of the IMF agreement will also have a positive effect by contributing to inflows of financial resources to shore up the budget and the balance of payments position and by facilitating access to international financial markets on concessional terms.

#### (a) Fiscal policy

In 2005, the results of the fiscal policy were a key factor for macroeconomic performance. The central government fiscal deficit before grants contracted, making it easier to achieve the monetary targets in terms of price and exchange-rate stability.

Current central government revenues expanded by 20.2% and the tax burden rose from 15.7% to 16.6% of GDP. However, with grants down from 4.7% of GDP to 3.3%, the share of total revenues in output (21.2%) diminished by half a percentage point.

For its part, total expenditure (including both current and capital expenditure), recorded similar levels to those of the previous year and stood at 23.1% of GDP. As a result, current savings represented 4.3% of GDP in 2005, up from 3.5% of GDP in 2004; the fiscal deficit (including grants) increased from 1.5% to 1.8% of GDP. It should be noted that the Government transferred the equivalent of 1.7% of GDP in recourses to the central bank, thereby improving its financial position.

The external public debt balance, which stood at US\$ 5.348 billion (equivalent to 109% of GDP), decreased slightly with respect to 2004. The appreciation of the dollar had a favourable effect: a more than US\$ 150 million reduction in the debt balance. The ratio of debt service to exports of goods remained constant at 10%.

#### (b) Monetary policy

One of the intermediate goals of the monetary programme in recent years was to build up reserves. This went hand in hand with a policy designed to reduce gradually the central bank's domestic borrowing, thus lessening its financial vulnerability and freeing up resources for the financial system; this has enabled it to increase the volume of intermediation and avoid sharp variations in interest rates. Reconciling currency stabilization with domestic debt reduction was contingent on coordination of monetary and fiscal policy. The measures adopted to reduce the deficit and increase external borrowing helped to boost reserves.

In 2005, the reserve requirement was maintained at 16.25%. Open market operations resulted in a reduction in the central bank's domestic debt, achieved through

the net redemption of private-sector securities. This was conducive to financial intermediation at lower interest rates.

The resources captured by the banking system were used to inject credit resources in the economy, which led to a 32% cumulative expansion in the loans portfolio. The credit expansion was concentrated in the private sector, since credit to the non-financial public sector declined. The structure of the loan portfolio revealed the buoyancy of household loans, loans to private businesses and finance companies. The expansion in the household loans portfolio (44%) was closely related to the increase in consumption. The fact that the financial system tends to direct its credit towards profitable and rapid recovery sectors is one of the factors that accounts for the strong expansion in consumer loans. This is reflected in the relationship between growth in aggregate consumption and the leverage of the financial system.

#### (c) Exchange-rate policy

In 2005, the government maintained its exchange rate policy of daily mini-devaluations consistent with a preannounced annual crawling-peg devaluation rate. Initially, the central bank policy was to reduce the crawling-peg rate, since inflation is closely related to the annual devaluation rate, which would help to moderate inflationary pressures. However, given the climate of political and economic uncertainty, as well as the high inflationary pressures, it decided to leave the crawling-peg rate at 5% per year, which led to a real exchange-rate appreciation.

#### (d) Other policies

As part of the complementary agenda associated with the entry into force of the DR-CAFTA agreement, progress was made in readjusting the legal framework of the country, principally on issues linked to market competition, the environment, the labour market, microfinance, free zones, mediation and trade arbitration. In general terms, this is expected to have a positive impact on the domestic economy. It will be recalled that in terms of tariffs, the agreement provides for preferential treatment for Nicaragua, guaranteeing most of its exports immediate access to the other markets and offering more vulnerable national products gradual, long-term liberalization.

Other negotiations in 2005 led to access to the European Union's new Generalized System of Preferences, which entered into force on 1 January 2006. Most of the exports under this system (excepting meat and dairy products) will enjoy favourable tariffs.

Table 1  
**NICARAGUA: MAIN ECONOMIC INDICATORS**

	1997	1998	1999	2000	2001	2002	2003	2004	2005 <sup>a</sup>
	<b>Annual growth rates<sup>b</sup></b>								
<b>Gross domestic product</b>	4.0	3.7	7.0	4.1	3.0	0.8	2.5	5.1	4.0
<b>Per capita gross domestic product</b>	1.9	1.7	4.9	2.0	0.9	-1.3	0.5	3.0	1.9
<b>Gross domestic product, by sector</b>									
Agriculture, livestock, hunting, forestry and fishing	-0.6	-0.4	6.0	12.1	2.7	-0.3	1.9	4.7	3.1
Mining	16.1	36.2	18.4	-15.5	13.6	5.6	-10.6	19.7	-5.7
Manufacturing	7.6	-0.3	7.0	4.3	5.9	2.1	2.4	8.6	4.8
Electricity, gas and water	4.9	11.0	0.1	8.9	8.3	1.4	5.1	5.0	3.4
Construction	-8.6	-1.4	36.4	-1.0	2.1	-13.3	2.7	10.7	6.0
Wholesale and retail commerce, restaurants and hotels	5.6	7.2	9.4	1.7	1.6	3.3	1.4	5.1	4.9
Transport, storage and communications	3.9	6.5	8.3	0.9	3.7	2.7	9.7	3.0	3.4
Financial institutions, insurance, real estate and business services	6.3	8.4	7.6	5.1	3.9	2.3	6.8	8.2	4.0
Community, social and personal services	3.8	2.6	4.5	2.3	5.1	2.0	2.4	2.6	2.7
<b>Gross domestic product, by type of expenditure</b>									
Consumption	3.7	4.7	6.1	5.2	4.1	3.6	2.1	3.7	3.2
General government	-4.1	4.4	8.2	4.8	-2.9	-4.6	5.6	4.9	0.5
Private	4.6	4.7	5.9	5.3	4.9	4.5	1.8	3.6	3.5
Gross domestic investment	23.6	4.3	27.1	-16.8	-8.4	-7.1	-1.0	4.2	10.1
Exports (goods and services)	14.4	5.8	12.4	12.5	7.3	-3.5	9.2	16.1	5.3
Imports (goods and services)	22.1	7.2	21.1	-4.7	0.7	-0.1	3.5	8.2	6.2
	<b>Percentages of GDP</b>								
<b>Investment and saving<sup>c</sup></b>									
Gross domestic investment	31.2	31.0	38.4	31.0	28.2	26.1	25.9	27.1	29.4
National saving	6.3	11.8	13.5	10.9	8.9	7.0	7.6	11.6	13.1
External saving	24.8	19.2	24.8	20.1	19.3	19.1	18.3	15.5	16.3
	<b>Millions of dollars</b>								
<b>Balance of payments</b>									
Current account balance	-841	-687	-928	-792	-796	-767	-749	-696	-800
Merchandise trade balance	-728	-749	-1 071	-921	-910	-918	-972	-1 075	-1 314
Exports, f.o.b.	745	761	749	881	895	917	1 050	1 365	1 552
Imports, f.o.b.	1 473	1 510	1 820	1 802	1 804	1 834	2 021	2 440	2 865
Services trade balance	-83	-84	-120	-122	-129	-112	-106	-101	-117
Income balance	-265	-185	-197	-202	-240	-200	-191	-192	-119
Net current transfers	235	331	460	453	483	462	519	673	750
Capital and financial balance <sup>d</sup>	548	285	533	336	304	366	280	617	766
Net foreign direct investment	203	218	337	267	150	204	201	250	230
Financial capital <sup>e</sup>	344	66	196	69	154	162	78	432	536
Overall balance	-293	-402	-395	-456	-492	-401	-470	-78	-34
Variation in reserve assets <sup>f</sup>	-173	30	-157	17	114	-85	-69	-169	-46
Other financing <sup>g</sup>	466	372	552	439	379	486	538	247	80
<b>Other external-sector indicators</b>									
Real effective exchange rate (index: 2000=100) <sup>h</sup>	101.2	101.3	101.9	100.0	101.1	103.1	106.8	108.9	108.3
Terms of trade for goods (index: 2000=100)	82.0	79.6	95.3	100.0	88.4	87.0	84.1	82.5	81.4
Net resource transfer (percentage of GDP)	22.1	13.2	23.7	14.6	10.7	16.2	15.3	15.0	14.8
Gross external public debt (millions of dollars)	6 001	6 287	6 549	6 660	6 374	6 363	6 596	5 391	5 348
Gross external public debt (percentage of GDP)	177.4	176.0	175.0	169.1	154.5	158.0	160.8	119.9	108.9
Net profits and interest (percentage of exports) <sup>i</sup>	-29.4	-19.6	-20.4	-18.3	-21.5	-17.5	-14.6	-11.7	-6.4
	<b>Average annual rates</b>								
<b>Employment</b>									
Labour force participation rate <sup>j</sup>	...	...	...	...	...	57.5	53.7	53.1	53.8
Open unemployment rate <sup>k</sup>	14.3	13.2	10.7	7.8	11.3	11.6	10.2	9.3	7.0
	<b>Annual percentages</b>								
<b>Prices</b>									
Variation in consumer prices (December-December)	7.3	18.5	7.2	9.9	4.7	4.0	6.6	8.9	9.6
Variation in nominal exchange rate (December-December)	12.0	12.0	10.3	6.0	6.0	6.0	6.0	5.0	0.3
Variation in average real wage	3.7	4.0	4.0	0.0	1.0	3.5	1.9	-2.2	0.2
Nominal deposit rate <sup>l</sup>	...	...	11.8	10.8	11.6	7.8	5.6	4.7	4.0
Nominal lending rate <sup>m</sup>	...	...	17.6	18.1	18.6	18.3	15.5	13.5	12.1

Table 1 (concluded)

	1997	1998	1999	2000	2001	2002	2003	2004	2005 <sup>a</sup>
	<b>Percentages of GDP</b>								
<b>Non-financial public sector</b>									
Total income <sup>n</sup>	23.4	24.3	25.9	24.0	22.4	24.3	26.6	28.7	29.4
Current income	20.1	22.1	20.6	19.4	18.6	...	...	...	...
Tax revenue	16.3	17.9	17.9	18.1	17.3	14.2	15.9	16.5	17.4
Capital income	0.1	0.1	0.2	0.1	...	...	...	...	...
Total expenditure	24.5	23.9	28.1	28.5	28.6	26.3	28.9	30.1	30.3
Current expenditure	15.6	16.3	15.5	16.7	18.3	...	...	...	...
Interest	3.4	3.2	2.0	2.2	2.3	2.2	3.1	2.1	1.9
Capital expenditure	8.8	7.6	12.7	11.8	10.3	...	...	...	...
Primary balance	2.4	3.7	-0.3	-2.3	-3.8	0.3	0.8	0.8	1.0
Overall balance	-1.0	0.4	-2.2	-4.5	-6.2	-1.9	-2.3	-1.3	-0.9
Debt of non-financial public sector	122.4	125.4	120.2	114.7	111.3	134.1	138.0	100.0	91.8
Domestic	...	...	...	...	...	21.5	22.5	21.3	20.9
External	122.4	125.4	120.2	114.7	111.3	112.6	115.5	78.7	70.9
<b>Money and credit<sup>o</sup></b>									
Domestic credit <sup>p</sup>	...	...	...	...	78.0	77.2	77.3	68.7	64.2
To the public sector	...	...	...	...	74.7	72.4	67.1	56.2	47.5
To the private sector	...	...	...	...	17.7	17.8	20.2	21.7	24.8
Other	...	...	...	...	-14.4	-13.0	-9.9	-9.2	-8.2
Liquidity (M3)	28.6	33.5	35.8	36.2	35.7	38.0	38.8	38.7	38.9
Currency in circulation and local-currency deposits (M2)	11.1	12.3	13.0	12.9	12.0	12.0	11.5	12.3	12.6
Foreign-currency deposits	17.4	21.2	22.9	23.3	23.6	26.0	27.3	26.4	26.3

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

<sup>a</sup> Preliminary figures. <sup>b</sup> Based on figures in local currency at constant 1994 prices. <sup>c</sup> Based on figures in local currency expressed in dollars at current prices. <sup>d</sup> Includes errors and omissions. <sup>e</sup> Refers to the capital and financial balance (including errors and omissions), minus net foreign direct investment. <sup>f</sup> A minus sign (-) denotes an increase in reserves. <sup>g</sup> Includes the use of IMF credit and loans and exceptional financing. <sup>h</sup> Annual average, weighted by the value of merchandise exports and imports. <sup>i</sup> Refers to net investment income as a percentage of exports of goods and services as shown on the balance of payments. <sup>j</sup> Economically active population as a percentage of the working-age population; nationwide total. <sup>k</sup> Unemployment rate as a percentage of the economically active population, urban total. Up to 1999 the figures refer to the nationwide total. <sup>l</sup> Weighted average rate on 30-day deposits. <sup>m</sup> Weighted average rate on short-term loans. <sup>n</sup> Includes grants. <sup>o</sup> The monetary figures are end-of-period balances. <sup>p</sup> Refers to net credit extended to the public and private sectors by commercial banks and other financial and banking institutions.

As regards structural reforms, mention should be made of a set of political commitments adopted in 2005 for accelerated approval in October and November of a series of bills which will lead to the conclusion of a new

agreement with IMF. These include the approval of the Tax Code, the adoption of the government budget for 2006 and reforms for strengthening the regulatory framework of bank supervision and risk management.

### 3. The main variables

#### (a) Economic activity

In 2005, real production growth moderated from 5.1% to 4%. The increase in GDP was triggered both by the expansion in exports (5.3%) and by growth of domestic demand (4.5%). If restocking is not included, however, the rise in domestic demand is much smaller (3.8%) owing to the contraction in real terms of public investment (-5.6%) and the weak growth in public consumption. Conversely, private investment picked up (10.8%), boosted by expenditure on construction

and investment in machinery and equipment. Private spending on consumption grew at a similar rate to that recorded in 2004.

The economic expansion is attributable to various factors: growth in the world economy and in particular in the United States and the countries that make up the Central American Common Market (CACM) fuelled external demand for the country's goods and services; stronger external demand stimulated production in the export sectors, especially of agricultural goods (sugar, sesame, seafood, meat and beef on the hoof) and industrial

Table 2  
NICARAGUA: MAIN QUARTERLY INDICATORS

	2004				2005 <sup>a</sup>				2006 <sup>a</sup>	
	I	II	III	IV	I	II	III	IV	I	II
Merchandise exports, f.o.b. (millions of dollars)	187	197	188	184	221	216	212	209	248	...
Merchandise imports, c.i.f. (millions of dollars)	506	551	531	624	615	670	642	668	690	...
International reserves (millions of dollars)	571	613	601	668	640	619	629	728	787	817 <sup>b</sup>
Real effective exchange rate (index: 2000=100) <sup>c</sup>	108.6	107.8	108.9	110.4	111.9	108.3	106.6	106.7	108.6	107.0
Consumer prices (12-month percentage variation)	7.3	7.7	9.0	8.9	8.4	9.7	10.8	9.6	10.9	10.8
Average nominal exchange rate (córdobas per dollar)	15.65	15.84	16.03	16.23	16.22	16.32	16.37	16.52	17.08	17.16
Average real wage (variation from same quarter of preceding year)	-1.6	-1.5	-2.3	-3.0	-1.1	-0.1	0.3	1.6	3.4	...
Nominal interest rates (annualized percentages)										
Deposit rate <sup>d</sup>	4.8	4.9	4.8	4.4	3.9	3.9	4.0	4.3	4.6	4.8 <sup>b</sup>
Lending rate <sup>e</sup>	14.6	12.9	13.4	13.1	13.0	12.9	11.7	10.8	12.6	8.3 <sup>b</sup>
Interbank interest rate	39.2	35.9	37.0	38.4	40.3	39.6	39.8	41.7	43.5	39.5 <sup>b</sup>
Domestic credit (variation from same quarter of preceding year) <sup>f</sup>	4.1	0.3	1.3	1.6	5.0	11.6	7.8	8.0	2.5	2.6 <sup>g</sup>
Non-performing loans as a percentage of total credit <sup>h</sup>	2.6	2.5	2.5	2.1	2.3	2.2	2.3	2.0	2.0	2.4 <sup>b</sup>

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

<sup>a</sup> Preliminary figures. <sup>b</sup> Data to May. <sup>c</sup> Quarterly average, weighted by the value of merchandise exports and imports. <sup>d</sup> Weighted average rate on 30-day deposits. <sup>e</sup> Weighted average rate on short-term loans. <sup>f</sup> Refers to net credit extended to the public and private sectors by commercial banks and other financial and banking institutions. <sup>g</sup> Data to April. <sup>h</sup> Refers to total credit extended by the banking system.

products (food and beverages, textiles and clothing, footwear, wood products and chemicals). A strong performance by the tourism sector also contributed to these positive results.

In the merchandise production sectors as a whole (which account for more than 40% of total GDP), the manufacturing industry and construction grew at a higher rate than the average for the economy, and agricultural production showed lower growth (3.1%). This growth is due essentially to the increase in the production of basic grains, the significant increase in exports of beef on the hoof to Mexico and other Central America countries and the recovery in shrimp and fish production. The expansion of the manufacturing industry is attributable to the production of textiles and clothing, foodstuffs, beverages and rum, tobacco, wood products, non-metallic products and chemicals. Construction was buoyed up by private investments in commercial, industrial and residential sectors.

Services also contributed to the expansion of the economy. The most dynamic sectors were commerce, financial services, transport and telecommunications. Performance in the construction, commerce and financial services sectors was determined to a large extent by higher wages in the public sector, the credit boom

recorded in the economy and the substantial growth in family remittances.

### (b) Prices, wages and employment

Inflation stood at 9.6%, above the rate planned at the beginning of the year. The international price for oil was one of the strongest factors of inflation, with a direct impact on fuel prices (27.1%), electricity (13.0%) and transport (13.4%), (in other words the essential inputs of the production system), and repercussions on the prices of other goods and services. Thus, the main determinants of the slight rise in inflation in 2005 were primary inputs and a limited set of related products in the production chain. The surge in inflation is therefore attributable to the strong external shock which occurred in a context of domestic vulnerabilities, including wage pressures in the public sector, disruptions in the agricultural sector and excess liquidity in the economic system.

According to the results of the household survey for measuring employment, job creation outpaced economic activity. New jobs showed a 5.5% increase over November 2004. The main employment-generating sectors were the manufacturing industry, community and social services and commerce. In addition, the process of labour market

formalization intensified and was reflected in the higher membership in the Nicaraguan Social Security Institute. Open unemployment fell for the third consecutive year in November 2005 to stand at 5.6%. In 2005, the real average wage increased by 5.3%, mainly as a result of adjustments in wages paid to central-government employees (9.3%), since the real average wage of formal private-sector wage-earners showed no increase. Official minimum wages were adjusted in May, when a nominal 16.5% increase was approved for construction workers and financial employees and a 15% increase for those engaged in other economic activities.

### (c) The external sector

The expansion of economic activity was accompanied by a sharper imbalance in the external sector. The current-account deficit (US\$ 800 million) widened from 15.5% of GDP in 2004 to 16.2% in 2005. This was due to the significant increase in the deficit on the merchandise trade balance (27.4% of GDP) since the income account deficit contracted sharply, reflecting the reduction in interest paid and the substantial increase in current transfers (11.5%), especially family remittances, the equivalent of 12.5%

of GDP and 75% of the current account deficit. The reduction in the official capital flows was compensated by private capital inflows. The higher net capital inflows were sufficient to finance the external imbalance, which led to a slight increase in the very limited net international reserves.

In 2005, foreign direct investment diminished slightly, from US\$ 250 million to US\$ 230 million. The services sector received the strongest inflows (83.7%), the principal beneficiaries being commerce, communications, the energy sector and the sugar industry.

Exports (including those from the free zones) expanded by 13.9%, while imports were up by 18.4%. The recovery in sales of traditional products and the expansion in non-traditional sales both contributed to growth in exports. Other factors include the buoyancy of exports from the free zones, especially those from the textile maquila, and the income generated by the tourist industry.

All the other import categories, except consumer goods, showed substantial increases. In particular, raw materials and intermediate goods were up, owing mainly to the higher import bill for oil and oil products (33.8%) and to purchases of capital goods required by the expansion of investment.



## Panama

### 1. General trends

Panama's economy continued to register a high level of growth (6.4%) thanks to favourable external conditions and buoyant domestic demand. The unemployment rate came down to 9.6% and the fiscal deficit narrowed to 2.5% of GDP. The balance-of-payments current account deficit also shrank to the equivalent of 5.3% of GDP, while inflation exceeded usual levels with an increase of 3.4%.

International service sectors such as the Colón Free Zone, the international banking centre, the Panama Canal, ports and tourism — as well as exports of national products — all benefited from the expansionary phase of the world economy and from the buoyancy of raw materials exports from South American countries. In these circumstances, rising international interest rates and high oil prices had a limited impact.

The government's agenda for 2005 included four main projects: fiscal reform, social security reform, the conclusion of free-trade negotiations with the United States and a referendum on the widening of the Panama Canal. Only the first two were achieved, and not without difficulty, since more than a month of strikes and protests followed the social security reform proposal. The government plans

to push ahead with the other two projects during 2006. Given its potential impact on the future of Panama's economy, the most important event in 2006 will be the referendum on the widening of the Panama Canal, due to be held at the end of the year.

In 2006, the rate of growth is expected to remain high, at around 6%, thanks to the continuation of trends observed in 2005. A number of new developments, including the construction of luxury apartment buildings in Panama City and the upgrading of sanitation in the Bay of Panama, could offset a slight slowdown in the growth of the international service sectors. The consolidation of the fiscal position is expected to continue and inflation will remain above usual levels but slightly lower than in 2005.

### 2. Economic policy

In 2005, government efforts were aimed at carrying forward fiscal rehabilitation, increasing transparency, continuing free trade negotiations and restructuring the public debt.

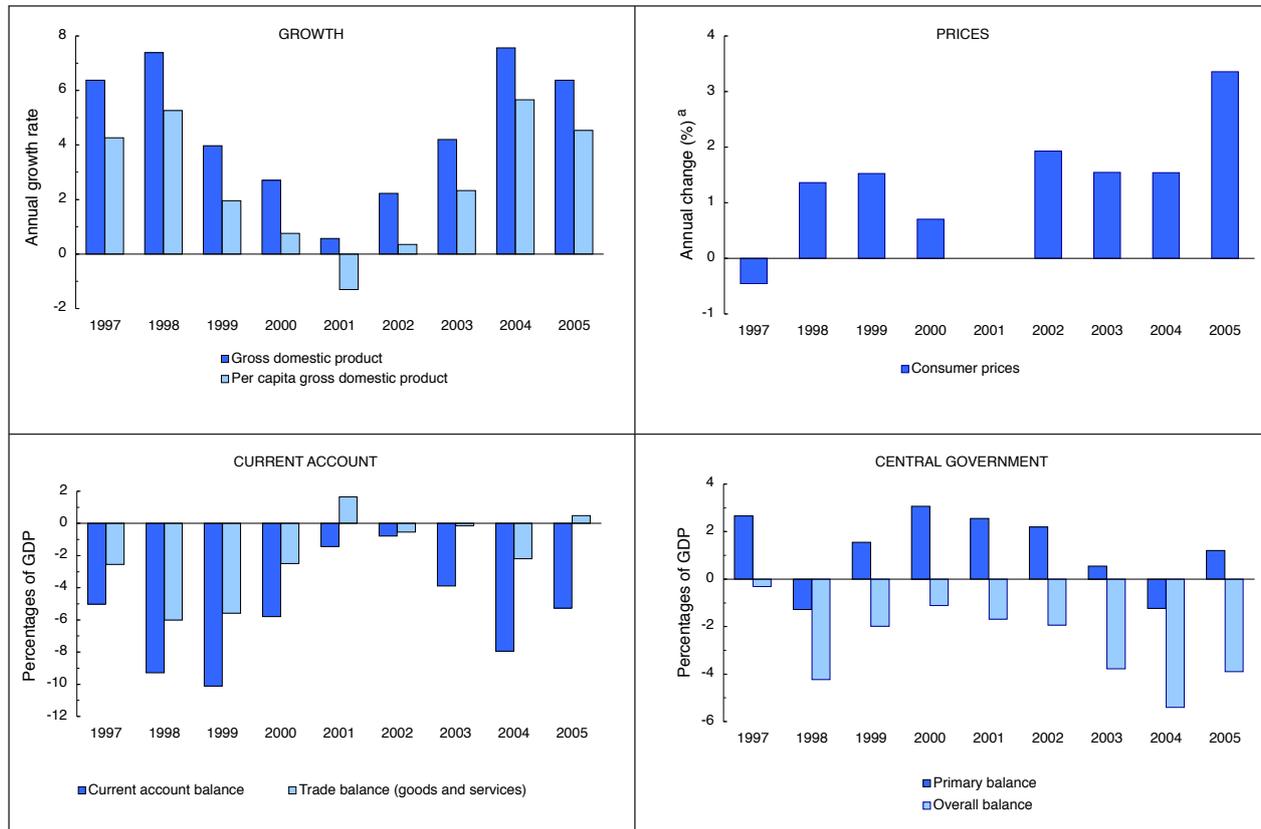
#### (a) Fiscal policy

At the end of 2004, the government adopted more orthodox methods to compile the fiscal accounts, giving a deficit of 4.9% of GDP for that year. In 2005, the deficit of the non-financial public sector (NFPS) narrowed to

2.5%. This reflected a 12.5% increase in revenues in real terms which, in turn, was partly attributable to buoyant production activity and the fiscal reforms. The surplus on the accounts of public enterprises swelled by about 60%. At the same time, expenditure held steady thanks to an explicit policy of spending restraint, while capital expenditure decreased by 10% in real terms. Having been negative by US\$ 217 million in 2004, current saving turned positive (US\$ 33.3 million) in 2005.

The central government deficit narrowed from 5.4% of GDP to 3.9%. Revenues were up by 11.7%, whereas

Figure 1  
**PANAMA: MAIN ECONOMIC INDICATORS**



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

expenditure expanded by only 2% in real terms. Tax revenues swelled by 7.8%, mainly owing to increased income-tax receipts (16%), while non-tax revenues rose by 18.6%.

In February 2005, the authorities adopted the Fiscal Equity Act, which provides for spending cuts (especially in the State payroll) and a restructuring of the tax system, including the elimination of many preferential regimes and tax exemptions (the latter are estimated to have represented US\$ 53.9 million in 2005). Another piece of legislation approved was the Social Security Fund Act, which combines the increased contribution parameters with the introduction of a system of individual accounts. This measure is intended to reverse the widening of the actuarial deficit, given that the operating deficit of the Social Security Fund weighed in at US\$ 369.7 million in 2005 (US\$ 1.4 million more than in 2004).

Another important initiative was the launch of the “Panamacompra” programme to facilitate government procurement and reduce corruption through increased transparency. The US\$ 369 million in accounts payable from the end of 2004 was whittled down to US\$ 164 million a year later. For 2006, US\$ 800 million is budgeted for investment, which is twice as much as in previous years.

The government continued to take an active approach to public debt management, taking advantage of low international interest rates. Between November 2005 and January 2006, the external debt was restructured to replace high-interest medium-term bonds with lower-interest long-term instruments. The debt swap involved US\$ 2.34 billion and extended extends the average maturity from 12 to 16 years, reducing the need for refinancing in the next few years. The measures pave the way for a future improvement in the risk rating of Panama’s debt, with a

view to achieving investment grade in the medium term. This would also help with the widening of the Panama Canal, as almost half of the financing will need to come from external sources.

The cost of restructuring, combined with increased liabilities to bilateral and multilateral lenders, was reflected in the US\$ 360 million increase in external public debt. As a proportion of GDP, however, this debt decreased from 50.8% to 48.8%, thanks to strong economic growth. Domestic debt fell from 19.4% of GDP to 17.2%, as the smaller fiscal deficit implied a lower borrowing requirement.

### **(b) The international banking centre and credit policy**

In 2005, the international banking centre turned in a good performance on the back of economic growth in Panama and region-wide, especially in South America. Banks took advantage of the high growth rates being posted by countries exporting raw materials (particularly petroleum) to step up their operations. At the national level, banks reaped the benefits of trends in private consumption and property investment.

The assets of the international banking centre rose 11.7% to US\$ 38.652 billion. Profits stood at US\$ 792 million, liquidity remained high and the ratio of capital to risk-weighted assets was 17.2%. Portfolio quality indicators also remain very favourable: reserves cover 131% of the non-performing portfolio, which represents only 1.6% of the total.

The loan portfolio increased significantly (14.8%), driven by the surge in international credit (21.6%). The expansion of net domestic credit was smaller (13.2%) but nonetheless significant. The buoyant economic conditions were reflected in an expansion in mortgage, consumer and business loans (19.5%, 14.3% and 9.0%, respectively). Contrasting with the upward trend in international interest rates, Panama's nominal interest rates remained stable, partly because they had not fallen as steeply as rates in the rest of the world had done and partly because of abundant liquidity in the international markets. Real interest rates dipped slightly as a result of higher inflation.

Consolidation of the bank regulation and supervision framework continued and received the endorsement of the International Monetary Fund (IMF). The sector now

complies with 90% of the principles of the Basel Capital Accord (Basel I) and has taken measures to combat money laundering and the financing of terrorism. In 2006, efforts will focus on the New Basel Capital Accord (Basel II) and on strengthening regional cooperation. This is vital, given the strong expansion of regional banking groups. Also in 2005, the granting of seven new banking permits attests to international interest in the activities of the international banking centre.

The positive trends carried over into the first quarter of 2006: profits were up by 32%, assets by 14% and domestic private-sector credit by 13.7%. However, interest rates are beginning to climb in the wake of international rates.

### **(c) Trade policy**

The policy of liberalizing trade through free-trade agreements continued in 2005 and received even greater impetus in 2006. Negotiations with the United States continued in 2005 but were not concluded on account of a number of divergences, mainly on agricultural issues. The free-trade agreement with Singapore, on the other hand, was concluded and ratified and came into effect. As a result, previously scarce Singaporean investment in Panama soared in excess of US\$ 100 million. After stalling at the end of 1990s, negotiations with Chile were reopened and rapidly concluded, and the agreement could enter into force in 2006.

In 2006, Panama defined its position in relation to negotiations with the European Union. Since in this instance the European Union negotiates only with regional blocs, not individual countries, Panama had to choose either the Andean Community or the Central American Common Market (CACM) as a regional integration partner, and opted ultimately for the latter. In May it was decided to initiate negotiations between the European Union, the Central American countries and Panama, with a view to forging a cooperation accord that would include a free trade agreement. Such an agreement presupposes stronger integration on the Central American isthmus; accordingly, Panama reopened free trade negotiations, which had stalled four years earlier, with the countries with which it does not yet have a free trade agreement (Costa Rica, Guatemala, Honduras and Nicaragua). The aim is to conclude the negotiations in the course of 2006.

Table 1  
**PANAMA: MAIN ECONOMIC INDICATORS**

	1997	1998	1999	2000	2001	2002	2003	2004	2005 <sup>a</sup>
	<b>Annual growth rates<sup>b</sup></b>								
<b>Gross domestic product</b>	6.4	7.4	4.0	2.7	0.6	2.2	4.2	7.6	6.4
<b>Per capita gross domestic product</b>	4.3	5.3	2.0	0.8	-1.3	0.4	2.3	5.7	4.5
<b>Gross domestic product, by sector</b>									
Agriculture, livestock, hunting, forestry and fishing	3.3	6.6	1.8	9.6	6.5	3.3	9.3	1.6	2.9
Mining	80.8	26.1	23.9	-10.6	-4.1	18.1	35.4	12.7	0.4
Manufacturing	3.3	2.2	1.1	-7.2	-6.3	-2.6	-3.4	3.5	1.8
Electricity, gas and water	6.2	-2.5	12.0	9.3	-4.7	6.9	1.4	6.3	2.8
Construction	6.7	11.9	36.0	1.3	-21.8	-7.1	32.5	13.9	1.0
Wholesale and retail commerce, restaurants and hotels	12.1	6.8	-3.9	3.8	3.7	-0.9	2.4	11.1	9.3
Transport, storage and communications	10.0	14.6	6.7	12.5	2.5	2.0	10.9	14.1	10.9
Financial institutions, insurance, real estate and business services	5.2	7.8	5.8	5.9	-0.5	-0.2	0.5	3.7	7.9
Community, social and personal services	3.1	4.2	3.7	-0.4	3.9	4.5	1.8	3.5	1.4
<b>Gross domestic product, by type of expenditure</b>									
Consumption	6.8	16.1	0.6	0.2	3.9	7.3	7.3	9.4	5.5
General government	-0.6	4.7	1.5	1.8	8.1	9.1	0.4	1.9	1.0
Private	8.5	18.5	0.4	-0.1	3.1	6.9	8.7	10.8	6.3
Gross domestic investment	4.2	10.9	3.5	-9.2	-24.2	-5.4	19.0	11.4	3.6
Exports (goods and services)	7.4	-0.9	-12.4	18.5	0.3	-2.5	-10.1	11.1	14.4
Imports (goods and services)	7.0	7.8	-14.7	10.3	-4.3	0.7	-3.5	14.5	8.1
	<b>Percentages of GDP</b>								
<b>Investment and saving<sup>c</sup></b>									
Gross domestic investment	25.7	27.2	25.8	24.1	17.6	15.7	19.0	19.3	20.8
National saving	20.7	17.9	15.7	18.4	16.2	15.0	15.1	11.4	15.5
External saving	5.0	9.3	10.1	5.8	1.4	0.8	3.9	7.9	5.3
	<b>Millions of dollars</b>								
<b>Balance of payments</b>									
Current account balance	-507	-1 016	-1 159	-673	-170	-96	-503	-1 127	-818
Merchandise trade balance	-685	-1 296	-1 340	-1 143	-696	-1 035	-1 202	-1 588	-1 358
Exports, f.o.b.	6 670	6 332	5 288	5 839	5 992	5 315	5 072	6 133	7 188
Imports, f.o.b.	7 355	7 627	6 628	6 981	6 689	6 350	6 274	7 722	8 546
Services trade balance	428	638	701	854	890	968	1 195	1 275	1 433
Income balance	-400	-517	-691	-560	-590	-272	-742	-1 042	-1 136
Net current transfers	151	159	171	177	226	244	246	228	243
Capital and financial balance <sup>d</sup>	850	911	1 350	595	803	242	236	732	1 493
Net foreign direct investment	1 299	1 203	864	624	467	99	771	1 012	1 027
Financial capital <sup>e</sup>	-449	-292	485	-29	336	143	-535	-280	466
Overall balance	343	-105	191	-77	633	146	-267	-395	675
Variation in reserve assets <sup>f</sup>	-611	20	-185	109	-622	-138	267	396	-521
Other financing <sup>g</sup>	268	85	-7	-32	-11	-8	1	-1	-154
<b>Other external-sector indicators</b>									
Real effective exchange rate (index: 2000=100) <sup>h</sup>	102.5	100.1	100.7	100.0	103.0	100.8	101.8	107.0	109.6
Terms of trade for goods (index: 2000=100)	103.9	104.7	104.6	100.0	102.7	101.6	97.2	95.3	93.5
Net resource transfer (percentage of GDP)	7.1	4.4	5.7	0.0	1.7	-0.3	-3.9	-2.2	1.3
Gross external public debt (millions of dollars)	5 051	5 349	5 568	5 604	6 263	6 349	6 504	7 219	7 580
Gross external public debt (percentage of GDP)	50.1	48.9	48.6	48.2	53.0	51.7	50.3	50.8	48.8
Net profits and interest (percentage of exports) <sup>i</sup>	-4.8	-6.3	-9.7	-7.2	-7.4	-3.6	-9.8	-11.8	-11.0
	<b>Average annual rates</b>								
<b>Employment</b>									
Labour force participation rate <sup>j</sup>	61.5	62.2	61.2	59.9	60.5	62.6	62.8	63.3	63.6
Unemployment rate <sup>k</sup>	13.4	13.6	11.8	13.5	14.0	13.5	13.1	11.8	9.6
	<b>Annual percentages</b>								
<b>Prices</b>									
Variation in consumer prices (December-December)	-0.5	1.4	1.5	0.7	0.0	1.9	1.5	1.5	3.4
Variation in real minimum wage	-1.3	2.7	3.4	3.8	7.0	-1.2	0.7	0.9	-3.0
Nominal deposit rate <sup>l</sup>	...	6.8	6.9	7.1	6.8	5.0	4.0	2.2	2.7
Nominal lending rate <sup>m</sup>	...	9.9	10.1	10.3	10.6	9.2	8.9	8.2	8.2

Table 1 (concluded)

	1997	1998	1999	2000	2001	2002	2003	2004	2005 <sup>a</sup>
	<b>Percentages of GDP</b>								
<b>Central government</b>									
Total income <sup>n</sup>	16.6	16.2	17.0	18.2	17.7	16.8	15.4	14.4	15.1
Current income	15.8	15.6	16.9	18.1	17.2	16.1	15.2	14.2	15.0
Tax revenue	10.3	10.1	10.6	9.6	8.8	8.6	8.7	8.5	8.6
Capital income	0.0	0.0	0.0	0.0	0.5	0.7	0.3	0.1	0.0
Total expenditure	16.9	20.4	19.0	19.3	19.4	18.8	19.2	19.8	19.0
Current expenditure	14.7	16.4	15.6	16.9	16.7	16.1	16.1	16.6	16.5
Interest	3.0	2.9	3.5	4.2	4.2	4.1	4.3	4.2	5.1
Capital expenditure	2.2	3.9	3.4	2.4	2.7	2.7	3.1	3.2	2.5
Primary balance	2.7	-1.3	1.6	3.1	2.6	2.2	0.5	-1.2	1.2
Overall balance	-0.3	-4.2	-2.0	-1.1	-1.7	-1.9	-3.8	-5.4	-3.9
Central government debt	63.4	62.0	66.0	65.5	70.1	69.0	66.6	70.0	66.6
Domestic	17.2	15.9	18.4	18.0	17.7	17.7	16.7	19.4	17.2
External	46.2	46.1	47.6	47.5	52.4	51.3	49.9	50.5	49.4
<b>Money and credit</b>									
Domestic credit <sup>o</sup>	63.4	70.1	82.0	92.5	95.6	92.5	87.1	84.5	83.0
To the public sector	-6.8	-7.6	-7.7	-7.3	-9.7	-7.4	-4.8	-1.5	-2.6
To the private sector	70.2	77.7	89.7	99.8	105.3	99.9	91.9	86.1	85.6
Liquidity (M3) <sup>p</sup>	58.1	61.0	65.8	70.2	75.3	76.3	73.3	72.1	69.5

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

<sup>a</sup> Preliminary figures. <sup>b</sup> Based on figures in local currency at constant 1996 prices. <sup>c</sup> Based on figures in local currency expressed in dollars at current prices. <sup>d</sup> Includes errors and omissions. <sup>e</sup> Refers to the capital and financial balance (including errors and omissions), minus net foreign direct investment. <sup>f</sup> A minus sign (-) denotes an increase in reserves. <sup>g</sup> Includes the use of IMF credit and loans and exceptional financing. <sup>h</sup> Annual average, weighted by the value of merchandise exports and imports. <sup>i</sup> Refers to net investment income as a percentage of exports of goods and services as shown on the balance of payments. <sup>j</sup> Economically active population as a percentage of the working-age population; nationwide total. <sup>k</sup> Unemployment rate as a percentage of the economically active population, nationwide total. Includes hidden unemployment. <sup>l</sup> Six-month deposits in the local banking system. <sup>m</sup> One- to five-year loans for commercial activities in the local banking system. <sup>n</sup> Includes grants. <sup>o</sup> Refers to net credit extended to the public and private sectors by commercial banks and other financial and banking institutions. <sup>p</sup> End-of-period figures.

### 3. The main variables

#### (a) Economic activity

Although the 6.4% growth rate was below the 7.6% recorded in 2004, it nevertheless represented a continuation of the expansionary phase of the business cycle, which could last for at least another five years, thanks to the project to widen the Panama Canal, which will require US\$ 5.25 billion in investment. In addition, plans have been announced to build two oil refineries in the next few years, which would involve several billion dollars in investment. Lastly, over US\$ 3.0 billion is to be invested in various tourism and real estate projects and the construction of a mega-port on the Pacific coast.

In 2005, growth was driven by external demand (up 14%), while domestic demand was less buoyant (6%). Gross domestic investment expanded by around 6%, mainly on the back of private investment, while the public component stood still. A similar pattern occurred

in consumption, with the private component up by 6.3% and the public component by only 1%. This pattern is now in its second year and is the result of efforts to rehabilitate public finances. In the first quarter of 2006, GDP grew by 7.9%.

Agriculture recorded an expansion of 2.9%, mainly thanks to buoyant non-traditional exports (melon, watermelon, pineapple and cattle on the hoof). Traditional export products, on the other hand, returned negative figures or stood still. Results were good in the production of beef and pork livestock, vegetables and cereals for the domestic market, while growth in the fishing sector remained low (2.6%).

Mining and construction both posted a meagre expansion (0.4% and 1%, respectively). The lacklustre performance of construction was the result of a strike over the social security reform, which paralysed the sector for an entire month. The manufacturing industry

Table 2  
**PANAMA: MAIN QUARTERLY INDICATORS**

	2004				2005 <sup>a</sup>				2006 <sup>a</sup>	
	I	II	III	IV	I	II	III	IV	I	II
Gross domestic product (variation from same quarter of preceding year) <sup>b</sup>	5.6	10.6	9.1	5.1	7.5	6.2	6.8	5.1	7.9	...
International reserves (millions of dollars)	974	792	469	631	1 039	1 139	894	1 211	1 193	1 235 <sup>c</sup>
Real effective exchange rate (index: 2000=100) <sup>d</sup>	105.9	106.2	106.7	109.2	109.8	109.7	109.7	109.1	110.3	110.7
Consumer prices (12-month percentage variation)	1.0	1.9	1.7	1.5	3.0	2.4	3.5	3.4	2.0	3.0
Average nominal exchange rate	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00
Nominal interest rates (annualized percentages)										
Deposit rate <sup>e</sup>	2.3	2.2	2.2	2.2	2.6	2.7	2.8	2.7	3.1	3.5
Lending rate <sup>f</sup>	8.4	8.0	8.0	8.5	8.5	8.3	8.1	8.0	8.2	8.1
Interbank interest rate <sup>g</sup>	1.6	1.7	2.1	2.2	2.7	3.0	3.3	3.5	3.9	...
Domestic credit (variation from same quarter of preceding year) <sup>h</sup>	4.4	8.5	8.8	9.9	5.8	6.5	8.4	9.4	14.8	14.0 <sup>i</sup>
Non-performing loans as a percentage of total credit <sup>j</sup>	2.6	1.9	1.9	1.7	2.0	1.9	1.9	1.7	1.6	...

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

<sup>a</sup> Preliminary figures. <sup>b</sup> Based on figures in local currency at constant 1996 prices. <sup>c</sup> Data to May. <sup>d</sup> Quarterly average, weighted by the value of merchandise exports and imports. <sup>e</sup> Six-month deposits in the local banking system. <sup>f</sup> Préstamos para actividades comerciales, a un año de plazo de la banca panameña. <sup>g</sup> 30-day rate. <sup>h</sup> Refers to net credit extended to the public and private sectors by commercial banks and other financial and banking institutions. <sup>i</sup> Data to April. <sup>j</sup> Refers to total credit extended by the multibanking system.

has been restructuring for over ten years to adapt from a high protection environment to a more open one, and this was reflected in growth of 1.8%.

Electricity, gas and water expanded by 2.8%. This was well below the figure of 10.9% returned in the transport, storage and communications sector which was driven, in turn, by a 12.2% increase in port activity (mainly thanks to movements of container freight). As for land transport, railway freight activity surged by an extraordinary 128%. This trend continued in the first quarter of 2006, with a growth rate of 102%. Air transport increased by 18%, with the continued expansion of Copa airlines and the renovation of Tocumen airport strengthening Panama's position as a regional air transport hub.

Panama Canal activities climbed by 4%, which was the result of a slight reduction in the number of transits but an increase in the size of vessels. The financial balance was much improved (11.9%) by the higher tolls. Total income exceeded US\$ 1.0 billion for the first time ever in the 2005 fiscal year and this trend continued into the first six months of 2006, with a 4.5% rise in transits of Panamax ships (the largest vessels the Panama Canal can accommodate) and a 17% increase in container ship tonnage.

Commerce, restaurants and hotels also posted buoyant growth, of 9.3%. Retail performance was average (4.5%), although this was compensated by a 13.1% expansion in the activity of the Colón Free Zone. This pattern

has continued in the first four months of 2006. Tourism continued to boom as tourist spending climbed by 19.8% and arrivals by 17.9%.

Financial institutions, insurance, property and services expanded by 7.9%, with growth of 16.4% in the banking sector alone. The balance for personal, community and social services (1.4%) was affected by a 0.7% decrease in governmental services.

#### (b) Prices, wages and employment

Price trends were markedly unfavourable. The consumer price index (CPI) was up by 2.9% as an annual average in 2005, compared with 0.5% the previous year. Although this figure is low for developing countries in general, it is nonetheless relatively high compared to the usual patterns in Panama's economy. In December 2005, inflation stood at 3.4%. Food and beverages (4.8%) played the most significant part in the overall increase, closely followed by housing, water, electricity and gas (4.7%) and transport (3.8%). The increase in transport prices reflected higher international prices for petroleum and petroleum products.

The wholesale price index climbed by 5.7%, compared with 4.4% the previous year. The increase was due to higher import prices (10.4%), as industrial prices rose by only 1.6% and agricultural prices fell by 0.2%. The fact that wholesale prices affect retail prices, combined with

continuingly high oil prices, suggests that inflation will remain high in 2006. This is confirmed by data from the first four months of the year, with 12-month consumer price inflation of 2.9% and a rise of 6.9% in the wholesale price index.

Although minimum wages are usually adjusted every two years, no adjustment was made in 2004 or 2005. A wage hike came in 2006, with an 8% increase from April. Labour-market indicators improved considerably as the unemployment rate dropped from 11.8% to 9.6% and the number of employed increased by 5%.

### (c) The external sector

The buoyancy of the world economy fuelled strong growth not only in Panama's traditional economic specialty of services, but also in merchandise exports. This narrowed the current account deficit from the equivalent of 7.9% of GDP to 5.3%. The financial account recorded large inflows of US\$ 1.49 billion from banking operations and foreign direct investment (FDI).

Robust growth of merchandise exports (17%), combined with a more moderate increase in imports (11%), helped to shrink the merchandise trade deficit. Re-exports from the Colón Free Zone, which represent the bulk of goods exports, grew by around 20% for the second consecutive year.

National exports expanded by 8.3%, which is slightly less than the 10.5% growth recorded the previous year.

Good performances were recorded for sugar (128%) and fruit such as watermelon and pineapple (68%). Lobster, shrimp and other sea products also fared well, while banana exports declined for the sixth year running (-10.8%). For 2006, agricultural exports are expected to increase by more than 20%.

The pattern of merchandise imports contrasted with the export trend: free zone imports increased by 7%, while those to the rest of the country were up by 14.8%. Imports of consumer goods rose by 20%, reflecting the good overall state of the economy. Capital goods imports also expanded considerably (16.6%) thanks to strong private investment, while intermediate goods were up 8.6%.

The balance of trade in services recorded a fresh gain, as its surplus swelled from US\$ 1.275 billion in 2004 to US\$ 1.433 billion in 2005. Transport services expanded 15% thanks to buoyant international trade. Tourist services have been the fastest-growing item in recent years, however. The income and transfers balances deteriorated slightly.

Net inflows of FDI recorded in the financial account represented US\$ 1.027 billion, which was US\$ 15 million up on 2004. These large inflows reflect the abundant liquidity in international markets combined with the particular features of Panama's economy that make it attractive to investors: the use of the dollar as legal tender, its deep, sophisticated financial market and the legal certainty it offers. Hefty inflows were also recorded by banks, partly due to the establishment of new banking institutions in Panama.





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## The Caribbean



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## Bahamas

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### 1. General trends

Economic growth increased from 1.8% in 2004 to 2.7% in 2005, driven by tourism, construction and financial services.

Increased economic activity led to higher tax receipts and a subsequent narrowing of the fiscal deficit. Economic growth also resulted in increased demand for credit, a need that was satisfied by commercial banks.

While the improved economic performance did not bring down the unemployment rate, the labour market was able to absorb the increase in the labour force as the participation rate rose.

The balance of payments worsened: the overall balance was negative as the capital and financial account surplus failed to cover the growing current account deficit. The current account deficit is attributable to higher international

oil prices and the rise in imports in the face of increased economic activity.

For 2006, growth of 4.7% is expected to affect the balance of payments in the short term. Despite the hefty external debt that is worrying the authorities, no significant changes are expected in terms of fiscal policy. This continuation of the status quo is partly due to the fact that elections are scheduled for 2007.

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### 2. Economic policy

#### (a) Fiscal policy

The fiscal deficit narrowed from 2.5% of GDP in 2004 to 1.9% in 2005 thanks to increased tax revenues (19.1% of GDP in 2005 compared with 17% in 2004), which successfully offset the rises in expenditure (20.9% of GDP in 2005 compared with 19.4% in 2004).

The performance of total public revenues (including grants) is due to higher levels of economic activity, particularly the expansion of imports and higher levels of hotel occupancy. These factors then resulted in significant increases in income from tax on international transactions and trade (26%) and especially gaming taxes (88%).

Levels of current expenditure (18% of GDP in 2004 and 19% in 2005) are attributable to government purchases,

and more specifically to transfers and subsidies. Capital expenditure (1.5% of GDP in 2004 and 1.9% in 2005) was associated with infrastructure projects, including building construction, road maintenance and the repair of State schools.

The fiscal deficit was financed mainly through domestic borrowing. This pushed up total public debt by 6.5% to stand at US\$ 2.7 billion, equivalent to 46% of GDP. Foreign-currency debt (which includes domestic and external debt) contracted by 5.4% to stand at US\$ 531 million in 2005 (9% of GDP, down from 10% in 2004), of which over 50% is external public debt. Total external debt decreased from 6.1% of GDP in 2004 to 5.7% in 2005, while debt servicing fell from 3.4% of GDP in 2004 to 2.9% in 2005.

Table 1  
**BAHAMAS: MAIN ECONOMIC INDICATORS**

	1997	1998	1999	2000	2001	2002	2003	2004	2005 <sup>a</sup>
	<b>Annual growth rates<sup>b</sup></b>								
<b>Gross domestic product</b>	4.9	6.8	4.0	1.9	0.8	2.3	1.4	1.8	2.7
<b>Per capita gross domestic product</b>	3.3	5.2	2.5	0.4	-0.6	0.8	0.1	0.4	1.4
<b>Gross domestic product, by sector</b>									
Agriculture, livestock, hunting, forestry and fishing	0.1	-2.4	-6.8	8.8	-6.9	20.7	-4.8	-11.7	-9.3
Mining	5.1	-1.2	-22.3	11.6	3.4	0.2	13.5	3.8	15.8
Manufacturing	8.8	-4.0	-0.6	7.4	13.0	2.2	-0.6	-3.2	5.2
Electricity, gas and water	7.5	11.3	2.4	0.2	11.3	3.6	5.7	2.4	4.3
Construction	32.0	21.2	8.3	13.3	-13.3	6.2	2.5	-7.4	6.2
Wholesale and retail commerce, restaurants and hotels	0.8	8.2	11.4	-3.4	4.9	-8.7	3.1	-0.3	2.7
Transport, storage and communications	4.1	12.4	0.7	10.4	-5.3	3.8	1.0	0.6	-0.3
Financial institutions, insurance, real estate and business services	12.1	10.7	9.1	5.4	3.1	1.1	3.8	4.0	3.5
Community, social and personal services	5.6	-0.6	-0.9	-7.4	-3.4	4.7	9.4	1.3	3.5
<b>Gross domestic product, by type of expenditure</b>									
Consumption	6.0	8.6	5.1	1.3	4.4	-1.0	3.3	1.9	0.7
General government	6.3	-0.8	-1.8	-4.9	3.8	9.1	4.9	1.2	2.7
Private	6.0	10.5	6.3	2.3	4.5	-2.6	3.0	2.0	0.3
Gross domestic investment	28.7	19.9	-0.4	13.6	-7.4	-0.2	-0.2	1.5	3.0
Exports (goods and services)	1.4	0.3	7.0	5.2	-5.7	7.7	-1.2	10.7	6.2
Imports (goods and services)	21.0	12.1	6.1	10.4	-4.6	-1.0	2.1	6.2	4.4
	<b>Millions of dollars</b>								
<b>Balance of payments</b>									
Current account balance	-472	-995	-672	-471	-594	-423	-472	-305	-513
Merchandise trade balance	-1 116	-1 374	-1 428	-1 371	-1 340	-1 327	-1 331	-1 428	-1 625
Exports, f.o.b.	295	363	380	805	423	422	427	477	523
Imports, f.o.b.	1 411	1 737	1 808	2 176	1 764	1 749	1 757	1 905	2 148
Services trade balance	757	542	857	1 029	835	1 046	962	1 013	1 134
Income balance	-153	-198	-138	-173	-199	-184	-153	-141	-107
Net current transfers	39	34	37	43	110	42	49	251	85
Capital and financial balance <sup>c</sup>	529	1 115	737	410	564	484	583	489	424
Net foreign direct investment	210	146	144	250	102	153	190	274	360
Financial capital <sup>d</sup>	319	969	593	161	461	331	393	215	64
Overall balance	57	119	65	-61	-30	61	111	184	-89
Variation in reserve assets <sup>e</sup>	-57	-119	-65	61	30	-60	-110	-183	88
Other financing <sup>f</sup>	0.0	0.0	0.0	0.0	0.4	-0.6	-0.7	-0.3	0.8
<b>Other external-sector indicators</b>									
Net resource transfer (percentage of GDP)	-0.1	0.0	2.4	4.8	4.6	0.8	2.4	1.0	3.3
Gross external public debt (millions of dollars)	335	323	338	349	328	310	363	343	335
Gross external public debt (percentage of GDP)	8.7	7.5	7.2	7.0	6.4	5.8	6.6	6.1	5.7
Net profits and interest (percentage of exports) <sup>g</sup>	-8.1	-10.4	-6.3	-6.1	-8.9	-7.4	-6.1	-5.2	-3.5
	<b>Average annual rates</b>								
<b>Employment</b>									
Unemployment rate <sup>h</sup>	9.8	7.8	7.8	...	6.9	9.1	10.8	10.2	10.2
	<b>Annual percentages</b>								
<b>Prices</b>									
Variation in consumer prices (December-December)	0.8	1.5	1.5	1.1	2.6	1.8	2.0	2.1	1.8
Nominal deposit rate <sup>i</sup>	...	...	...	...	...	...	3.9	3.8	3.2
Nominal lending rate <sup>j</sup>	...	...	...	...	...	...	12.0	11.2	10.4
	<b>Percentages of GDP</b>								
<b>Central government<sup>k</sup></b>									
Total income	19.9	18.8	19.8	19.1	16.7	16.7	17.2	17.0	19.1
Current income	19.9	18.8	19.8	19.1	16.7	16.7	16.9	16.7	18.8
Tax revenue	17.3	17.0	18.1	17.1	15.0	15.1	15.1	15.1	16.8
Capital income <sup>l</sup>	...	...	...	...	...	...	0.3	0.3	0.2
Total expenditure	20.9	19.7	19.8	18.6	19.5	19.4	19.5	19.4	20.9
Current expenditure	18.6	17.4	17.4	16.9	17.5	17.9	18.1	18.0	19.0
Interest	2.5	2.3	2.0	1.8	2.0	1.9	2.1	2.0	2.1
Capital expenditure	2.4	2.2	2.4	1.7	2.0	1.6	1.5	1.5	1.9
Primary balance	1.4	1.4	2.0	2.3	-0.8	-0.8	-0.3	-0.5	0.2
Overall balance	-1.0	-0.9	0.0	0.5	-2.8	-2.7	-2.4	-2.5	-1.9
External public debt	8.7	7.5	7.2	7.0	6.4	5.7	6.6	6.1	5.7
<b>Money and credit</b>									
Net domestic credit	70.9	74.1	75.3	78.9	84.5	86.8	85.5	89.4	91.8
To the public sector	13.0	12.7	13.3	13.1	13.4	15.5	14.8	16.0	15.7
To the private sector	58.0	61.4	62.1	65.8	71.2	71.3	70.7	72.1	76.1
Liquidity (M3)	62.0	63.2	65.4	67.9	70.8	69.3	71.2	75.3	79.5
Currency in circulation and local-currency deposits (M2)	61.1	62.0	64.2	66.5	69.4	69.3	69.4	73.4	77.2
Foreign-currency deposits	0.9	1.2	1.2	1.4	1.4	0.0	1.8	1.9	2.2

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

<sup>a</sup> Preliminary figures. <sup>b</sup> Based on figures in local currency at constant 1991 prices. <sup>c</sup> Includes errors and omissions. <sup>d</sup> Refers to the capital and financial balance (including errors and omissions), minus net foreign direct investment. <sup>e</sup> A minus sign (-) denotes an increase in reserves. <sup>f</sup> Includes the use of IMF credit and loans and exceptional financing. <sup>g</sup> Refers to net investment income as a percentage of exports of goods and services as shown on the balance of payments. <sup>h</sup> Unemployment rate as a percentage of the economically active population, nationwide total. Includes hidden unemployment. <sup>i</sup> Weighted average of interest rate on deposits. <sup>j</sup> Weighted average of interest rate on loans and overdrafts. <sup>k</sup> For the period 1997-2003, information refers to the fiscal year. <sup>l</sup> Includes grants.

In 2006, current revenue is projected to rise by 11% as a result of increased economic activity. Current expenditure will climb by 14% owing to debt servicing (33%), while capital expenditure will expand by 19%. This could negatively affect the fiscal situation and push up the country's level of indebtedness.

### **(b) Monetary and exchange-rate policy**

In 2005, the authorities eased the monetary stance following the large build-up of excess liquidity in the banking system during 2004. The discount rate for open-market operations was reduced from 5.5% to 5.25% in February 2005. Commercial banks therefore reduced their prime lending rate from 6% to 5.5%, thereby reducing the interest rate spread from 7.4% in 2004 to 7.15% in 2005. This, in turn, pushed up demand for credit to 13% (compared with 5% in 2004).

Most loans (83%) were for the private sector. Personal loans increased (14%), with the highest growth rates

recorded in consumer credit and residential mortgages (12% and 17%).

Buoyant demand for credit, combined with import growth, facilitated the reduction of commercial banks' excess liquidity (US\$ 156 million). This was in contrast with the US\$ 157 million inflows from operations related to natural disasters. The result was a 13% contraction in external reserves, which at year end represented the equivalent of 19.5 weeks of non-oil merchandise imports (compared with 23.3 weeks in 2004).

So far in 2006, the surge in commercial banks' excess liquidity (which is double the level observed in 2005) has forced the monetary authorities to implement additional measures to stimulate activity in the inter-bank market. The authorities relaxed restrictions on capital transactions in foreign currency by reducing the premium levied on such operations. They also reduced the refund on repatriation of invested capital from 20% to 10%, and introduced an allowance for investments of Bahamians abroad.

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## **3. The main variables**

### **(a) Economic activity**

Economic activity expanded moderately (2.7% in 2005 compared with 1.8% in 2004), on the basis of tourism, construction and financial services. Growth is expected to be 4.7% in 2006.

In 2005, total tourist arrivals edged up slightly (0.9% as opposed to 8.9% in 2004), mainly owing to the effects of hurricanes Katrina, Rita and Wilma on the United States (the country's main tourist market). Cruise arrivals decreased marginally (0.3%) in 2005, while stopover visitors increased by 4.4%.

Accordingly, tourist spending heightened by 9.9% to stand at US\$ 2.1 billion. Per capita spending of stopover visitors rose by 6.5% to US\$ 1,244 in 2005. Hotel industry earnings strengthened as a result of increased occupancy rates (70% up from 66% in 2004) and higher room rates (up 4%).

Growth in tourism is expected to pick up pace in 2006. Changes in United States tax legislation will benefit the country: from 2006, United States companies will be able to make tax deductions against conferences hosted in the Bahamas. The country will also continue to benefit from increased competition in the airline industry, which has

reduced the effect of higher oil prices on transport costs. Lastly, the Atlantis tourist complex is due to complete its Phase III expansion in New Providence in 2006, after which major construction is expected to begin in Cable Beach.

Construction activity picked up thanks to increased investment in tourism and to reconstruction projects in the wake of the natural disasters that struck the country in 2004. The number of residential mortgage commitments increased by 61%, and those for commercial mortgage commitments by 98%.

### **(b) Prices, wages and employment**

Cumulative inflation at December 2005 was 1.8% (compared with 2.1% in December 2004). This was mainly attributable to a 1.6% decline in clothing and footwear and the small increase in transport and communications (-0.2%), as airline competition neutralized the rise in international fuel prices. Other major components, such as food and rentals, increased by 2.9% and 3.2% respectively.

The unemployment rate remained stable at 10.2%. The labour force increased by 1.3%, while the participation rate rose from 75.7% in 2004 to 76.3% in 2005. Construction is the largest employer (22% of the labour force), followed

by social and personal services, which employ 20% of the total.

**(c) The external sector**

The balance of payments posted a deficit of 1.5% in 2005, compared with 3.2% in 2004. This was because the capital and financial account surplus (equivalent to 7.2% of GDP, compared with 8.6% in 2004) was not sufficient to offset the considerable widening of the current account deficit (8.7% in 2005 compared with 5.4% in 2004).<sup>1</sup> Reserves therefore contracted by US\$ 88 million (compared to the US\$ 183 million increase in 2004).

The current account balance is attributable to the widening of the trade deficit, which was mainly due to

the higher oil bill, which represents 24% of international merchandise purchases. The increase in non-oil imports was another contributing factor, albeit a less significant one.

The positive balance in the services account (19.3% of GDP compared with 17.9% in 2004) reflected buoyant tourist activity, yet was only able to partially offset the merchandise trade deficit. The deficit on the income balance narrowed from 2.5% of GDP in 2004 to 1.8% in 2005, thanks to an improvement in the net creditor position of commercial banks.

The surplus on the capital and financial account is due to increased foreign direct investment flows to the tourism sector (6.1% of GDP in 2005 compared with 4.8% in 2004). Increases in share capital investments, private debt and real estate sales also contributed to this result.

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<sup>1</sup> Not including errors and omissions.

## Barbados

### 1. General trends

In 2005 Barbados recorded moderate economic growth (3.9%) compared with 2004 (4.8), owing to the decline in tourism, the mainstay of the country's economy. Construction, on the other hand, picked up significantly in relation to the previous year.

The fiscal stance was loosened slightly in 2005 and the overall fiscal deficit widened. Fiscal performance reflected a decline in the tax burden and increased expenditure. Despite lower GDP growth, inflation climbed to 7.4% in 2005 (compared with 4.3% in 2004), which reflected higher fuel prices and excess demand for construction materials.

The monetary authorities adopted a tight policy stance to combat rising inflation and moderate the effects of higher fuel prices on demand for imports. This

demand rose considerably and the resulting increase in the balance-of-payments current account deficit was not entirely offset by the surplus on the capital and financial accounts. The economy therefore experienced a loss in net international reserves.

Higher GDP growth (4.3%) is expected in 2006 as a result of the positive impact on tourism and construction of preparations for the 2007 Cricket World Cup. Larger revenues from tourism should cover the increased demand for imports of construction materials.

### 2. Economic policy

Economic policy was directed towards containing the surge in inflation and the balance-of-payments current account deficit. Structural reforms were also introduced to boost private-sector activity; these included the liberalization of the telecommunications market and strengthening of the programme to develop domestic production.

#### (a) Fiscal policy

The fiscal position deteriorated,<sup>1</sup> with the overall deficit increasing from 2.2% of GDP in 2004 to 4.0% in 2005. This was the combined effect of the smaller tax burden and increased expenditure fuelled by the extension of loans.

Tax revenues in current prices held steady. Personal income tax receipts decreased as a result of the downward revision of the tax rate from 40% to 37.5%, and an increase in the personal tax allowance from B\$ 8,750 to B\$ 10,000. Corporate tax takings, however, increased by

13%. Indirect taxes climbed thanks to higher receipts from excise taxes on some classes of motor vehicles, while the VAT intake stood still.

Total expenditure expanded (from 36% of GDP in 2004 to 37% in 2005), owing to higher spending on goods and services (3.6% and 3.9% of GDP in 2004 and 2005, respectively) and in net lending (from 0% of GDP in 2004 to 1.4% in 2005). These loans went mainly to small and medium-sized enterprises and the Barbados Tourism Investment Corporation (BTIC).

External public debt increased in 2005 and total central government debt rose from 78% of GDP in 2004 to 87% in 2005.

#### (b) Monetary and exchange-rate policy

Monetary policy in 2005 continued to be directed towards containing the widening balance-of-payments current account deficit, as the expansion in credit

<sup>1</sup> The fiscal outcome has been calculated on the basis of the calendar year to correspond with other macroeconomic data.

Table 1  
**BARBADOS: MAIN ECONOMIC INDICATORS**

	1997	1998	1999	2000	2001	2002	2003	2004	2005 <sup>a</sup>
	<b>Annual growth rates<sup>b</sup></b>								
<b>Gross domestic product</b>	4.6	6.2	0.5	2.3	-2.6	0.5	2.0	4.8	3.9
<b>Per capita gross domestic product</b>	4.2	5.9	0.2	2.0	-2.9	0.2	1.8	4.5	3.6
<b>Gross domestic product, by sector</b>									
Agriculture, livestock, hunting, forestry and fishing	-0.6	-13.3	9.5	3.7	-9.5	-4.2	-4.0	-5.7	3.5
Mining	-1.7	47.5	9.2	-8.4	-12.6	-6.6	-7.0	6.1	4.3
Manufacturing	3.8	3.4	-2.4	-0.5	-8.2	0.2	-0.7	1.9	2.9
Electricity, gas and water	3.8	9.1	5.0	0.0	3.7	1.8	2.8	2.2	5.0
Construction	14.2	16.9	10.0	1.1	6.8	7.7	0.6	2.8	13.4
Wholesale and retail commerce, restaurants and hotels	5.9	9.5	-4.6	4.8	-4.4	-0.6	5.2	7.6	1.0
Transport, storage and communications	2.9	6.7	4.3	0.9	0.6	-2.9	2.6	5.2	4.8
Community, social and personal services <sup>c</sup>	3.5	4.3	1.9	1.3	-1.2	1.6	0.6	4.9	4.5
	<b>Millions of dollars</b>								
<b>Balance of payments</b>									
Current account balance	-50	-63	-148	-145	-111	-168	-169	-337	-410
Merchandise trade balance	-599	-651	-714	-744	-681	-702	-801	-971	-1 069
Exports, f.o.b.	289	270	275	286	271	253	264	293	359
Imports, f.o.b.	888	921	989	1 030	952	955	1 066	1 264	1 428
Services trade balance	550	591	571	603	570	550	647	668	725
Income balance	-48	-56	-71	-82	-93	-102	-107	-122	-148
Net current transfers	47	52	66	78	93	86	92	88	82
Capital and financial balance <sup>d</sup>	54	55	182	324	326	145	237	180	342
Net foreign direct investment	14	15	16	18	17	17	58	-16	0
Financial capital <sup>e</sup>	40	40	166	306	309	128	179	196	342
Overall balance	4	-7	35	179	215	-23	67	-157	-68
Variation in reserve assets <sup>f</sup>	5	7	-35	-179	-216	23	-68	157	68
Other financing <sup>g</sup>	-8	1	1	1	1	1	1	1	0
<b>Other external-sector indicators</b>									
Real effective exchange rate (index: 2000=100) <sup>h</sup>	98.1	100.6	101.0	100.0	98.4	100.1	104.5	108.7	107.4
Gross external public debt (millions of dollars)	382	391	436	578	746	733	738	788	874
Gross external public debt (percentage of GDP)	17.3	16.5	17.6	22.3	29.3	29.6	27.4	28.0	29.3
Net profits and interest (percentage of exports) <sup>i</sup>	-3.8	-4.3	-5.4	-5.9	-7.0	-7.8	-7.5	-8.0	-8.5
	<b>Average annual rates</b>								
<b>Employment</b>									
Labour force participation rate <sup>j</sup>	67.8	67.8	67.8	68.6	69.5	68.4	69.2	69.5	69.6
Unemployment rate <sup>k</sup>	14.5	12.3	10.4	9.2	9.9	10.3	11.0	9.8	9.1
	<b>Annual percentages</b>								
<b>Prices</b>									
Variation in consumer prices (December-December) (annual average)	3.6	1.7	2.9	3.8	-0.3	0.9	0.3	4.3	7.4
Nominal deposit rate	...	...	...	...	...	...	2.8	3.0	3.7
Nominal lending rate	...	...	...	...	...	...	7.6	7.4	8.4
	<b>Percentages of GDP</b>								
<b>Non-financial public sector</b>									
Total income	32.6	32.5	31.4	32.9	34.3	34.6	34.5	33.7	32.8
Tax revenue	30.5	30.1	29.7	30.7	32.1	32.0	32.3	32.2	30.6
Total expenditure <sup>l</sup>	33.5	33.3	33.8	34.4	37.8	40.9	37.2	35.9	36.8
Current expenditure	27.5	28.1	28.4	29.0	31.6	33.7	32.2	32.1	31.6
Interest	4.3	4.3	4.6	4.6	5.4	5.4	5.0	4.8	4.7
Capital expenditure	5.8	5.4	5.3	5.4	5.8	7.2	5.0	3.8	3.8
Primary balance	3.4	3.5	2.2	3.1	1.9	-1.0	2.3	2.6	0.7
Overall balance	-0.9	-0.8	-2.4	-1.5	-3.5	-6.4	-2.7	-2.2	-4.0
External debt of the central government	15.9	14.3	15.7	19.8	26.7	27.2	24.8	23.7	25.6
<b>Money and credit</b>									
Domestic credit	...	...	...	...	...	...	68.1	72.7	79.7
To the public sector	...	...	...	...	...	...	17.5	20.4	20.4
To the private sector	...	...	...	...	...	...	50.6	52.3	59.3
Liquidity (M3)	83.7	81.9	87.1	87.4	95.4	110.3	110.6	121.5	120.4
Currency in circulation and local-currency deposits (M2)	76.1	75.0	79.2	80.7	88.3	101.3	100.7	110.7	110.3
Foreign-currency deposits	7.6	6.9	7.8	6.7	7.1	9.0	9.9	10.8	10.1

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

<sup>a</sup> Preliminary figures. <sup>b</sup> Based on figures in local currency at constant 1974 prices. <sup>c</sup> Includes financial institutions, insurance, real estate and business services. <sup>d</sup> Includes errors and omissions. <sup>e</sup> Refers to the capital and financial balance (including errors and omissions), minus net foreign direct investment. <sup>f</sup> A minus sign (-) denotes an increase in reserves. <sup>g</sup> Includes the use of IMF credit and loans and exceptional financing. <sup>h</sup> Annual average, weighted by the value of merchandise exports and imports. <sup>i</sup> Refers to net investment income as a percentage of exports of goods and services as shown on the balance of payments. <sup>j</sup> Economically active population as a percentage of the working-age population. <sup>k</sup> Unemployment rate as a percentage of the economically active population. Includes hidden unemployment. <sup>l</sup> Includes net lending.

helped to push up imports. Another policy objective was to maintain price stability in view of worsening inflation.

To this end, the Central Bank of Barbados tightened its monetary stance and raised the discount rate by 2.5 percentage points. This was backed up by three increases in the minimum deposit rate, which rose from 2.25% to 4.25% in the first nine months of the year.

At the same time, commercial banks hiked up the price of credit and the weighted average nominal rate on loans increased from 7.8% to 9.5%.

These measures, together with the decrease in the

stock of international reserves, slowed the growth rate of the money supply from 22.1% in 2004 to 6.8% in 2005 in the case of narrow money, and from 14.7% in 2004 to 9.2% in 2005 in the case of broad money, and checked the expansion in commercial banks' surplus liquidity. Nonetheless, overall credit posted an increase (especially private-sector credit).

The bulk of the increase in credit (over 45%) in 2005 corresponded to large personal loans, reflecting demand for mortgages and consumer durables, while credit to tourist enterprises recovered well and was up by over B\$ 77 million.

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### 3. The main variables

#### (a) Economic activity

The economic growth rate slowed down in 2005 as the tourist sector contracted. Sectors that fared better included agriculture, manufacturing and, especially, construction.

Tourism value-added fell by almost 4% after having made a comeback in 2004. Activities related to both the long-stay and the cruise-ship sectors suffered, in the former case partly because there was no English cricket tour in 2005, which always affects the number of visitors. The cruise-ship sector was affected by the home-porting of a number of cruise ships in the United States. Another negative factor is that Barbados is regarded as a costly destination.

The performance turned in by the construction sector (2.8% in 2004 and 13.4% in 2005) was the result of buoyant residential construction, work on a cricket stadium and other major infrastructure projects.

Agricultural output picked up (-5.7% and 3.5% in 2004 and 2005, respectively), with sugar production rising by 11.3% thanks to favourable weather conditions.

Similarly, the growth rate of manufacturing output (2.9%) was one percentage point higher than the previous year. For a long time, manufacturing was hampered by competitiveness problems stemming from high production costs and weak productivity. In 2005, however, increased demand for certain manufacturing products boosted overall value-added.

Activity in business and financial services expanded by over 4%, propelled by an increase in the registration of international businesses and offshore companies.

#### (b) Prices, wages and employment

Inflation climbed to 7.4% in 2005, compared with 4.3% in 2004. This was the result of higher international fuel prices (11.5%) which, in turn, pushed up the price of transport services by 9%. The overall impact was cushioned by food prices, however, which climbed by a moderate 4%, compared with 7% the previous year. The introduction of the import tax in September 2005 also contributed to the rise in inflation.

In the framework of the tripartite agreements, public-sector wages rose by 3% in 2005 (less than half the rate of inflation). Meanwhile, continued buoyancy in the labour-intensive construction sector helped to lower the unemployment rate (9.1%). This benefited male employment, since men form the bulk of the labour force in the construction sector.

#### (c) The external sector

The overall balance was in deficit by the equivalent of 2.3% of GDP, since the widening of the current account deficit (from 12% of GDP in 2004 to 13.8% in 2005) was not offset by the capital and financial account surplus (4.8% of GDP in 2004 and 11.9% in 2005).

The current account result reflects the rise in imports (from 44.9% of GDP in 2004 to 47.9% in 2005) resulting from greater demand for construction materials and a higher energy bill, which more than offset the increase in exports of manufactures, foodstuffs and beverages.

The surplus on the services account (23.8% and 24.3% of GDP in 2004 and 2005, respectively) swelled

despite the decline in tourist activity (27.6% in 2004 and 26.1% in 2005).

The capital and financial account performance was linked to the expansion of tourism capacity, infrastructure projects and preparations for the Cricket World Cup.

In 2006, the balance-of-payments position is expected to improve, with the overall deficit projected to stand at 1.2% of GDP. Moderate growth of imports (5%) will slow the increase in the merchandise deficit. Merchandise exports are expected to decline marginally, but this will be offset by an upturn in services, particularly tourism, thanks to the Cricket World Cup.

## Belize

### 1. General trends

The economy of Belize expanded at a more moderate rate of 3.1% in 2005, compared to 4.6% in 2004. This growth was driven by the buoyancy of tourism and fishing, which offset the contraction in construction and manufacturing and the stagnation of agriculture.

The widening of the fiscal deficit was mainly due to the considerable increase in debt servicing, despite the combined effects of tax increases, a cutback in capital spending and the rise in official grants and donations. The deficit was financed by expanding the external debt stock.

The monetary authorities adopted a restrictive policy in order to at least partially neutralize the impact of the

fiscal expansion on spending and the balance of payments.

The external sector posted a positive balance equivalent to 1.6% of GDP, mostly owing to the increase in the capital and financial account surplus, which more than compensated for the deterioration in the current account.

Projections for 2006 include growth of 2.5% and a fiscal deficit of less than 3% of GDP.

### 2. Economic policy

#### (a) Fiscal policy

The central government's deficit widened from 6% of GDP in 2004 to 6.4% in 2005 owing to the higher level of current spending and a drop in government revenues.

The downward trend in public revenues, which slipped from 25.3% of GDP in 2004 to 24% in 2005, was due to the contraction of capital inflows, as current income expanded from 22.3% of GDP in 2004 to 23.1% in 2005. The rise in tax revenues, was due to the increase in corporate taxes and taxes on consumption and trade, among others. Non-tax current income was higher because of the rise in licenses and the return of loans to the Belize Social Security Board.

Current expenditure climbed from 22.6% of GDP in 2004 to 25.1% in 2005, mainly owing to debt servicing (31% of total current expenditure) and, to a lesser extent, the increase in the public wage bill (10% of GDP) and purchases of goods and services.

Capital expenditure contracted (by 8.7% and 5.3% of GDP in 2004 and 2005, respectively) despite higher spending on infrastructure, which accounted for 52% of the total.

The widening of the fiscal deficit pushed up the external debt stock from 82.2% of GDP in 2004 to 84.3% in 2005.

The authorities hope to reduce the fiscal gap to a figure below 3% of GDP in 2006. This is based on the expectation of higher economic growth, as the government does not plan to introduce any further tax measures.

#### (b) Monetary and exchange-rate policies

In 2005, the monetary authorities adopted a contractionary policy in order to counteract the effect of the expansion of net external assets and public and private spending. International reserves were buttressed by increased external borrowing, bond issues, exports of traditional products and income from the sale of equity in Belize Telecommunications Limited.

As part of this strategy, in May 2005 the legal reserve requirements for commercial banks were raised from 7% to 8% for cash reserves and from 20% to 21% for assets. The commercial banks' lending capacity was also reduced, except for long-term loans of its liquid assets to the government. Lastly, the government agreed, together

Table 1  
**BELIZE: MAIN ECONOMIC INDICATORS**

	1997	1998	1999	2000	2001	2002	2003	2004	2005 <sup>a</sup>
<b>Annual growth rates<sup>b</sup></b>									
<b>Gross domestic product</b>	3.6	3.7	8.7	13.0	4.6	4.7	9.2	4.6	3.1
<b>Per capita gross domestic product</b>	1.0	1.2	6.2	10.4	2.3	2.4	6.9	2.4	1.0
<b>Gross domestic product, by sector</b>									
Agriculture, livestock, hunting, forestry and fishing	6.6	2.4	10.7	11.5	-0.4	0.5	38.9	9.2	0.3
Mining	-2.9	3.0	7.4	23.3	3.3	-5.4	0.0	5.7	3.2
Manufacturing	4.2	-3.8	6.5	24.2	-0.7	1.5	-0.4	12.1	-1.2
Electricity, gas and water	5.0	1.6	7.9	9.8	0.3	2.7	8.5	-1.5	0.6
Construction	-5.4	-2.3	16.6	38.9	1.3	3.7	-17.8	4.5	-5.6
Commerce, restaurants and hotels	5.3	8.7	9.8	12.1	8.3	3.8	3.8	2.9	8.1
Transport and communications	5.7	5.2	11.4	13.1	7.9	7.1	8.1	6.0	2.9
Financial institutions and insurance	3.0	3.5	13.1	17.3	6.3	17.7	16.9	4.3	4.6
Other services	0.8	3.5	1.2	4.4	4.2	4.0	5.0	1.4	-3.3
<b>Gross domestic product, by type of expenditure</b>									
Consumption	2.6	5.9	6.8	7.9	8.8	7.4	3.2	3.9	...
General government	4.0	2.1	-2.4	7.0	6.1	13.1	4.8	0.3	...
Private	2.3	6.7	8.6	8.1	9.3	6.4	3.0	4.6	...
Gross domestic investment	9.5	11.5	69.7	63.9	-17.1	-17.4	1.8	-14.2	...
Exports (goods and services)	13.2	5.1	13.0	8.7	4.0	8.7	13.2	-1.3	...
Imports (goods and services)	12.1	10.4	24.6	20.1	-0.8	2.6	2.1	-7.4	...
<b>Millions of dollars</b>									
<b>Balance of payments</b>									
Current account balance	-32	-60	-73	-162	-184	-166	-176	-150	-152
Merchandise trade balance	-90	-105	-114	-197	-209	-187	-207	-175	-238
Exports, f.o.b.	193	186	262	282	269	310	316	306	318
Imports, f.o.b.	283	291	376	478	478	497	522	481	556
Services trade balance	46	41	42	28	43	44	70	87	141
Income balance	-23	-32	-40	-53	-67	-69	-85	-114	-111
Net current transfers	35	36	40	60	48	47	46	51	56
Capital and financial balance <sup>c</sup>	33	46	100	213	181	160	146	119	170
Net foreign direct investment	8	13	96	23	61	25	-11	103	107
Financial capital <sup>d</sup>	25	33	4	190	120	135	158	16	63
Overall balance	1	-14	27	52	-3	-5	-30	-31	18
Variation in reserve assets <sup>e</sup>	-1	14	-27	-52	3	5	30	31	-18
<b>Other external-sector indicators</b>									
Net resource transfer (percentage of GDP)	1.5	2.0	8.2	19.3	13.2	9.9	6.2	0.5	5.3
Gross external public debt (millions of dollars)	...	230	254	430	486	577	754	851	933
Gross external public debt (percentage of GDP)	...	33.4	34.7	51.7	55.9	62.3	76.9	82.2	84.3
Net profits and interest (percentage of exports) <sup>f</sup>	-7.1	-9.8	-9.8	-12.2	-15.3	-14.1	-16.1	-21.0	-17.9
<b>Average annual rates</b>									
<b>Employment</b>									
Unemployment rate <sup>g</sup>	12.7	14.3	12.8	11.1	9.1	10.0	12.9	11.6	11.0
<b>Annual percentages</b>									
<b>Prices</b>									
Variation in consumer prices (December-December)	1.0	-0.8	-1.2	0.6	1.1	2.3	2.6	3.1	3.7
Nominal deposit rate <sup>h</sup>	6.6	6.4	5.8	5.4	4.4	4.3	4.8	5.2	5.3
Nominal lending rate <sup>i</sup>	16.3	16.5	16.3	16.0	15.5	14.8	14.4	13.9	14.3
<b>Percentages of GDP</b>									
<b>Central government<sup>j</sup></b>									
Total income	24.0	26.0	29.5	26.1	27.8	30.6	23.1	25.3	24.0
Current income	22.0	21.9	23.0	20.4	26.3	29.1	21.5	22.3	23.1
Tax revenue	19.7	19.7	17.4	17.8	23.9	26.7	18.9	20.2	20.7
Capital income	2.0	4.1	6.4	5.7	0.7	0.2	1.3	1.3	0.3
Total expenditure	25.2	27.7	32.9	31.8	39.4	34.2	34.1	31.3	30.4
Current expenditure	19.3	19.2	19.9	17.9	30.7	27.0	20.0	22.6	25.1
Interest	1.9	1.8	2.1	2.5	10.1	6.4	3.9	5.9	7.7
Capital expenditure	5.9	8.5	13.1	14.0	8.7	7.2	14.1	8.7	5.3
Primary balance	0.6	0.1	-1.4	-3.2	-1.5	2.8	-7.1	-0.2	1.3
Overall balance	-1.3	-1.7	-3.5	-5.7	-11.6	-3.6	-11.0	-6.0	-6.4
Public debt total	...	...	...	...	66.4	74.3	92.5	109.2	96.9
Domestic	...	...	...	...	10.2	11.8	12.6	12.7	12.9
External	...	33.4	34.6	51.6	56.2	62.5	79.9	96.5	84.0
<b>Money and credit</b>									
Domestic credit	47.5	49.4	51.9	49.6	50.8	53.6	53.8	59.1	58.3
To the public sector	7.9	8.0	8.8	9.7	9.3	8.3	4.8	10.2	5.9
To the private sector	39.6	41.5	43.1	39.9	41.5	45.3	49.0	51.7	52.4
Liquidity (M3)	52.6	53.7	54.9	53.9	58.1	57.4	56.4	56.3	58.8

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

<sup>a</sup> Preliminary figures. <sup>b</sup> Based on figures in local currency at constant 2000 prices. <sup>c</sup> Includes errors and omissions. <sup>d</sup> Refers to the capital and financial balance (including errors and omissions), minus net foreign direct investment. <sup>e</sup> A minus sign (-) denotes an increase in reserves. <sup>f</sup> Refers to net investment income as a percentage of exports of goods and services as shown on the balance of payments. <sup>g</sup> Unemployment rate as a percentage of the economically active population, nationwide total. <sup>h</sup> Saving rate. <sup>i</sup> Weighted average rate for loans. <sup>j</sup> Up to 2003, indicators for income, expenditure and balances correspond to the fiscal year.

with the Belize Social Security Board, to sterilize the expansionary effect of its liquid income flow.

This monetary policy stance moderated the growth of monetary aggregates. The narrow money supply expanded by 4%, compared to 13% in 2004, while broad money grew by 7% (13% in 2004). Consequently, interest rates

for loans rose by 10 basis points, to 8.9%. The interest rate hike dampened the demand for credit (19.7% and 4.2% in 2004 and 2005).

In 2006, the central bank has maintained its restrictive policy, raising the legal reserve requirement for commercial banks by one percentage point.

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### 3. The main variables

#### (a) Economic activity

In 2005, the 3.1% expansion in economic activity (compared to 4.6% in 2004), was driven by tourism, transport and communications and distribution sectors.

The tourism sector, the spearhead of the economy, grew by 3.5%, with a 3% increase in the number of long-stay visitors, thanks at least in part to the expansion of hotel and air transport capacity. The number of cruise passengers, which has much less impact on the economy, was down.

The performance of the construction industry reflected the completion of hydroelectric infrastructure projects and the cutback in government capital spending.

Manufacturing declined by 1.2% owing to the closure of operations in the sugar industry and the poor performance of most products intended for the domestic market, while a rise in taxes discouraged consumption. This contraction in manufacturing was softened by growth in the output of concentrated juices.

Agriculture stagnated, with growth of scarcely 0.3%, compared to 9.2% the previous year. This poor performance was due to a variety of factors, including: adverse weather conditions, as in the case of sugar; lower prices for some traditional crops, such as bananas; a decrease in the lobster industry's production capacity and in some other activities; and pests, including outbreaks affecting forestry activities. These factors were exacerbated by increased production costs due to higher international energy prices.

#### (b) Prices, wages and employment

The inflation rate rose from 2.8% in 2004 to 3.1% in 2005 as a consequence of higher international oil prices, utility rates and taxes. A breakdown of the consumer price index (CPI) shows that the categories of transport and communications; food, beverages and tobacco; and rent, water and fuel posted the highest increases (5.7%, 4.7% and 4.2%, respectively).

The unemployment rate continued its downward trend. In 2005 it amounted to 11%, compared to 11.6% in 2004, despite a 2% expansion of the labour force. The sectors where job creation grew most rapidly were tourism, public services, and community, social and personal services (16.2%, 21.6% and 11.5%, respectively).

#### (c) The external sector

The overall balance showed a positive result of 1.6% of GDP (-3% in 2004), as the current account deficit was easily financed by the capital and financial account surplus. Net international reserves expanded accordingly.

The trend in the current account reflected the strong performance of the services account (thanks to the tourism boom), but the trade gap actually widened. The increase in the overall trade deficit was attributable to the rise in the value of merchandise imports associated with the country's hefty energy bill, in addition to the stagnation of exports. External sales were hurt by the drop in volume of the country's main traditional exports and by a decline in the average export price for lobsters.

The balance on the capital and financial account reflected the increase in the government's liabilities associated with the refinancing of its net loan balances.



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## Cuba

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### 1. General trends

According to data from Cuba's National Statistical Office, the country's economy grew by 11.8% (compared with 5.4% in 2004), thanks to improved availability of foreign exchange, the rising value of nickel exports, and growth in tourism services; the latter was particularly boosted by the sale of professional services to the Bolivarian Republic of Venezuela, generating income which helped to pay the oil bill. All this was despite adverse weather conditions, including the worst drought in a century and three hurricanes which created direct and indirect damage estimated by the government at US\$ 3.661 billion (7.9% of GDP in 2005).

For the third consecutive year there were surpluses on both the current account (US\$ 7 million) and the balance-of-payments capital account (US\$ 500 million), which boosted foreign reserves, providing improved protection against possible external shocks.

Goods and services imports (35.2%) grew faster than exports (19.3%); family remittances declined and net factor service payments rose.

The fiscal gap widened from 3.5% in 2004 to 4.2% in 2005 and there was a sizeable increase in cumulative monetary liquidity (M2) in the hands of the population (35.5%), although inflation was not affected (3.7%). Fixed-term deposits were up by 76%.

The Government estimates that growth in 2006 will exceed 10%, thanks to growing trade with the Bolivarian Republic of Venezuela and China. Oil and gas extraction is expected to rise, and an increase of about 70% is planned

in public investments, with priority for social programmes, housing, the energy sector, tourism and nickel.

Agricultural output is also expected to grow. Sugar production should hold steady at its 2005 level, but 4.6% growth is expected in the non-sugar sector. A growth rate of 15% is projected in construction and transport, and the numbers of foreign tourists and gross tourism revenue are also forecast to rise (10% and 8%, respectively).

Official estimates point to another current account surplus, resulting from an increased trade surplus, but partly counteracted by increased net factor service payments and reduced current transfers. Exports are expected to rise by 17.7% and imports to fall by 1.5%. The capital-account surplus will also help to boost international reserves.

The fiscal gap is expected to fall to 3.4% of GDP, and retail sales should be up 26% thanks to increased supply of goods and services to the population.

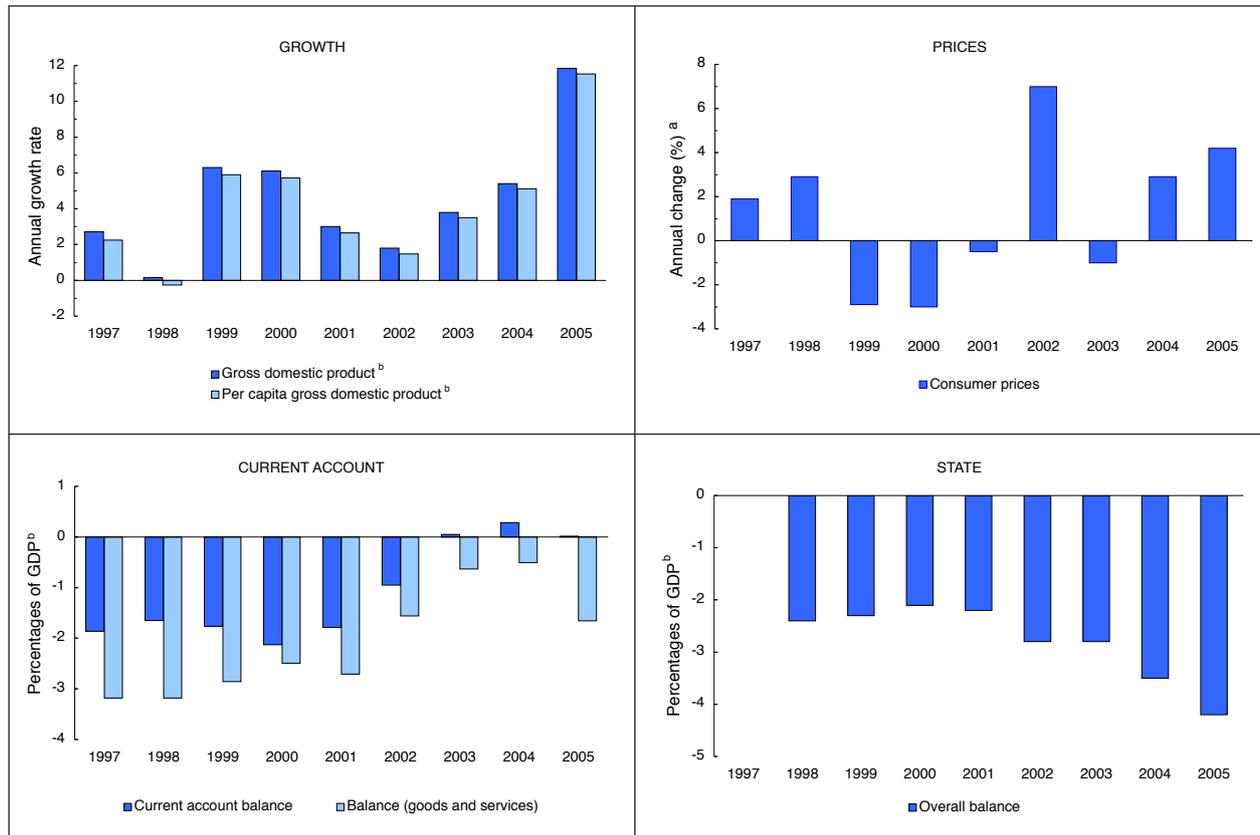
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### 2. Economic policy

The Cuban economy has various strengths and weaknesses which have to be taken into account in formulating economic policy. The strengths include highly skilled human resources, and the universal provision of basic services such as education, health care, culture and sport. However, the economy suffers from weaknesses such as the lack of efficiency in the use of available resources

and poor business management. These are reflected in the country's external financial deficit, although there have been some improvements. The crisis in the sugar industry is another factor, together with the lack of modern technology in production facilities resulting from several years of low investment, and the terms of trade have worsened, mostly because of increasing world prices

Figure 1  
CUBA: MAIN ECONOMIC INDICATORS



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

<sup>a</sup> December-December variation.

<sup>b</sup> From 2000, the data used came from the new calculations of the National Statistical Office of Cuba.

for oil and foodstuffs. The functioning of the economic system is also hindered by market segmentation and the duality of monetary and price structures. Legal restrictions on own-account work do nothing to improve the supply of goods and services to the population, stimulate job creation or increase tax revenue.

Economic policy in 2005 focused on fighting corruption, restructuring the electric-power sector, rehabilitating transport, mitigating the effects of drought, the housing and food programme, job creation, raising public-sector wages and retirement pensions, improving household consumption levels, intensifying social programmes, repairing and modernizing hospitals and polyclinics, centralized control of foreign exchange, strengthening control over external trade and diversifying it geographically, and reforming the system of regulated distribution of goods and services at subsidized prices.

Increased import capacity, resulting from the greater availability of foreign exchange, has paved the way

for improvements in the supply of goods and services in response to higher wages and pensions, and in the relative price structure through reduced subsidies and price increases for electric power and other goods and services. This policy was pursued in order to avoid more acute shortages of goods and services, expansion of the informal market, and a decline in labour productivity.

#### (a) Fiscal policy

Revenue increased by slightly less than expenditure (24.3% and 25.2%, respectively), leading to a larger fiscal deficit. Fiscal revenue was boosted by improved production; current income rose by 23.7%, but capital income stagnated. Tax revenue grew more slowly (17.3%) than non-tax revenue (40.7%).

Receipts from indirect taxes rose faster (22.8%) than those from direct taxes (9.7%). Circulation and sales tax receipts were up 24.1%, but service tax receipts by only 10.2%.

Within direct taxes, social security contributions increased by 14.9%, receipts from the tax on the utilization of the labour force by 8.2%, and those from profit taxes by 6.9%.

On the expenditure side, capital outlays rose faster (39.2%) than current expenditure (23.4%). In accordance with the social content of fiscal policy, the largest spending increases were on social welfare (67.9%), social security (34.5%), sport (26.3%), health care (24.3%), culture and the arts (18.2%), education (14.3%) and housing and community services (12.7%).

Particularly noteworthy in the category of transfers to the business and cooperative sector, which increased at the same rate as current expenditure, were economic assistance to basic cooperative production units (196.7%) and compensation for losses (18.4%).

Increases to social-security and social-welfare pensions implemented in April 2005 involved additional spending equivalent to 2.6% of GDP.

### **(b) Monetary and exchange-rate policy**

In 2005, monetary policy focused on implementing the measures adopted in 2004 as part of the institutional reform, including centralized control of foreign currency and the strengthening of the national currency. As of November 2004 cash transactions in United States dollars were prohibited and the circulation of the convertible peso was extended nationwide, to protect national sovereignty in monetary policy. A 10% commission will be charged for changing dollars into convertible pesos.

As of 18 March 2005, the exchange rate in the parallel market was cut from 26 to 24 non-convertible Cuban pesos (CUP) for the sale of convertible pesos or United States dollars, for personal transactions in the network of State

currency exchange offices, and from 27 to 25 pesos for personal purchases of convertible pesos.

On 9 April 2005 the convertible peso was revalued by 8% against all foreign currencies, including the United States dollar and the euro.

The purchasing power of the Cuban currency has strengthened, and the authorities have announced that they will continue to revalue it gradually until monetary unification is achieved. As a result, the population's bank balances in dollars declined by 57% in 2005, balances in convertible pesos more than tripled and those in Cuban pesos increased by 35%.

The new monetary policy has had a variety of results. First, international reserves have increased and have been concentrated in the Central Bank of Cuba, giving the financial system improved security. There is now greater control and efficiency in the use of resources, and Cuba's financial institutions have more liquidity and are more solvent.

The centralization of the State's foreign-currency income has facilitated the payment of external debt and of obligations arising out of new external financial commitments. There is more precision in the measurement of the money supply, facilitating decision-making to protect monetary and financial stability.

Similarly, the authorities have improved the use of the banking system for domestic and external financial transactions, and the use of United States dollars in cash inflows to Cuba has fallen from 80% to 30%. Euros, Canadian dollars and pounds sterling are now more widely used.

Lastly, exchange control has been consolidated, leading to improved commercial and financial discipline and greater efficiency in spending.

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## **3. The main variables**

### **(a) Economic activity**

According to official statistics, GDP rose by 11.8% in 2005, the best figure seen in recent decades, compared with 5.4% in 2004. Investment grew faster than consumption, and was particularly strong in the energy sector, the nickel industry, education, health and international tourism services, and works implemented to mitigate the impact of the severe drought affecting the country.

Government consumption increased more than private consumption. Despite a fall in family remittances, household consumption rose because of salary increases.

The National Statistical Office reports that the sectors with the greatest expansion were community, social and personal services (28%), construction (18.9%), tourism (12.3%), transport, storage and communications (8.2%) and commerce, restaurants and hotels (4.8%), whereas the agricultural sector slumped (-11.6%), mining was

Table 1  
CUBA: MAIN ECONOMIC INDICATORS

	1997	1998	1999	2000	2001	2002	2003	2004	2005 <sup>a</sup>
	<b>Annual growth rates<sup>b</sup></b>								
<b>Gross domestic product</b>	2.7	0.2	6.3	6.1	3.0	1.8	3.8	5.4	11.8
<b>Per capita gross domestic product</b>	2.3	-0.3	5.9	5.7	2.6	1.5	3.5	5.1	11.5
<b>Gross domestic product, by sector</b>									
Agriculture, livestock, hunting, forestry and fishing	2.3	-14.1	11.6	9.1	0.9	-2.5	2.4	0.2	-11.6
Mining	2.8	-11.7	2.7	33.2	-3.5	12.4	1.8	-4.7	0.1
Manufacturing	6.2	-8.1	7.2	5.1	-0.6	0.2	-2.0	2.5	1.2
Electricity, gas and water	7.0	3.7	8.1	12.8	1.1	2.4	3.1	-2.5	-1.6
Construction	3.0	-2.6	7.5	8.4	-5.3	-2.4	4.4	10.0	18.9
Wholesale and retail commerce, restaurants and hotels	-0.2	5.8	0.7	7.6	4.4	2.0	5.0	0.7	4.8
Transport, storage and communications	3.1	15.6	17.6	5.0	8.4	0.0	2.7	4.8	8.2
Financial institutions, insurance, real estate and business services	1.7	5.1	12.7	0.9	5.4	1.2	0.2	4.9	1.0
Community, social and personal services	3.6	0.2	4.7	3.5	4.5	4.2	6.8	11.3	28.0
<b>Gross domestic product, by type of expenditure</b>									
Consumption	2.3	1.5	5.1	2.3	3.4	3.1	6.3	4.9	...
General government	2.3	0.1	5.2	2.9	2.7	4.8	6.6	10.9	...
Private	2.3	1.9	5.1	2.1	3.8	2.1	6.2	1.6	...
Gross domestic investment	7.6	-11.0	0.5	11.3	0.8	-10.8	-9.6	14.8	...
Exports (goods and services)	-4.9	5.8	12.8	14.1	-3.6	-3.8	5.8	9.5	...
Imports (goods and services)	-1.9	1.4	2.4	-0.2	-3.8	-7.3	12.1	12.9	...
	<b>Percentages of GDP</b>								
<b>Investment and saving<sup>c</sup></b>									
Gross domestic investment	16.2	14.3	12.9	13.5	12.3	10.1	9.4	9.3	...
National saving	14.3	12.6	11.1	11.1	10.4	9.2	9.0	9.8	...
External saving	1.9	1.7	1.8	2.5	1.9	0.9	0.4	-0.5	...
	<b>Millions of dollars</b>								
<b>Balance of payments</b>									
Current account balance	-437	-392	-462	-696	-605	-343	20	116	7
Merchandise trade balance	-2 265	-2 689	-2 909	-3 120	-2 847	-2 388	-2 574	-2 918	-5 003
Exports, f.o.b.	1 823	1 540	1 456	1 675	1 622	1 422	1 671	2 180	2 160
Imports, f.o.b.	4 088	4 229	4 365	4 796	4 469	3 810	4 245	5 098	7 163
Services trade balance	1 519	1 932	2 163	2 306	1 931	1 825	2 329	2 710	4 240
Income balance	-483	-449	-514	-622	-502	-600	-650	-650	-200
Net current transfers	792	813	799	740	813	820	915	974	970
Capital and financial balance <sup>d</sup>	457	409	485	805	595	300	200	800	500
Net foreign direct investment	442	207	178	448	0	0	0	0	0
Financial capital <sup>e</sup>	15	203	307	357	595	300	200	800	500
Overall balance	21	17	23	109	-11	-43	220	916	507
Variation in reserve assets <sup>f</sup>	-21	-17	-23	-109	11	43	-220	-916	-507
<b>Other external-sector indicators</b>									
Official exchange rate (pesos per dollar)	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00
Average unofficial exchange rate (pesos per dollar)	23.00	21.00	20.00	21.00	26.00	26.00	26.00	26.00	24.00
Terms of trade for goods (index 2000=100)	67.0	64.2	53.2	47.4	49.2	45.8	44.9	44.4	...
Total gross external debt (millions of dollars) <sup>g</sup>	10 146	11 209	11 078	10 961	10 893	10 900	11 300	12 000	...
Total gross external debt (percentage of GDP) <sup>g</sup>	43.3	47.1	42.4	33.5	32.2	30.2	29.3	29.2	...
Net profits and interest (percentage of exports) <sup>h</sup>	-12.2	-10.9	-11.9	-13.0	-11.0	-14.1	-13.3	-11.9	-11.5
	<b>Average annual rates</b>								
<b>Employment</b>									
Unemployment rate <sup>i</sup>	7.0	6.6	6.3	5.5	4.1	3.3	2.3	1.9	1.9
	<b>Annual percentages</b>								
<b>Prices</b>									
Variation in consumer prices <sup>j</sup> (December-December)	1.9	2.9	-2.9	-3.0	-0.5	7.0	-1.0	3.0	3.7
	<b>Percentages of GDP<sup>k</sup></b>								
<b>State income and expenditure</b>									
Current income	...	50.5	49.6	44.6	49.6	43.8	45.9	46.7	51.5
Current expenditure	...	48.3	45.8	42.3	40.8	42.2	42.8	43.7	48.1
Fiscal balance	...	-2.4	-2.3	-2.1	-2.2	-2.8	-2.8	-3.5	-4.2
<b>Liquidity</b>									
Currency in circulation	...	...	...	15.5	18.9	19.2	17.2	18.0	21.1
M1	...	...	32.2	33.7	34.9	31.1	29.1	32.9	...
M2	...	...	34.4	36.6	37.8	35.0	35.4	42.7	...

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

<sup>a</sup> Preliminary figures. <sup>b</sup> Based on figures in local currency at constant 1997 prices. Data not comparable from 2001 onwards due to changes in methodology. <sup>c</sup> Based on figures in local currency expressed in dollars at current prices, not including the new calculations of the National Statistical Office of Cuba for the period 2000-2005. <sup>d</sup> Includes errors and omissions. <sup>e</sup> Refers to the capital and financial balance (including errors and omissions), minus net foreign direct investment. <sup>f</sup> A minus sign (-) denotes an increase in reserves. <sup>g</sup> Calculated using the official exchange rate of 1 peso to the dollar. <sup>h</sup> Refers to net investment income as a percentage of exports of goods and services as shown on the balance of payments. <sup>i</sup> Unemployment rate as a percentage of the economically active population, nationwide total. <sup>j</sup> Local-currency markets. <sup>k</sup> From 2000, the data used came from the new calculations of the National Statistical Office of Cuba.

stagnant (0.1%), manufacturing growth was slow (1.2%) and financial services crept up slightly (1%).

The upturn in community, social and personal services was due to the provision of professional services (in areas such as health, education, culture and sport) to the Bolivarian Republic of Venezuela, Guatemala, Pakistan and other countries, as well as improvements to those services within Cuba.

Despite problems relating to the efficient use of resources, construction was boosted by strong investment, the development of tourism infrastructure and the repair of direct and indirect damage caused by the hurricanes. In particular, housing construction grew by 160%, after having remained depressed for a long period. It is expected that 150,000 housing units will be completed between September 2005 and December 2006.

International tourism expanded thanks to improved international promotion, greater efficiency in the use of available resources and the expansion in the accommodation available (6.4%, equivalent to 48,100 rooms). The hotel occupancy rate fell, however (55.7% in 2005, compared with 63.5% in 2004). Gross income expanded (10.7%; US\$ 2.34 billion). Tourists came mainly from Canada (26%), Spain (8.4%), the Bolivarian Republic of Venezuela (8%), Italy (7.3%) and Germany (5.4%).

Communications and data-processing services grew by 8% thanks to capital formation in that area, which has led to improved service for both Cubans and tourists visiting the country. The digitalization of the telephone network reached almost 90%. Commerce, restaurant and hotel services expanded owing to growth in tourism and stronger domestic demand.

The agricultural sector declined sharply, owing to the effects of the hurricanes and the intense drought and also inefficiencies in the use of available resources. Levels of activity were down in both the sugar-cane and non-sugar-cane segments, and also in livestock production.

The stagnation of the mining sector was due to a decline in the extraction of petroleum (-9.6%) and nickel (-0.4%), although natural gas production was up (5.6%).

In the energy sector, output of refined oil was up (2.5%), as were motor gasoline other than aviation fuel (23%), kerosene (21%) and liquefied petroleum gas (29.3%); production of fuel oil stagnated (0.2%) and manufactured gas was down (-3.1%).

Electric power generation continued to decline in 2005 (-2%) owing to breakdowns in electric power plants, the lengthening of their maintenance periods and the impact of eight hurricanes over the past four years. The crisis in the electric power system is due to the technical obsolescence of equipment, leading to low levels of efficiency, high self-consumption rates in thermoelectric

plants (7% of the power generated), considerable transmission and distribution losses (17%), and outdated domestic equipment affecting households' electric power consumption. A crash programme to improve saving and efficiency is being implemented, and the provision of electric power already showed some improvement in the first few months of 2006.

The performance of manufacturing was uneven, with output rising in 12 out of 20 segments. Non-sugar industrial output increased by 3.2%, but sugar plummeted by 48%. Although production was damaged by the drought and hurricanes, inefficiency in the use of available resources was also a factor.

### **(b) Prices, wages and employment**

The consumer price indices in local and foreign currency rose by 3.7% and 5%, respectively. This inflation resulted from higher monetary liquidity in the hands of the population, supply difficulties resulting from the drought and hurricanes, stronger domestic demand due to higher pensions and wages, and rising hard-currency fuel prices. Prices in the formal and informal markets were up by 8.4% and 3.3%, respectively, but prices in the free markets for agricultural products edged up by just 1.2%.

On 1 May 2005 wage increases were promulgated for 1.6 million workers, raising the minimum wage from 100 to 225 Cuban pesos, and resulting in additional budgetary outlays equivalent to 2.3% of GDP.

A new wage increase was implemented as of December 2005, benefiting 2.2 million workers, with an annual cost equivalent to 2.7% of GDP, and resulting in an average monthly increase of 44 Cuban pesos per worker (12.7%). This measure meant that all public-sector workers had received a wage increase. The unemployment rate remained virtually unchanged at 1.9%, thanks to increased waged employment in the State sector.

### **(c) The external sector**

The country's main exports of traditional goods made up the following percentages of the total: nickel (50%), medicines (13%), tobacco (11%), and sugar and sugar cane derivatives (8%), compared with the 2001 levels of 7.1%, 2.1%, 13.3% and 33.9%, respectively. World prices for nickel and sugar were up. The increase in nickel sales was considerable, but sugar and sugar cane derivatives had fallen to fourth place in just five years. Exports of non-traditional products continued their upward trend, particularly in areas such as pharmaceutical products, biotechnology and genetic engineering.

There was a reduction in the role of family remittances as a source of external financing in the economy, but sales in dollar shops increased by 6%.

The number of joint ventures with foreign corporations fell from 313 in 2004 to 287 in 2005, but there was a considerable upswing in foreign direct investment from China, the Bolivarian Republic of Venezuela and Canada.

Imports of goods and services also rose, with an increased volume of higher-priced goods, especially petroleum and foodstuffs. The surplus on the services balance climbed steeply as a result of growth in international tourism, professional services and telecommunications.

There has been a significant change in Cuba's trade in goods with the Americas (50%), Europe (29%) and Asia (19%), compared with 40.6%, 43.4% and 15.3% in 2000, respectively. Imports from the European Union crept up slightly (0.5%), to US\$ 1.553 billion, but exports to the European Union declined by 2.5%, to US\$ 817 million.

Cuba's main trading partners were the Bolivarian Republic of Venezuela, China, Spain, Canada, the Netherlands, Brazil, Italy, Mexico, and Japan. Trade with the Bolivarian Republic of Venezuela has been rising rapidly, with goods and services exports to that country climbing from US\$ 500 million in 2000 to US\$ 2.5 billion in 2005.

Cuba is the third largest trading partner of the Bolivarian Republic of Venezuela, after the United States of America and Colombia. This is due in large part to the 90,000 barrels of oil per day supplied to Cuba by the Bolivarian Republic of Venezuela. In 2005, the value of Cuba's imports of hydrocarbons from that country totalled US\$ 1.8 billion. Cuba's trade with China also increased significantly, by 67%, or US\$ 873 million.

The country's external debt declined and its debt profile improved. Only 27% of the country's obligations are now short-term ones, and the rest is medium- and long-term credit, whereas formerly the majority of Cuba's liabilities were short term ones.

## Dominican Republic

### 1. Main trends

The economic recovery was consolidated in 2005 and GDP growth surpassed all expectations, at 9.2%. The number of employed was up by 2.1% and real minimum wages climbed significantly. Inflation dropped from 28.7% to 7.4% and the public-sector deficit narrowed to 3.3% of GDP. These trends have strengthened in 2006 and an annual growth rate of 8% is projected.

A strong recovery in domestic demand fuelled the upturn in imports of inputs and capital goods. National exports gathered momentum but maquila exports continued to perform poorly. The balance-of-payments current account moved from a surplus to a small deficit although family remittances expanded again. Broader availability

of foreign currency in 2005 fuelled the appreciation of the exchange rate and helped to replenish international reserves.

Legislative elections in May 2006 turned out well for the government, thus creating the conditions to deepen the economic reforms of the past biennium.

### 2. Economic policy

Fiscal and monetary policies were again coordinated with a view to maintaining the credibility of macroeconomic policy. The targets set in government and monetary programmes and in the agreement signed with the International Monetary Fund (IMF) were easily met.

#### (a) Fiscal policy

The central government deficit was 0.7% of GDP (compared to 4% in 2004) and the non-financial public sector (NFPS) deficit was equivalent to 0.4% of GDP (2.8% in 2004). The quasi-fiscal deficit narrowed from 4% to 2.9% of GDP. The public sector closed the financial year with a consolidated deficit equivalent to 3.3% of GDP, which was slightly less than half of the previous year's negative balance.

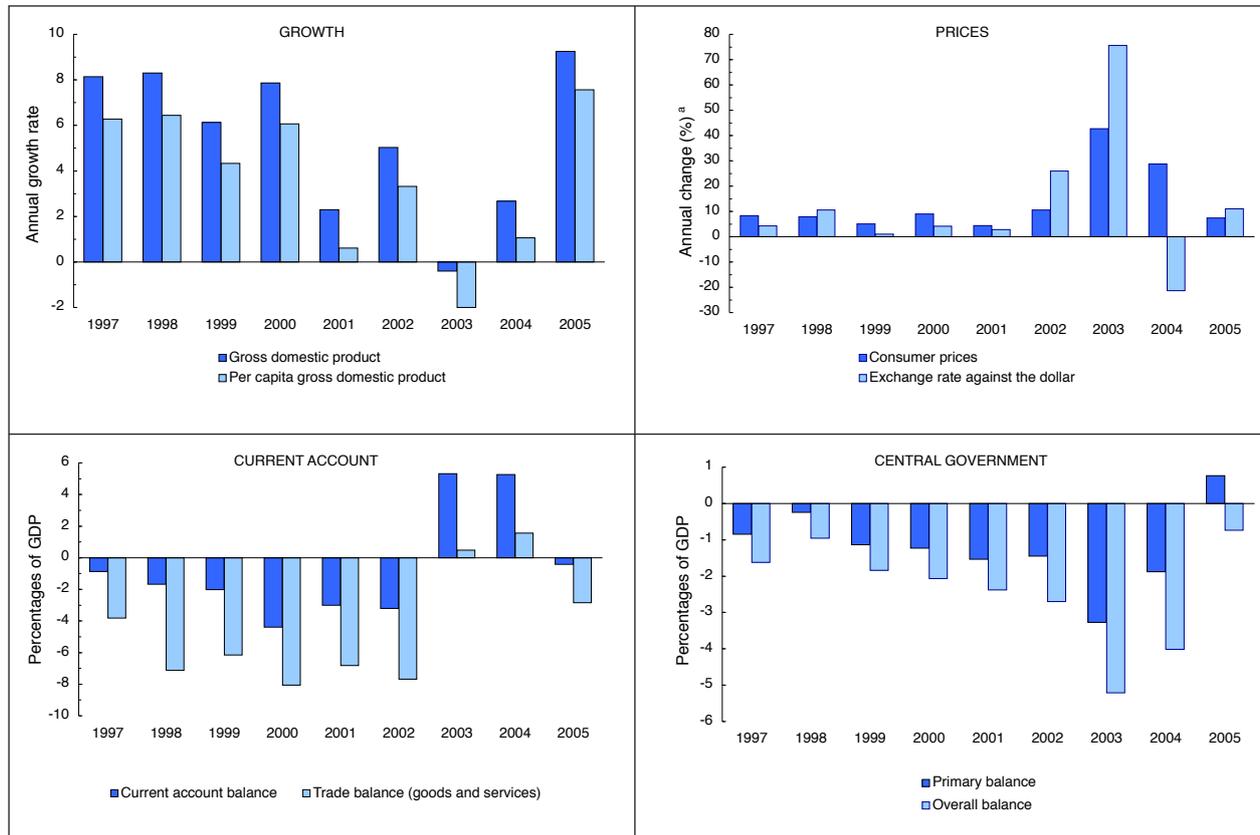
The central government's total revenues rose 15.8% in real terms, with revenues from taxes, particularly indirect taxes, generating most of the increase. This was thanks to the tax reforms of late 2004, which raised the goods and services transfer tax (ITBIS) from 12% to 16% and increased the selective consumption tax (ISC) on alcoholic

beverages and cigarettes. The fiscal reform of December 2005 broadened the base and coverage of ITBIS, raised the ISC rate to 20% and introduced a selective tax of 13% on the consumption of petroleum products.

Revenues from direct taxation rose by 17% in real terms, with the bulk of receipts coming from income taxes, but the fastest-growing item in 2005 was assets tax, which generated additional revenues of 1.632 billion pesos, 70% more than a year before. Under the fiscal reform of 2005, the tax on real property, luxury dwellings and unbuilt urban sites approved in 2004 was replaced in December 2005, in the case of single-owner businesses, with a new assets tax. The 2005 reform also created a tax of 17% of c.i.f. value on newly imported vehicles and established new income tax rates effective as of 2006. The new rates were 15%, 20%, 25% and 30%, depending on income bracket, for natural persons and a single rate of 30% for legal persons.

Spending policy was consistent with budget ceilings, the central government's expenditure obligations and public debt servicing commitments. Outlays on domestic debt servicing declined because of falling interest rates,

Figure 1  
DOMINICAN REPUBLIC: MAIN ECONOMIC INDICATORS



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

but other components of current spending rose. Unlike what had occurred in 2004, transfers — almost all to the electricity sector — declined slightly. Capital spending rose substantially, particularly fixed investment, which recorded a real increase of 78.4%.

The cost of servicing the external public debt totalled US\$ 872 million, 2.3% less than in 2004, thanks to the negotiation of maturities with the Paris Club, the London Club and sovereign bondholders. Arrears in the servicing of external public debt were well down on 2004.

### (b) Monetary policy

Monetary policy management resulted in the reduction of inflation to single digits. The median rates of interest on zero-coupon certificates and on certificates directly sold to the public declined by 12 and 11 percentage points, respectively, to close at 13% and 12%. The maturities of certificates, which stood at 30 days in early 2004, lengthened gradually to an average of 14

months at the start of 2006, which significantly changed the central bank's maturity profile and lowered the cost of its liabilities, despite an increase of almost 30% in the balance of certificates. Reflecting the lesser cost of interest payments, the quasi-fiscal deficit narrowed by one GDP percentage point, 0.2% of GDP more than expected.

Net international reserves in the central bank expanded by US\$ 1.038 billion, exceeding the established target. Most of the build-up of reserves was sterilized.

The downward trend in the interest rates on central bank certificates spilled over to bank rates. With inflation falling, the real cost of money turned sharply positive: the real average annual lending rate was 17.9%, compared with -13.1% a year earlier, and the real deposit rate was 7.6% (as against -19.9% in 2004).

Money expanded by 10.4% in real terms, which was consistent with the overall upturn in the economy and reflected the increase in sight deposits and cash in circulation. By contrast, other monetary aggregates expanded at much lower rates. Local-currency liquidity (M2) and

broad liquidity recorded real increases of only 4.4%.

Loans extended by commercial banks were up by a nominal 12.1%. Commercial and consumer lending accounted for over half of this portfolio (55.1%), although loans for building and home buying grew at an extraordinary pace (annual rates of 68% and 210%, respectively), increasing their share from 5% to 9% of the total.

### (c) Exchange-rate policy

The free currency float operated efficiently. The peso's tendency to appreciate, which had begun in the second half of 2004, reached an inflection point in August 2005 at around 29 pesos to the dollar. From September 2005 onwards, the exchange rate moved gradually upwards to averages of over 33 pesos to the dollar and even, in the first two months of 2006, above 34 pesos to the dollar. The result of these trends was a year-on-year depreciation of 11% in December 2005, but a 28.3% average appreciation of the real exchange rate.

### (d) Other policies

In 2005 new regulations were put in place to enhance the oversight capacity of the Superintendence of Banks. In 2006 a programme was launched to inspect the asset quality of full service banks. The results of such inspections will form the mandatory basis for the preparation of financial statements.

In the energy sector, a contingency plan was created to improve the operational and financial management of distribution companies. In view of the sector's fragile financial position, the government proposed in 2006 to conduct a monthly performance evaluation in order to implement measures as required to offset the fiscal impact of any deviation, so that the non-financial public sector balance would not be affected.

The new Letter of Intent submitted to IMF in April 2006 includes a structural reform programme which, if approved by Congress, will modernize the institutional structures needed to process economic policy.

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## 3. The main variables

### (a) Economic activity

The economic recovery strengthened in 2005 with a higher-than-expected expansion of GDP (9.2%). Per capita GDP grew by 7.6%, taking it almost four percentage points higher, in real terms, than it had been before the crisis of 2003. This momentum carried over into the first quarter of 2006, with a rate similar to that recorded in the second half of 2005 (12.6%). Economic growth is expected to be 8% in 2006.

The economy's momentum has been driven by domestic demand. In 2005 private consumption was up by 11.7% after contracting the year before, and gross fixed investment rose by 12.2% after two straight years of shrinkage. As a proportion of GDP, private consumption is now close to regaining pre-crisis levels, though the investment ratio is still more than six percentage points short of the 2001-2002 average. In the first quarter of 2006 growth in investment began to gather strength, with a year-on-year rate of 26.6%. If this trend continues, in 2006 the investment ratio should fully regain the ground lost.

Agriculture posted a positive growth rate (7.4%), more than triple the 2004 figure, which pushed the general production index above the level seen prior to the 2003

crisis. This expansion was almost entirely attributable to livestock activities, which grew strongly (14.2%) for the second year running, boosted by official development programmes. By contrast, crop-farming output contracted for the fourth year in a row. The dip of 1.8% in 2005 reflected sharp downturns in sugar cane (12.6%) and cocoa (38.4%), which account for a large share of the total. The fall in output of these two crops —and of others such as pineapples, oranges and beans— was largely due to weather conditions. Crop-farming output did, however, show clear signs of increasing as of the period July-September and into the first quarter of 2006 (with a 19% rise in volume). Unless there are adverse weather conditions, in 2006 agriculture should enjoy a positive annual growth rate for the first time since 2002.

The different branches of manufacturing performed unevenly in 2005. An overall increase of 7.9% was driven by local non-sugar industry, which was up by 8.5%. The dynamic performance of manufacturing was directly linked to the upturn in domestic demand and the first-quarter data for 2006 suggest that performance will be good this year too. By contrast, the sugar industry and free-zone textiles contracted in 2005, by 6.8% and 5.4%, respectively, owing to constraints on raw material supply and the rising costs

Table 1  
DOMINICAN REPUBLIC: MAIN ECONOMIC INDICATORS

	1997	1998	1999	2000	2001	2002	2003	2004	2005 <sup>a</sup>
	<b>Annual growth rates<sup>b</sup></b>								
<b>Gross domestic product</b>	8.1	8.3	6.1	7.9	2.3	5.0	-0.4	2.7	9.2
<b>Per capita gross domestic product</b>	6.3	6.4	4.3	6.1	0.6	3.3	-2.0	1.1	7.6
<b>Gross domestic product, by sector</b>									
Agriculture, livestock, hunting, forestry and fishing	-1.9	1.7	1.3	4.0	9.4	2.7	3.3	2.4	7.4
Mining	2.3	-15.4	-0.4	12.0	-19.7	-2.6	8.0	6.0	-1.7
Manufacturing	10.2	7.1	7.0	6.6	-1.2	5.0	-0.4	2.0	7.9
Electricity, gas and water	16.7	8.3	6.5	3.9	15.1	6.7	-7.5	-16.4	3.6
Construction	1.3	18.4	12.0	-2.7	-3.6	5.8	-12.5	-6.5	6.8
Wholesale and retail commerce, restaurants and hotels	8.2	3.7	5.3	6.8	-0.0	3.8	3.2	3.2	12.6
Transport, storage and communications	14.8	16.4	15.5	12.8	11.1	13.2	4.9	11.6	18.7
Financial institutions, insurance, real estate and business services	3.7	4.1	6.2	4.1	14.8	4.9	-3.9	-0.2	3.2
Community, social and personal services	6.0	6.5	1.3	2.9	6.1	2.8	3.0	3.1	2.7
<b>Gross domestic product, by type of expenditure</b>									
Consumption	9.2	8.2	5.4	8.7	5.7	4.4	-3.3	1.1	11.7
General government	13.0	9.2	3.4	4.6	8.7	8.4	-2.2	-5.3	11.9
Private	9.1	8.1	5.5	8.9	5.6	4.2	-3.3	1.4	11.7
Gross domestic investment	15.9	43.2	-0.9	7.3	-10.6	9.0	-30.2	-4.7	14.5
Exports (goods and services)	14.1	7.3	5.2	9.7	-5.3	2.5	6.9	3.1	4.9
Imports (goods and services)	18.6	21.5	0.9	10.3	-4.5	3.7	-13.1	-2.4	11.6
	<b>Percentages of GDP</b>								
<b>Investment and saving<sup>c</sup></b>									
Gross domestic investment	19.0	24.0	22.7	23.5	19.9	21.1	15.8	17.0	15.0
National saving	18.1	22.3	20.7	19.1	16.9	17.9	21.1	22.2	14.6
External saving	0.9	1.7	2.0	4.4	3.0	3.2	-5.3	-5.3	0.4
	<b>Millions of dollars</b>								
<b>Balance of payments</b>									
Current account balance	-163	-338	-429	-1 027	-741	-798	1 036	1 142	-143
Merchandise trade balance	-1 995	-2 617	-2 904	-3 742	-3 503	-3 673	-2 156	-1 952	-3 481
Exports, f.o.b.	4 614	4 981	5 137	5 737	5 276	5 165	5 471	5 936	6 133
Imports, f.o.b.	6 609	7 597	8 041	9 479	8 779	8 838	7 627	7 888	9 614
Services trade balance	1 275	1 182	1 602	1 854	1 826	1 757	2 249	2 291	2 495
Income balance	-795	-890	-975	-1 041	-1 092	-1 152	-1 393	-1 724	-1 886
Net current transfers	1 352	1 987	1 848	1 902	2 028	2 269	2 336	2 528	2 730
Capital and financial balance <sup>d</sup>	254	350	581	978	1 256	243	-1 583	-596	813
Net foreign direct investment	421	700	1 338	953	1 079	917	613	758	899
Financial capital <sup>e</sup>	-167	-350	-757	25	177	-674	-2 196	-1 354	-86
Overall balance	91	11	151	-48	515	-555	-546	546	670
Variation in reserve assets <sup>f</sup>	-40	-98	-194	70	-519	527	358	-542	-1 103
Other financing <sup>g</sup>	-51	87	42	-22	4	28	189	-4	433
<b>Other external-sector indicators</b>									
Terms of trade for goods (index: 2000=100)	106.1	108.0	105.7	100.0	100.9	101.5	97.9	96.7	95.8
Net resource transfer (percentage of GDP)	-3.1	-2.3	-1.7	-0.4	0.7	-3.5	-14.3	-10.7	-1.8
Total external debt (millions of dollars) <sup>h</sup>	3 572	3 546	3 661	3 682	4 177	4 536	5 987	6 380	6 756
Total external debt (percentage of GDP) <sup>h</sup>	18.9	17.6	17.3	15.7	17.0	18.2	30.7	29.4	19.5
Net profits and interest (percentage of exports) <sup>i</sup>	-11.3	-11.9	-12.2	-11.6	-13.0	-14.0	-15.6	-18.3	-18.8
	<b>Average annual rates</b>								
<b>Employment</b>									
Labour force participation rate <sup>j</sup>	54.1	52.6	53.5	55.2	54.3	55.1	54.7	56.3	55.9
Open unemployment rate <sup>k</sup>	16.0	14.4	13.8	13.9	15.6	16.1	16.7	18.4	18.0
	<b>Annual percentages</b>								
<b>Prices</b>									
Variation in consumer prices (December-December)	8.4	7.8	5.1	9.0	4.4	10.5	42.7	28.7	7.4
Variation in nominal exchange rate (December-December)	4.2	10.6	1.0	4.2	2.8	25.9	75.6	-21.4	11.0
Variation in real minimum wage	-1.6	7.5	-1.1	-0.4	5.7	-0.5	-9.2	-15.0	18.7
Nominal deposit rate <sup>l</sup>	13.3	17.0	15.4	18.6	16.1	16.4	20.6	21.1	12.7
Nominal lending rate <sup>m</sup>	19.0	23.5	22.2	23.6	20.0	21.3	27.8	30.3	21.4

Table 1 (concluded)

	1997	1998	1999	2000	2001	2002	2003	2004	2005 <sup>a</sup>
	<b>Percentages of GDP</b>								
<b>Central government</b>									
Total income	16.2	16.1	15.8	15.9	16.5	16.8	16.1	16.4	17.9
Current income <sup>n</sup>	15.9	15.9	15.6	15.8	16.3	16.5	15.9	16.2	17.8
Tax revenue	15.1	15.2	14.9	14.9	15.7	15.7	14.8	15.1	16.8
Capital income	0.3	0.1	0.0	0.0	0.1	0.2	0.0	0.0	0.0
Total expenditure	17.5	16.5	17.4	15.6	17.6	18.5	19.6	19.5	19.3
Current expenditure	11.5	11.7	12.2	11.8	11.8	12.0	12.4	14.6	14.5
Interest	0.8	0.7	0.7	0.8	0.8	1.3	1.9	2.1	1.5
Capital expenditure	6.0	4.7	5.2	3.8	5.8	6.5	7.2	4.9	4.7
Primary balance	-0.8	-0.2	-1.1	-1.2	-1.5	-1.4	-3.3	-1.9	0.8
Overall balance	-1.6	-1.0	-1.8	-2.1	-2.4	-2.7	-5.2	-4.0	-0.7
<b>Money and credit<sup>o</sup></b>									
Domestic credit <sup>p</sup>	25.4	28.2	31.0	33.1	35.4	38.6	41.3	31.3	...
To the public sector	1.3	1.0	1.7	2.0	1.8	2.2	2.6	2.3	...
To the private sector	24.2	27.1	29.3	31.1	33.5	36.4	38.7	28.9	...
Currency in circulation and local-currency deposits (M2)	25.0	26.7	28.7	29.2	31.6	34.4	39.5	34.0	31.9

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

<sup>a</sup> Preliminary figures. <sup>b</sup> Based on figures in local currency at constant 1991 prices. <sup>c</sup> Based on figures in local currency expressed in dollars at current prices. <sup>d</sup> Includes errors and omissions. <sup>e</sup> Refers to the capital and financial balance (including errors and omissions), minus net foreign direct investment. <sup>f</sup> A minus sign (-) denotes an increase in reserves. <sup>g</sup> Includes the use of IMF credit and loans and exceptional financing. <sup>h</sup> Refers to guaranteed public and private external debt. <sup>i</sup> Refers to net investment income as a percentage of exports of goods and services as shown on the balance of payments. <sup>j</sup> Economically active population as a percentage of the working-age population. Nationwide total. <sup>k</sup> Unemployment rate as a percentage of the economically active population, nationwide total. <sup>l</sup> 90-day certificates of deposit. <sup>m</sup> Average of the prime rate. <sup>n</sup> Includes grants. <sup>o</sup> The monetary figures are annual averages. <sup>p</sup> Refers to net credit extended to the public and private sectors by commercial banks and other financial and banking institutions.

of industrial inputs. Although some of these problems persist, there are now clear signs of a recovery.

The end of the Multifibre Arrangement in January 2005 accounts to a large extent for the minus signs among the free zone production figures. With the elimination of preferential access to the United States market, 56 textiles firms closed, while 15 firms in other lines of business were forced into liquidation by other types of problems. Taking into account the establishment of 69 new firms (20 of them in the textile segment), the sector experienced a net loss of 17,900 jobs in 2005. This segment of the Dominican economy does not appear to have finished adjusting to the new market conditions, judging by the 4.7% fall in its output in the first quarter of 2006.

The decline in nominal rates of interest and the price of some key inputs, combined with increases in mortgage loans and public works, fuelled an upturn in construction in 2005 (6.8%). Driven by these same factors, the industry gathered further momentum in January-March 2006, when it recorded a year-on-year expansion of 31.8%.

In 2005 the communications sector made further gains on the rapid expansion seen in the preceding years, with an upswing of 22.2%. This pattern has continued into 2006 with a real variation of 30.3% in the first quarter.

Production of electric power and water improved on the 2004 figures, with growth of 3.6% thanks to an upturn in generation capacity and despite a shortage of

fuel and persistent technical problems in power plants. This pattern is expected to continue in 2006.

Rising tourist numbers, combined with longer stays and higher average expenditure, made 2005 another year of expansion in the hotels, bars and restaurants sector. Value added and foreign direct investment (FDI) were up by 6.8% and 132% on the respective 2004 figures in this branch of activity. Tourist arrivals continued to increase in the first quarter of 2006 (8.8%), underpinning a positive outlook for the sector in the coming months.

With annual growth of 4.9%, the financial sector began to recover from the downturn of 2003 and stagnation of 2004. In the first quarter of 2006 the volume of transactions conducted rose by a sharp 21.3%, consistently with the upturn in the wider economy.

Rising levels of economic activity, together with increased employment and purchasing power, helped to bring about an ample recovery in the commerce sector after the contraction of 2004. Commerce expanded by 17.2% in 2005 and 16.1% in the first quarter of 2006 and the outlook remains good for this branch of activity.

## (b) Prices, wages and employment

Inflation averaged 4.2% in 2005, down from 51.2% in 2004. The December-December rate of inflation was 7.4%, compared to 28.7% a year earlier. Almost two thirds of general inflation in 2005 (4.7 points) was

Table 2  
**DOMINICAN REPUBLIC: MAIN QUARTERLY INDICATORS**

	2004				2005 <sup>a</sup>				2006 <sup>a</sup>	
	I	II	III	IV	I	II	III	IV	I	II
Gross domestic product (variation from same quarter of preceding year) <sup>b</sup>	-0.1	4.8	-1.1	3.8	4.3	7.2	10.4	14.6	...	...
Merchandise exports, f.o.b. (millions of dollars)	1 342	1 489	1 525	1 538	1 422	1 564	1 532	1 615	...	...
Merchandise imports, f.o.b. (millions of dollars)	1 702	1 920	2 073	2 081	2 122	2 369	2 616	2 507	...	...
International reserves (millions of dollars)	424	453	560	798	1 247	1 456	1 488	1 843	1 831	2 059 <sup>c</sup>
Consumer prices (12-month percentage variation)	62.3	60.3	47.9	28.7	4.3	-1.0	4.2	7.4	8.3	10.3
Average nominal exchange rate (pesos per dollar)	48.47	47.25	41.48	31.06	27.78	27.84	29.14	32.77	33.76	32.51
Nominal interest rates (annualized percentages)										
Deposit rate <sup>d</sup>	20.2	23.0	20.7	20.7	19.3	10.5	8.8	12.3	12.1	11.3
Lending rate <sup>e</sup>	29.1	31.7	30.7	29.8	28.7	21.8	18.2	17.1	17.7	16.9
Interbank interest rate	45.8	50.5	26.3	24.5	19.3	9.5	9.5	12.0	11.9	11.5
Non-performing loans as a percentage of total credit <sup>f</sup>	7.4	7.9	7.1	6.4	6.8	7.8	7.3	6.6	6.9	6.7 <sup>g</sup>

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

<sup>a</sup> Preliminary figures. <sup>b</sup> Based on figures in local currency at constant 1970 prices. <sup>c</sup> Data to May. <sup>d</sup> 90-day certificates of deposit. <sup>e</sup> Average of the prime rate. <sup>f</sup> Refers to total credit extended by the consolidated financial system. <sup>g</sup> Data to April.

attributable to the rise in international oil prices. The largest price hike occurred in transport services, with an annual variation of 24.7%. By contrast, the index for goods, beverages and tobacco, which represent almost half of the consumer basket, recorded a small annual variation (0.5%), which helped to soften the impact of hydrocarbons on inflation.

The effect of international oil prices on the consumer price index continued to be felt strongly in 2006. Cumulative inflation in the first four months of the year (2.12%) clearly indicated an upward pressure that will last for the rest of the year, suggesting that inflation will exceed the 2005 figure. Not including oil, the rate of cumulative inflation for the first four months was 0.9%.

In 2005 the main labour market indicators stopped deteriorating and the employment survey conducted in October showed the broad unemployment rate declining, at 17.5%, compared with 19.7% a year earlier, which brought the annual average down from 18.4% to 18%. Commerce and tourism generated the largest numbers of jobs; employment continued to contract in manufacturing and other services. The consolidation of economic momentum in 2006 should stimulate an improvement in the basic labour market indicators.

Wages regained part of their purchasing power. After a series of nominal increases that started in late 2004, the average real minimum wage rose substantially across all sectors in 2005: almost 18% in the public sector, 10.5%

in the free zones and nearly 20% in the rest of the private sector. This represented a break with three consecutive years of sharp declines, but real minimum wages are still below 2001 values.

### (c) The external sector

After running a surplus for two years, the balance-of-payments current account reverted to a negative balance in 2005, moving from a surplus of 6.1% of GDP to a deficit of 0.5%. This reflects an increase of US\$ 1.529 billion on the trade deficit, equivalent to a variation of 78%.

Merchandise imports rose 21.9%, driven entirely by non-maquila activities, since free-zone imports contracted by 4.5%. Consumer goods imports were up 44.2%, reflecting an upswing in personal consumption. Imports of capital goods and of raw and intermediate materials also climbed strongly (29.9% and 30.6%, respectively). A rise of 33% in international petroleum prices pushed the oil bill up by US\$ 784 million. In the first quarter of 2006, imports of raw materials increased by 15.8%, as a result of the sustained drive of domestic activity.

Exports recovered somewhat, but still performed sluggishly in 2005. Three quarters of the US\$ 197 million increase (3.3% up on 2004) came from national exports, of which a very large proportion were national goods bought by foreign tourists during their stay in the

country. Free-zone exports, which account for 77% of all merchandise exports, registered little variation (1.1%). Textile manufactures, which represent two fifths of free-zone exports, contracted sharply, by 10.2%. National exports kept up the momentum in 2006 with a 22% climb in the first quarter.

The surplus on the services account increased by 8.9%, thanks to additional tourism revenues. Family remittances continued to be an important source of income, standing at almost US\$ 2.39 billion (8.1% more than the 2004 figure). Remittances continued to expand

in the first quarter of 2006, with a year-on-year increase of 14.3%, and are expected to keep up this pace for the rest of the year.

In 2005 FDI came in at US\$ 900 million, 18.5% more than the year before. These funds went mainly to tourism, construction of new free zones and telecoms. FDI inflows are expected to be larger in 2006.

International reserves were boosted US\$ 1.103 billion by the balance of payments, reaching US\$ 1.843 billion at the end of 2005. This figure was equivalent to three months of non-maquila imports.



## Guyana

### 1. General trends

The adverse effects of the floods on Guyana's main economic sectors, coupled with rising oil prices in international markets, resulted in a contraction in the country's economy in 2005. GDP declined by 3%, following growth of 1.6% in 2004. Imports expanded sharply in response to reconstruction needs. Nevertheless, the overall balance of payments showed a surplus equivalent to 1% of GDP, largely attributable to substantial capital inflows.

Fuelled by surging international oil prices and tight agricultural supply conditions in the domestic market, inflation trended upwards to 8.2% (compared with 5.5% in 2004). Public sector wages were raised by 7% in 2005, which, given the inflation level, meant that real incomes declined marginally.

The public finance position weakened in 2005, reflecting the economic downturn combined with a broad public investment programme that encompassed reconstruction and rehabilitation following the flood damage and preparations for the Cricket World Cup. The central government's overall deficit after grants more than doubled.

The monetary policy stance was loosened early in the year, in order to stimulate credit demand for the financing of reconstruction work, but was later tightened to counter the expansion of liquidity in the system.

Economic activity is expected to recover in 2006, in spite of fresh flooding in the early part of the year, since the damage was less severe than that caused in 2005. GDP is projected to grow by 4.3%, while inflation will be around 6%. Public finances are expected to improve as growth in total revenues should exceed expansion in total expenditure. The balance of payments will worsen to show an overall deficit of over US\$ 6 million.

### 2. Economic policy

#### (a) Fiscal policy

The central government's overall deficit after grants widened to 14.2% of GDP (compared with 6.9% in 2004), owing essentially to the increase in capital expenditure (22.4% in 2005, as against 14.3% in 2004). This expenditure went mainly to infrastructure work, modernization of the public sector and the economic rehabilitation following the floods of early 2005. The poor performance of the non-financial public enterprises contributed significantly to the total deficit.

The increase in current expenditure from 32% of GDP in 2004 to 36% in 2005 was due to an expansion in

purchases of goods and services, transfers to the Linden community and support to the rice industry.

Current revenues increased to 35.7% of GDP, reflecting improved tax administration and receipts.

In 2005, the domestic and external public debt stock increased. The growth in domestic debt stemmed from sterilization operations, while the expansion in external debt reflected obligations contracted in order to finance the modernization programme of the State-owned Guyana Sugar Corporation (GUYSUCO) and the construction of the new cricket stadium. This increase in debt stock occurred despite Guyana's qualification for the Multilateral Debt Relief Initiative (MDRI), under which the country's

Table 1  
**GUYANA: MAIN ECONOMIC INDICATORS**

	1997	1998	1999	2000	2001	2002	2003	2004	2005 <sup>a</sup>
	<b>Annual growth rates<sup>b</sup></b>								
<b>Gross domestic product</b>	6.2	-1.7	3.8	-1.4	2.3	1.1	-0.7	1.6	-3.0
<b>Per capita gross domestic product</b>	5.9	-2.0	3.5	-1.7	2.0	0.9	-0.8	1.4	-3.1
<b>Gross domestic product, by sector</b>									
Agriculture, livestock, hunting, forestry and fishing	4.0	-6.7	15.9	-9.0	3.4	3.4	-2.3	2.8	-10.8
Mining	15.0	2.7	-8.4	5.9	4.2	-6.9	-8.7	-6.5	-17.8
Manufacturing <sup>c</sup>	2.3	-8.7	15.5	-13.9	2.5	10.9	-0.5	2.5	-13.8
Construction	13.1	4.7	-10.0	6.6	2.0	-3.9	5.6	4.1	9.4
Wholesale and retail commerce, restaurants and hotels	5.6	5.3	-8.0	5.2	0.5	-0.9	-2.6	1.9	8.6
Transport, storage and communications	8.9	-3.1	2.1	7.1	5.4	4.5	4.9	3.6	9.4
Financial institutions, insurance, real estate and business services	5.1	3.8	0.0	3.6	-3.5	-0.8	1.6	1.0	6.1
Community, social and personal services	3.4	0.7	1.2	4.6	0.7	-0.8	1.1	1.2	3.4
	<b>Millions of dollars</b>								
<b>Balance of payments</b>									
Current account balance	-111	-102	-78	-115	-134	-111	-91	-70	-150
Merchandise trade balance	-48	-54	-25	-80	-94	-68	-59	-58	-235
Exports, f.o.b.	593	547	525	505	490	495	513	589	551
Imports, f.o.b.	642	601	550	585	584	563	572	647	786
Services trade balance	-23	-32	-31	-24	-20	-24	-20	-47	-82
Income balance	-80	-60	-61	-58	-64	-59	-52	-39	-33
Net current transfers	40	44	39	47	44	40	40	74	167
Capital and financial balance <sup>d</sup>	110	89	100	156	160	125	100	27	158
Net foreign direct investment	52	44	46	67	56	44	26	0	0
Financial capital <sup>e</sup>	58	45	54	88	104	82	74	27	158
Overall balance	-2	-13	22	40	26	15	10	-43	8
Variation in reserve assets <sup>f</sup>	3	23	-11	-24	-10	-6	0	32	-24
Other financing <sup>g</sup>	-1	-10	-10	-16	-16	-9	-9	12	16
<b>Other external-sector indicators</b>									
Net resource transfer (percentage of GDP)	4.2	3.0	4.6	12.1	12.2	8.6	5.6	-0.1	18.5
Gross external public debt (millions of dollars)	1 513	1 507	1 211	1 193	1 197	1 247	1 085	1 071	1 096
Gross external public debt (percentage of GDP)	223.9	227.9	193.4	178.4	181.2	185.8	154.9	141.6	143.1
Net profits and interest (percentage of exports) <sup>h</sup>	-10.8	-8.7	-9.1	-8.6	-9.6	-8.8	-7.5	-5.3	-4.8
	<b>Annual percentages</b>								
<b>Prices</b>									
Variation in consumer prices (December-December)	4.2	4.7	8.7	5.8	1.5	6.0	5.0	5.5	8.2
Variation in nominal exchange rate (December-December)	1.8	14.0	10.2	2.4	2.6	1.2	2.0	2.2	0.0
Nominal deposit rate <sup>i</sup>	7.4	7.1	8.1	7.3	6.7	4.3	3.8	3.4	3.4
Nominal lending rate <sup>j</sup>	17.0	17.0	17.1	17.2	17.3	17.3	16.6	16.6	15.1
	<b>Percentages of GDP</b>								
<b>Central government</b>									
Total income <sup>k</sup>	34.5	33.3	33.8	37.0	37.0	40.5	37.3	39.5	44.2
Current income	31.9	30.7	29.8	31.8	31.1	32.2	31.5	33.0	35.7
Tax revenue	29.4	28.6	26.9	29.1	28.3	29.5	28.8	30.9	33.7
Capital income	2.6	2.6	4.0	5.2	6.0	0.0	0.0	0.0	0.0
Total expenditure	41.7	40.1	35.7	44.4	47.6	46.1	46.5	46.4	58.4
Current expenditure	26.3	28.0	25.7	31.3	35.3	34.8	34.5	32.1	36.1
Interest	...	...	...	...	8.8	7.7	6.2	4.9	4.6
Capital expenditure	15.4	12.1	10.0	13.2	12.4	11.4	12.0	14.3	22.4
Primary balance <sup>k</sup>	...	...	...	...	-1.8	2.0	-3.0	-2.0	-9.6
Overall balance <sup>k</sup>	-7.2	-6.8	-2.0	-7.4	-10.6	-5.7	-9.1	-6.9	-14.2
Public-sector external debt	185.7	188.6	163.6	144.7	143.4	152.4	132.3	128.1	139.4
<b>Money and credit</b>									
Domestic credit	22.4	25.9	22.6	18.8	20.3	18.8	17.9	18.6	23.7
To the public sector	-16.2	-14.6	-16.5	-20.2	-17.3	-17.3	-10.7	-5.4	-1.7
To the private sector	42.1	44.8	43.5	43.9	43.4	41.7	34.9	30.6	31.9
Other	-3.4	-4.3	-4.4	-4.9	-5.8	-5.6	-6.3	-6.5	-6.5
Liquidity (M3)	60.3	60.2	56.6	60.9	65.7	68.0	69.8	69.5	74.6

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

<sup>a</sup> Preliminary figures. <sup>b</sup> Based on figures in local currency at constant 1988 prices. <sup>c</sup> Includes electricity, gas and water. <sup>d</sup> Includes errors and omissions. <sup>e</sup> Refers to the capital and financial balance (including errors and omissions), minus net foreign direct investment. <sup>f</sup> A minus sign (-) denotes an increase in reserves. <sup>g</sup> Includes the use of IMF credit and loans and exceptional financing. <sup>h</sup> Refers to net investment income as a percentage of exports of goods and services as shown on the balance of payments. <sup>i</sup> Rate on small savings. <sup>j</sup> Weighted average of prime interest rate. <sup>k</sup> From 2002, includes grants.

entire debt with the International Monetary Fund (IMF) and the International Development Association (IDA) of the World Bank was forgiven. In total, US\$ 283 million in debt were written off.

### **(b) Monetary and exchange-rate policies**

In 2005, monetary policy was aimed at achieving price and exchange-rate stability, while fostering private-sector credit to productive sectors to promote growth and employment.

During the year, the monetary base expanded owing mainly to the increase in net international assets (25% in 2005), since the central bank's net domestic credit was flat. The flow of remittances and official emergency assistance following the natural disaster account in part for the growth in net international assets. This was reflected in an increase in the narrow and broad monetary aggregates (by 10.2% and 7.9%, respectively), as well as by increased liquidity in the commercial banking system (up by 48% in 2004, compared with 7% in 2005).

The effect of the higher level of liquidity was two-fold. First, combined with rising oil prices, it generated

stronger demand for foreign exchange, which forced the monetary authority to intervene in the foreign-exchange market. The Guyana dollar depreciated marginally (0.2%) against the United States dollar. Consequently, the rate of exchange closed 2005 at G\$ 200.94 to the dollar.

Second, there was a stronger demand for low-risk financial instruments, such as treasury bonds, whose yield diminished as a result (from 3.79% at the end of December 2004 to 3.74% at the end of December 2005). In turn, the lower yield of these instruments forced commercial banks to channel their resources towards alternative uses. Thus, the average lending rate fell from 16.6% in 2004 to 15.1% in 2005.

Consistently with this trend, credit to the private sector expanded quite significantly (33.4%) as demand for loans from the productive sector and from private individuals rose in the wake of the flooding; in the former case for the rehabilitation of productive enterprises and in the latter for consumption. Mortgage loans increased considerably as well, reflecting in part the flood damage caused to housing. The increase in personal loans was driven by demand for consumer durables and other household goods.

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## **3. The main variables**

### **(a) Economic activity**

The level of economic activity of the main productive sectors was severely hurt by the impact of the floods on the main productive sectors in the early part of the year.

Agriculture value-added declined by 10.8% in 2005, compared with a 2.8% increase in 2004. Sugar production plummeted by 23.9%, while rice output showed a smaller reduction. Another reason for the lower sugar output was the diminished sucrose content of the canes in the wake of the flood and this situation was compounded by strikes and worker absenteeism. A significant part of the rice crop was lost to the floods, with some fields not harvested.

Mining output also contracted in 2005, by 18% after a downturn of 7% in 2004. Gold declarations<sup>1</sup> fell

by over 27%, reflecting the depletion of reserves in the OMAI Gold Mines, which later shut down. Increased output by individual operators seeking to capitalize on higher international gold prices was not enough to offset this downturn. Diamond production was down by 21.5% owing to the temporary closure of mining operations because of the threat of flood-borne malaria, and to lower prices.

Manufacturing output declined by 14% in 2005, compared with an expansion of 2.5% in 2004, reflecting the sharp contraction in sugar production. Other sectors, such as alcoholic beverages and paint production were up, but could not compensate for the lower sugar output.

Conversely, construction activity expanded by 9.4% (4.1% in 2004), in response to a sharp increase in public

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<sup>1</sup> The quantity of gold declared by producers is often less than their actual production as some is sold in the informal trade and unaccounted for in the official figures.

spending on flood-damage repair and rehabilitation work and on the construction of the World Cup Cricket Stadium and housing.

### **(b) Prices, wages and employment**

Higher inflation in 2005 was due to domestic shortages following the floods, with a 7.8% rise in the cost of food, especially fresh fruits, vegetables, milk and meat products. Transport and communications and housing prices also increased (by 13.8% and 11.6%, respectively), the former reflecting rising international oil prices and the latter, strong housing demand.

In an effort to contain demand for wage hikes, the government raised public sector wages by only 7%, slightly below inflation. This brought the minimum wage to US\$ 124.13 per month.

In the framework of public-sector restructuring and rationalization, employment in this sector declined by 1.7% in 2005. Employment losses in public enterprises, including Guysuco (4.5%) and Aroaima Bauxite Company (9.8%) were offset by a 3.2% gain in the number of employees in the central government.

### **(c) The external sector**

The overall balance of payments position improved significantly in 2005 to post a surplus of US\$ 8 million, equivalent to 1% of GDP, compared with a deficit of US\$ 43 million in 2004. This outturn was facilitated by an upturn in capital inflows, associated with private investment, and by reduced debt payments.

The current account deteriorated, the structural deficit doubling to reach US\$ 150 million (19.6% of GDP). The current account was affected by the sharp rise in oil prices and the decrease in the quantity and value of commodity exports. Exports declined by 6.5% to US\$ 551 million, following a strong recovery in 2004. Export volumes were down for all the major commodities, except bauxite and timber. Revenues from sugar exports contracted by 13.6% and those from exports of rice declined by 16.1%, in both cases as a result of the floods in the early part of the year.

The import bill increased by over 21%, reflecting higher oil prices, flood rehabilitation and the higher demand generated by an expanded infrastructure expansion programme, partly linked to the Cricket World

Cup. Imports of consumer goods increased significantly in response to rising demand in the wake of the flood. Intermediate goods imports climbed strongly as a result of higher fuel prices. A positive development was a 14.1% increase in imports of capital goods for capacity-building in mining and agriculture, which is important for future growth. Imports were strongly up despite the downturn in output.

The services account deficit worsened again in 2005, while net factor service payments continued to decline, reflecting lower debt service payments thanks to forgiveness of part of the country's liabilities. Interest payments on public-sector and Bank of Guyana debt declined by US\$ 0.5 million and US\$ 1.9 million, respectively, in 2005.

Meanwhile, current transfers increased to US\$ 167 million (21% of GDP), reflecting a strong increase in grants extended to mitigate some of the impacts of the flooding.

The surplus on the capital and financial account increased six-fold to stand at US\$ 158 million or 20.6% of GDP. This was partly due to the increase in private investment, larger disbursements on existing commitments and lower debt service payments. Foreign direct investment stood at US\$ 76.8 million, owing largely to capacity-building in mining and telecommunications, especially cellular telephony.

With the improvement in the balance of payments position, international reserves at the Bank of Guyana strengthened to US\$ 251 million, equivalent to three months of import cover.

In 2006, the balance of payments position is expected to weaken, to yield an overall deficit of US\$ 6.7 million. The merchandise account will also deteriorate, since imports are expanding at a faster rate (4%) than exports (2.5%). Gold revenues will decline owing to the closure of OMAI Gold Mines, the largest producer. Sugar and rice exports should, however, help to offset this reduction. Imports are expected to expand owing to the continued rise in fuel costs and to expenditure on public infrastructure and private-sector projects.

The current account is also expected to show the effects of higher net payments for services and a fall-off in remittances, leading to a deficit of around US\$ 199 million. Capital account inflows are expected to increase by about 9%, however. The overall balance-of-payments deficit will be financed by debt relief under the Multilateral Debt Relief Initiative.

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## Haiti

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### 1. General trends<sup>1</sup>

Following two years of transitional government, the elections held in February and April 2006 heralded a more settled political and institutional situation, with René Garcia Préval sworn in as President in May and the formation of a new parliament. Yet considerable challenges remain, particularly in terms of normalizing the social climate in a framework of justice and security, establishing a forum for national dialogue and building up the new authorities' capacity to respond to the numerous long-deferred social demands.

The social peace plan announced by the new authorities consists of a set of emergency measures focused on humanitarian aid, job creation, basic public services (electricity, water and sanitation) and economic revival, with a view to dealing with unfinished business left over from the transitional period. This will be funded by resources approved as part of the Haiti Interim Cooperation Framework (ICF), some of which have already been assigned to specific projects, although no disbursements have yet reached the stage of actual expenditure.

In 2005, GDP grew by only 1.8%, despite improvements in the benchmark indicators of macroeconomic equilibrium. Inflation stood at 14.8%, the fiscal deficit narrowed to 0.5% of GDP and net international reserves amounted to US\$ 68 million. Nonetheless, the volatile political and social environment, with the much-postponed elections

and the climate of instability that prevailed for most of the year, had many negative effects.

Two thirds of the way through the 2006 fiscal year, many question marks remain although the post-election political stabilization process, the new government and the programmes announced by the new authorities bode well for the rest of the year. Uncertainty surrounds issues such as the source of additional funds for extending the ICF until December 2007, the scope of new cooperation agreements, the benefits of Haiti's eligibility for the Heavily Indebted Poor Countries (HIPC) Debt Initiative (approved in April) and a possible Poverty Reduction and Growth Facility (PRGF). Despite the announced efforts to jump-start the economy immediately, current trends for the year point to a modest increase in GDP (2.5%) in a context of fiscal discipline, a stabilized exchange rate and relatively well-controlled inflation (15%).

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### 2. Economic policy

During the 2005 fiscal year, the authorities maintained a tight stance in terms of fiscal, monetary and foreign-exchange policy, in keeping with the guidelines agreed with international financial institutions (the International Monetary Fund (IMF) and the World Bank) under the Emergency Post-Conflict Assistance (EPCA) programme.

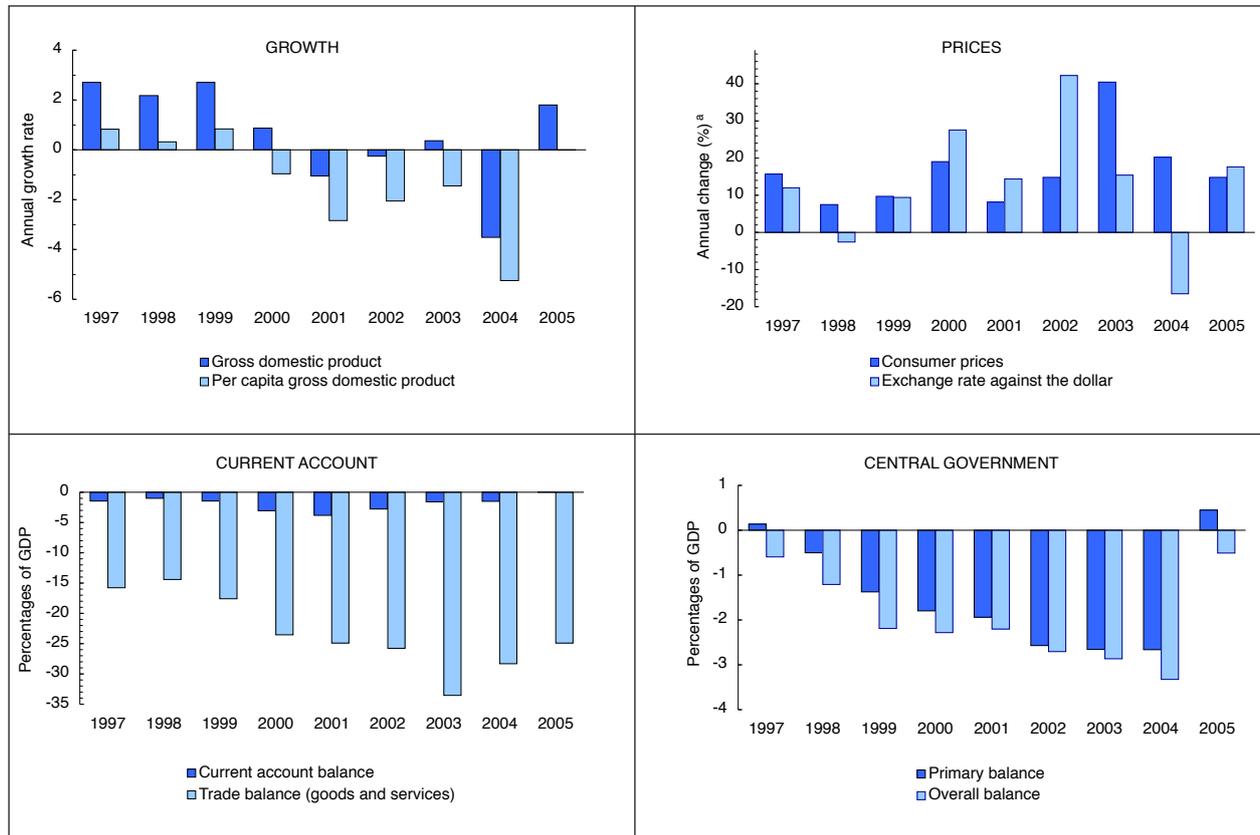
The latter was arranged in January 2005, and a recent IMF assessment report suggests that it will be renewed until September 2006.

In order to access such programme benefits, however, the new authorities will have to follow precise guidelines. In particular, they will have to comply with

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<sup>1</sup> The analysis refers to fiscal year 2005 (October 2004-September 2005) and 2006 (October 2005-September 2006).

Figure 1  
**HAITI: MAIN ECONOMIC INDICATORS**



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

a Poverty Reduction Strategy (PRS), ensure they are HIPC eligible and establish mechanisms for monitoring spending on poverty reduction. According to the economic policy guidelines announced by the new President, the government's main objective is to protect the achievements made in terms of macroeconomic and financial stabilization, and this will facilitate implementation of the EPCA programme.

#### (a) Fiscal policy

In 2005, the fiscal deficit stood at 0.5% of GDP, less than one sixth of the 3.3% recorded in 2004. This was largely due to a sharp drop in capital expenditure using national financing. Indeed, capital expenditure in real terms amounted to less than half the previous year's figure, because investment fell below the level originally provided for in the Economic Recovery Programme (PROREC), and the authorities actively tightened fiscal control. However, this was partly offset by investments

based on external financing, either in the form of budget support (donations) or in accordance with the Interim Cooperation Framework (ICF). The main beneficiaries were infrastructure projects for highways and agriculture.

Total expenditure in real terms was down 4% as a result of lower capital expenditure. The 9.1% rise in current expenditure (resulting from the 21% wage increase for civil servants) was mitigated by a substantial expansion of current revenues (11.5%), particularly from customs (7.7%). Financing therefore remained within the range agreed with IMF.

Additional resources approved during the current fiscal year, including those from multilateral sources (the Inter-American Development Bank (IDB), the World Bank and the European Union) and bilateral sources (Canada and Spain), will provide the financial authorities with more room for manoeuvre in the rest of the year. This should enable them to expedite expenditure on socio-economic programmes without jeopardizing the IMF-agreed targets in terms of budgetary and fiscal control.

The better-than-expected performance of fiscal revenues to March 2006 was mainly due to the widening of the corporate tax base. The fiscal outcome was also improved because expenditure was delayed by hold-ups in obtaining certain external funds and by the limited absorptive capacity of the public sector. This was despite the subsidy (approximately 1.30 billion gourdes) granted to the State electricity company, which did not benefit from “extraordinary donations” as in the previous financial year.

External budgetary financing required for the rest of the fiscal year will have to cover a shortfall of around US\$ 18 million. A substantially larger shortfall (of US\$ 80 million) is expected for the 2006-2007 fiscal year. Both constitute very short-term challenges that the new authorities will have to overcome in consultation with international financial institutions and bilateral counterparts.

### (b) Monetary policy

During 2005, a smaller monetary base (-2.9%) in real terms, stalled net domestic credit (0.9%) and other monetary indicators reflected a monetary policy stance that was generally tight, while designed to permit a certain degree of recovery. Positive growth was recorded for M1 (7%) and M3 (7.8%), with the latter being due to the dramatic surge in foreign-exchange liquidity (18.6%).

Net domestic credit to the economy (29.6% of GDP) was down two percentage points on 2004, largely owing to the public sector component, which declined by 10% in real terms. The authorities maintained high yields

(nominal rate of 18.9%) on the bonds of the Bank of the Republic of Haiti (BRH) in order to contain any surge in inflation.

The composition of reserve requirements (legal reserve 31%) in gourdes and foreign exchange was changed between February and May 2006 to free up more dollars on the market and reverse the depreciation of the exchange rate that had been observed at the beginning of the year. By the third quarter of the 2006 fiscal year, a degree of stability had been achieved in terms of the exchange rate, which even appreciated in real terms.

However, there is concern surrounding the banking system’s arrears rate (nonperforming or delinquent loans as a percentage of the loan portfolio), which soared to 14.1% compared with 8.5% at the end of the previous fiscal year.

### (c) Exchange-rate policy

The increased availability of dollars in the economy has enabled BRH to build up reserves in excess of US\$ 200 million (including foreign exchange deposits of commercial banks). The Bank’s purchases of foreign exchange (US\$ 42.3 million) contributed to this performance, which surpassed the targets agreed upon with IMF for the current fiscal year.

During the first nine months of the 2006 fiscal year, the average real exchange rate showed an appreciation of the gourde in a continuation of the trend observed during 2005 (real appreciation of 13%). This was the result of the increased inflow of foreign exchange into the economy.

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## 3. The main variables

The standstill in per capita GDP (while overall GDP edged up by 1.8%), the chronic job creation deficit, the loss of purchasing power, international but mainly national volatility and a structural vulnerability based on the prevailing deep-seated inequality and inequity have hardly been conducive to getting the country back on track towards growth.

### (a) Economic activity

During 2005, low growth in agriculture (2.6%) and construction (3%) contributed to the small rise in GDP, and will probably once again be the main reasons for the predicted outcome for 2006 (2.5%). In the manufacturing

sector, the most noteworthy performer was the maquila-dominated textile industry, with a 3.6% expansion (almost twice the 1.7% rate for the sector as a whole) and positive growth for the third year in a row. The volume of maquila exports swelled by 33.5%. Other manufacturing activities either stagnated or grew only marginally.

Agriculture benefited from steady inflows of resources from commitments under the Haiti Interim Cooperation Framework (US\$ 30 million) and from the public purse. These resources were largely channelled towards recovering production supply and strengthening certain high-potential agricultural niches.

In terms of aggregate supply and demand, the year 2005 saw upward trends in imports (2.6%) and exports (3.4%).

Table 1  
HAITI: MAIN ECONOMIC INDICATORS

	1997	1998	1999	2000	2001	2002	2003	2004	2005 <sup>a</sup>
	<b>Annual growth rates<sup>b</sup></b>								
<b>Gross domestic product</b>	2.7	2.2	2.7	0.9	-1.0	-0.3	0.4	-3.5	1.8
<b>Per capita gross domestic product</b>	0.8	0.3	0.8	-1.0	-2.8	-2.1	-1.4	-5.2	0.0
<b>Gross domestic product, by sector</b>									
Agriculture, livestock, hunting, forestry and fishing	-1.5	-0.2	-2.8	-3.6	0.9	-3.7	0.2	-4.8	2.6
Mining	10.2	9.5	6.8	6.1	-4.9	2.2	0.7	-5.0	4.5
Manufacturing	0.3	0.3	-3.0	-0.5	0.1	1.6	0.4	-2.5	1.6
Electricity, gas and water	5.3	-2.8	-3.6	-9.2	-27.1	2.0	3.3	11.1	7.1
Construction	9.1	11.2	10.4	8.3	0.7	1.0	1.9	-2.7	3.0
Wholesale and retail commerce, restaurants and hotels	5.8	3.1	4.0	4.5	0.4	2.9	0.6	-6.4	1.4
Transport, storage and communications	7.2	7.1	17.0	12.5	2.2	-0.2	1.6	0.8	3.2
Financial institutions, insurance, real estate and business services	6.8	5.9	3.2	4.4	-0.7	-1.5	0.2	-0.8	1.3
Community, social and personal services	1.2	1.3	-0.1	-1.6	-2.6	1.1	-1.4	-3.2	1.6
<b>Gross domestic product, by type of expenditure</b>									
Consumption	3.0	3.1	8.4	14.8	-1.6	-1.2	0.9	-3.7	2.2
General government	-0.1	1.1	0.2	1.3	...	...	...	...	...
Private	3.4	3.4	9.4	16.3	8.1	-1.2	0.9	-3.7	2.2
Gross domestic investment	7.6	-3.2	24.0	18.3	-1.2	2.6	3.1	-3.2	1.4
Exports (goods and services)	14.2	23.3	16.5	6.3	-2.2	-2.1	7.1	9.8	3.4
Imports (goods and services)	7.2	6.6	22.7	29.3	-2.1	-1.2	3.2	-1.1	2.6
	<b>Percentages of GDP</b>								
<b>Investment and saving<sup>c</sup></b>									
Gross domestic investment	24.5	26.0	27.7	27.3	25.9	25.1	30.7	27.3	27.4
National saving	23.1	25.0	26.3	24.3	22.0	22.3	29.1	25.8	29.0
External saving	1.5	1.0	1.4	3.0	3.8	2.8	1.6	1.5	-1.6
	<b>Millions of dollars</b>								
<b>Balance of payments</b>									
Current account balance	-48	-38	-59	-111	-134	-89	-45	-56	67
Merchandise trade balance	-354	-341	-677	-755	-750	-706	-783	-833	-850
Exports, f.o.b.	205	299	341	332	305	274	333	378	459
Imports, f.o.b.	560	641	1 018	1 087	1 055	980	1 116	1 210	1 308
Services trade balance	-158	-201	-43	-108	-124	-123	-166	-203	-185
Income balance	-14	-12	-13	-9	-9	-14	-14	-12	-37
Net current transfers	478	516	674	761	750	754	918	993	1 138
Capital and financial balance <sup>d</sup>	78	73	80	64	131	8	37	91	-16
Net foreign direct investment	4	11	30	13	4	6	14	6	10
Financial capital <sup>e</sup>	74	62	50	51	127	3	23	85	-26
Overall balance	30	34	21	-47	-2	-81	-8	35	51
Variation in reserve assets <sup>f</sup>	-51	-29	-34	57	-5	49	25	-50	-22
Other financing <sup>g</sup>	21	-5	12	-10	7	32	-17	15	-29
<b>Other external-sector indicators</b>									
Terms of trade for goods (index: 2000=100)	101.4	107.6	104.2	100.0	101.2	100.2	98.7	96.0	92.4
Net resource transfer (percentage of GDP)	2.6	1.5	2.0	1.2	3.7	0.8	0.2	2.6	-2.0
Gross external public debt (millions of dollars)	1 025	1 104	1 162	1 170	1 189	1 212	1 287	1 316	1 335
Gross external public debt (percentage of GDP)	31.6	29.4	28.4	31.9	33.9	37.7	45.5	36.0	32.1
Net profits and interest (percentage of exports) <sup>h</sup>	-3.6	-2.4	-2.4	-1.8	-2.1	-3.2	-3.0	-2.3	-6.1
	<b>Annual percentages</b>								
<b>Prices</b>									
Variation in consumer prices (December-December)	15.7	7.4	9.7	19.0	8.1	14.8	40.4	20.2	14.8
Variation in nominal exchange rate (December-December)	12.0	-2.6	9.4	27.5	14.4	42.2	15.4	-16.5	17.6
Variation in real minimum wage	-13.9	-11.3	-7.9	-11.9	-11.6	-8.9	33.5	-14.7	-13.2
Nominal deposit rate <sup>i</sup>	10.8	13.1	7.4	11.8	13.6	8.2	14.0	10.9	3.5
Nominal lending rate <sup>j</sup>	21.5	23.5	22.9	25.1	28.6	25.5	30.7	34.1	27.1
	<b>Percentages of GDP</b>								
<b>Central government</b>									
Total income <sup>k</sup>	10.1	9.6	9.2	8.2	7.8	8.3	9.1	8.9	10.9
Current income	8.9	8.5	9.1	8.0	7.4	8.2	8.9	8.9	9.7
Tax revenue	8.7	8.3	8.8	7.9	7.4	8.2	8.9	8.9	9.7
Total expenditure	10.7	10.8	11.4	10.5	10.0	11.0	12.0	12.2	11.5
Current expenditure	9.4	8.8	9.3	8.1	8.2	9.0	9.2	9.6	10.2
Interest	0.7	0.7	0.8	0.5	0.3	0.1	0.2	0.7	1.0

Table 1 (concluded)

	1997	1998	1999	2000	2001	2002	2003	2004	2005 <sup>a</sup>
Capital expenditure	1.3	2.0	2.1	2.4	1.8	2.0	2.7	2.6	1.2
Primary balance	0.1	-0.5	-1.4	-1.8	-1.9	-2.6	-2.7	-2.7	0.4
Overall balance	-0.6	-1.2	-2.2	-2.3	-2.2	-2.7	-2.9	-3.3	-0.5
Central government debt									
Domestic	40.0	36.6	38.6	43.8	46.2	60.2	57.5	46.7	40.8
External	12.0	11.1	12.1	13.6	14.8	17.4	17.2	14.8	13.1
External	28.0	25.5	26.5	30.2	31.5	42.7	40.4	31.8	27.7
<b>Money and credit<sup>l</sup></b>									
Domestic credit <sup>m</sup>	23.8	23.4	24.1	26.6	28.0	30.0	31.0	29.6	26.6
To the public sector	10.1	9.0	9.9	11.5	13.4	14.9	15.0	14.6	12.4
To the private sector	13.7	14.4	14.2	15.2	14.7	15.2	15.9	15.1	14.2
Liquidity (M3)	...	29.7	30.8	34.8	36.1	37.8	41.2	40.9	38.7
Currency in circulation and local-currency deposits (M2)	...	22.8	22.9	24.0	24.2	24.4	24.6	24.4	22.6
Foreign-currency deposits	...	7.0	7.9	10.7	11.9	13.3	16.6	16.5	16.0

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

<sup>a</sup> Preliminary figures. <sup>b</sup> Based on figures in local currency at constant 1986-1987 prices. <sup>c</sup> Based on figures in local currency expressed in dollars at current prices. <sup>d</sup> Includes errors and omissions. <sup>e</sup> Refers to the capital and financial balance (including errors and omissions), minus net foreign direct investment. <sup>f</sup> A minus sign (-) denotes an increase in reserves. <sup>g</sup> Includes the use of IMF credit and loans and exceptional financing. <sup>h</sup> Refers to net investment income as a percentage of exports of goods and services as shown on the balance of payments. <sup>i</sup> Average of highest and lowest rates on time deposits, commercial banks. <sup>j</sup> Average of highest and lowest lending rates, commercial banks. <sup>k</sup> Includes grants. <sup>l</sup> The monetary figures are annual averages. <sup>m</sup> Refers to net credit extended to the public and private sectors by the monetary authority and deposit banks.

Within the latter, particularly impressive performances were turned in by maquila exports (33%) and mangos (15%). During the first half of 2006, however, mango exports to the United States suffered a major decline in real terms (-69%). As for imports, rice soared during 2005 and 2006, with an increase of 18% in value and 59% in volume terms. Investment growth (1.4%) was less than expected due to delayed disbursements of external resources for public works. The 2.2% rise in consumption was not enough to improve per capita consumption, which remained stagnant (0.4%).

### (b) Prices, wages and employment

In 2005, the hike in international petroleum prices pushed up hydrocarbon import prices by 44%, which in turn had a strong impact on various links in the price chain including transport (22%). In March 2006, price increases slowed, with hydrocarbon prices up by 18%, leading to an 11.3% rise in transport prices. The cost of the basic basket of foodstuffs, on the other hand, continued to grow (16.7%) at almost the same rate as the previous year (18%). In April 2006, annualized inflation was higher for imported basic foodstuffs (21.6%) than for those of national origin (15.2%).

Household purchasing power suffered as the real minimum wage retreated 13% in 2005 and 10% in 2006. Meanwhile, few jobs were created, and they were temporary, unskilled and poorly paid, to boot. This was a far cry from the expectations announced in the transitional government's programmes.

### (c) The external sector

In 2005, the balance of payments posted a current account surplus of US\$ 67 million, or 1.5% of GDP. Net inflows of remittances (US\$ 925 million) and donations (US\$ 212 million) successfully offset the US\$ 1.034 billion trade deficit, which was largely caused by worsening terms of trade (-10.3%). Forecasts for 2006 predict a similar pattern, resulting from two major constraints: the continuing rise in international hydrocarbon prices, and problems with availability of external resources. Unlike in 2005, the capital account is nonetheless expected to reflect a net income of resources.

The main agricultural export products — mangos, essential oils, cocoa and coffee — accounted for only 15% of overall exports, totalling US\$ 217 million (for the maquila industry, only value added is counted). Maquila products remain the largest category of exports, representing US\$ 155 million, 71% of the total. Coffee exports declined despite favourable international prices, while export volumes rose for mangos (15%) and essential oils (27%).

In the first half of 2006, there was a considerable reversal of the strong performance of the three main products, as mangos slumped by 70%, essential oils by 24% and cocoa by 16%.

Besides hydrocarbons (which make up 19% of the total), imports were concentrated on rice, wheat, chicken and dairy products, a subset that represents 40% of food imports and 10% of total imports. During the first six

Table 2  
**HAITI: MAIN QUARTERLY INDICATORS**

	2004				2005 <sup>a</sup>				2006 <sup>a</sup>	
	I	II	III	IV	I	II	III	IV	I	II
Merchandise exports, f.o.b. (millions of dollars)	76	100	107	110	104	129	119	...	...	...
Merchandise imports, c.i.f. (millions of dollars)	247	359	361	339	340	345	360	...	...	...
Consumer prices (12-month percentage variation)	20.8	24.1	22.5	20.2	17.2	13.4	14.2	14.8	16.6	14.1 <sup>b</sup>
Average nominal exchange rate (gourdes per dollar)	42.66	37.28	36.30	35.90	36.32	38.20	41.43	42.16	42.20	39.43
Nominal interest rates (annualized percentages)										
Deposit rate <sup>c</sup>	15.3	13.0	9.3	5.9	3.0	2.5	3.6	4.8	6.0	5.3
Lending rate <sup>d</sup>	33.0	36.5	33.8	33.0	31.8	27.5	24.1	25.0	24.8	31.0
Domestic credit (variation from same quarter of preceding year) <sup>e</sup>	15.8	8.4	11.8	1.3	2.6	11.4	10.9	14.9	10.4	...
Non-performing loans as a percentage of total credit <sup>f</sup>	7.5	...	...	...	10.3	9.6	12.4	12.2	...	...

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

<sup>a</sup> Preliminary figures. <sup>b</sup> Data to May. <sup>c</sup> Average of highest and lowest rates on time deposits, commercial banks. <sup>d</sup> Average of highest and lowest lending rates, commercial banks. <sup>e</sup> Refers to net credit extended to the public and private sectors by commercial banks and other financial and banking institutions. <sup>f</sup> Refers to total credit extended by the financial system.

months of the 2006 fiscal year, wheat prices increased by 8%, chicken by 18% and dairy products by 36%.

The balance-of-payments financial account recorded net outflows of US\$ 18 million, largely due to the US\$ 70 million capital flight from the private banking system. Disbursements resulting from external debt (US\$ 98.1 million) were similar to payments for services (US\$ 101.2 million). Expectations of greater foreign investment were not generally fulfilled except in telecommunications, where a new mobile telephone company began operating in May 2006, competing directly with the two existing enterprises.

With the return to political normality, expectations for the rest of fiscal 2006 should largely reverse the situation that prevailed in 2005. Most multilateral and bilateral

financial institutions have expressed their commitment to provide increased resources.

IDB agreed to new loans totalling US\$ 540 million over the next three years, US\$ 140 million of which are part of new ICF commitments from July 2006 onwards. The many donors showing their commitment to helping the new government deal with future challenges include the European Commission (20 million euros), the World Bank (US\$ 20 million), Canada (US\$ 48 million) and the United States Agency for International Development (USAID) (US\$ 40 million). These signals, while positive, will require the implementation in the medium term of additional measures such as debt relief schemes under the HIPC initiative and creditor programmes to grant forgiveness for more of Haiti's external debt.

## Jamaica

### 1. General trends

Jamaica maintained modest growth (1.4% in 2005, compared with 0.9% in 2004 and) due to the negative impact that rising international petroleum prices and natural disasters have had on production. Growth was led by buoyant tourism, construction and mining sectors, while manufacturing and agriculture contracted.

This sluggish economic growth —coupled with the fall in government income in the wake of hurricanes and the partial implementation of a tax reform package— caused a reduction in the tax burden that prevented the government from balancing its fiscal accounts. Nevertheless, efforts to control expenditure enabled the government to reduce its overall fiscal deficit from 4.8% of GDP in 2004 to 3.3% in 2005.<sup>1</sup>

This performance is partly attributable to the reduction of interest rates resulting from the stance taken by the monetary authorities during the first half of the year. In the second half of the year, a rise in inflation expectations forced the authorities to act with greater caution in order to maintain the stability of prices and the exchange rate.

The overall result of the balance of payments was positive, which swelled the stock of international reserves. The current account deficit, which widened owing to

rising petroleum prices and decreased earnings for certain traditional export products, was amply offset by the surplus in the capital and financial account. The surplus is attributable partly to increased inflows of foreign direct investment in the tourism and mining sectors, and partly to the rise in official flows resulting from the placement of Eurobonds on the international market.

The forecast for 2006 is 2.8% growth on the back of a rebounding agricultural sector, the continued dynamism of mining and tourism and 9% inflation. The government intends to continue focusing its efforts on reducing the fiscal deficit and the public debt, the latter being one of the main obstacles to Jamaica's medium- and long-term development. The fiscal objectives are based on expectations of stronger growth, a favourable international climate, an expansionary monetary policy and the renewal of the Memorandum of Understanding between the government and the Confederation of Trade Unions.

### 2. Economic policy

In 2005, economic policy was centered on the reduction of the public debt. This entailed adopting an expansionary monetary policy (which was called into question because it triggered a rise in inflation) and containing the expansion of the public wage bill.

#### (a) Fiscal policy

The government reduced the fiscal deficit with rigorous public spending control (33% of GDP in 2005, compared with 36% in 2004), the effects of which were

<sup>1</sup> The fiscal year runs from April 1 to March 31 of the following year.

Table 1  
**JAMAICA: MAIN ECONOMIC INDICATORS**

	1997	1998	1999	2000	2001	2002	2003	2004	2005 <sup>a</sup>
	<b>Annual growth rates<sup>b</sup></b>								
<b>Gross domestic product</b>	-1.0	-1.2	1.0	0.7	1.5	1.1	2.3	0.9	1.4
<b>Per capita gross domestic product</b>	-1.8	-2.0	0.2	0.0	0.9	0.6	1.8	0.5	1.0
<b>Gross domestic product, by sector</b>									
Agriculture, livestock, hunting, forestry and fishing	-13.3	-2.4	2.1	-12.5	6.3	-7.0	4.8	-8.9	-7.3
Mining	4.3	1.8	0.1	-1.0	2.6	3.3	4.9	2.6	2.8
Manufacturing	-2.6	-4.8	-1.9	0.6	0.8	-0.9	-0.9	3.0	-1.0
Electricity, gas and water	6.6	6.3	4.6	2.2	0.7	4.6	4.7	-0.1	4.1
Construction	-2.7	-6.6	-1.5	0.7	2.3	2.6	1.5	5.0	7.0
Wholesale and retail commerce, restaurants and hotels <sup>c</sup>	0.8	-1.3	-0.5	1.2	0.0	0.1	1.0	1.3	1.1
Transport, storage and communications	6.3	6.4	6.8	6.5	5.1	6.2	3.6	0.9	1.2
Financial institutions, insurance, real estate and business services	-8.3	-3.6	3.6	1.9	-4.8	4.0	3.3	0.3	1.0
Community, social and personal services <sup>c</sup>	0.5	1.0	0.7	1.5	-0.2	0.5	2.3	2.0	1.6
	<b>Millions of dollars</b>								
<b>Balance of payments</b>									
Current account balance	-332	-334	-216	-367	-759	-1 074	-773	-509	-975
Merchandise trade balance	-1 132	-1 131	-1 187	-1 442	-1 618	-1 871	-1 943	-1 945	-2 587
Exports, f.o.b.	1 700	1 613	1 499	1 563	1 454	1 309	1 386	1 602	1 659
Imports, f.o.b.	2 833	2 744	2 686	3 004	3 073	3 180	3 328	3 546	4 246
Services trade balance	467	477	655	603	383	315	552	572	670
Income balance	-292	-308	-333	-350	-438	-605	-571	-583	-637
Net current transfers	625	628	647	821	914	1 087	1 189	1 446	1 580
Capital and financial balance <sup>d</sup>	162	378	80	886	1 624	832	342	1 203	1 203
Net foreign direct investment	147	287	429	394	525	407	604	542	602
Financial capital <sup>e</sup>	15	91	-349	492	1 099	425	-263	661	601
Overall balance	-170	44	-136	518	865	-242	-432	694	229
Variation in reserve assets <sup>f</sup>	205	-27	155	-499	-847	261	448	-686	-229
Other financing <sup>g</sup>	-35	-17	-19	-19	-18	-19	-16	-8	0
<b>Other external-sector indicators</b>									
Real effective exchange rate (index: 2000=100) <sup>h</sup>	100.7	96.0	97.7	100.0	101.6	101.1	115.9	114.3	105.6
Gross external public debt (millions of dollars)	3 278	3 306	3 024	3 375	4 146	4 348	4 192	5 120	5 376
Gross external public debt (percentage of GDP)	44.0	42.7	39.1	42.8	51.1	51.3	51.2	58.0	53.0
Net profits and interest (percentage of exports) <sup>i</sup>	-8.6	-9.1	-9.6	-9.8	-13.1	-18.8	-16.2	-14.9	-15.6
	<b>Average annual rates</b>								
<b>Employment</b>									
Labour force participation rate <sup>j</sup>	66.6	65.6	64.5	63.3	63.0	63.6	64.4	64.3	63.9
Unemployment rate <sup>k</sup>	16.5	15.5	15.7	15.5	15.0	14.2	11.4	11.7	11.3
	<b>Annual percentages</b>								
<b>Prices</b>									
Variation in consumer prices (December-December)	9.2	7.9	6.8	6.1	8.7	7.3	14.1	13.7	12.9
Variation in nominal exchange rate (December-December)	3.6	2.6	10.7	10.2	4.3	6.0	20.7	2.0	4.5
Nominal deposit rate <sup>l</sup>	14.5	12.9	11.8	10.5	9.4	9.1	8.3	6.7	5.9
Nominal lending rate <sup>l</sup>	46.3	42.1	36.8	32.9	29.4	26.1	25.1	25.1	23.2
	<b>Percentages of GDP</b>								
<b>Central government</b>									
Total income <sup>m</sup>	24.8	25.8	29.2	29.1	27.0	28.0	30.3	31.1	29.4
Current income	24.4	25.3	27.0	28.1	25.7	26.2	28.7	29.3	27.9
Tax revenue	22.2	23.3	24.4	25.1	23.8	24.6	26.5	27.0	25.6
Capital income	0.2	0.2	1.9	0.5	0.7	1.6	1.4	1.0	1.3
Total expenditure <sup>n</sup>	32.3	32.5	33.3	30.0	32.6	35.7	36.1	35.9	32.7
Current expenditure	27.0	29.5	30.0	27.6	29.9	33.8	35.0	33.9	30.3
Interest	9.2	12.0	13.4	12.4	13.4	14.9	17.8	16.7	13.9
Capital expenditure	4.9	2.6	2.9	2.7	2.7	1.9	1.1	2.0	2.4
Primary balance	1.7	5.4	9.4	11.5	7.8	7.2	12.0	11.9	10.6
Overall balance	-7.5	-6.7	-4.0	-0.9	-5.6	-7.6	-5.8	-4.8	-3.3
Public-sector external debt	48.2	45.8	41.9	46.1	54.8	55.4	58.3	63.8	55.4
<b>Money and credit<sup>o</sup></b>									
Domestic credit <sup>p</sup>	...	...	42.3	40.1	41.6	40.2	43.4	43.3	40.6
To the public sector	...	...	33.9	33.4	35.1	31.9	32.4	29.6	25.8
To the private sector	...	...	10.4	8.6	8.7	10.2	13.0	15.2	15.6
Other	...	...	-1.9	-1.9	-2.2	-1.9	-2.0	-1.5	-0.9
Liquidity (M3)	...	...	39.5	39.6	39.3	39.6	38.3	39.1	34.6
Currency in circulation and local-currency deposits (M2)	...	...	30.7	30.1	29.5	28.9	26.0	25.8	22.8
Foreign-currency deposits	...	...	8.9	9.6	9.8	10.6	12.4	13.3	11.8

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

<sup>a</sup> Preliminary figures. <sup>b</sup> Based on figures in local currency at constant 1996 prices. <sup>c</sup> Restaurants and hotels are included in community, social and personal services. <sup>d</sup> Includes errors and omissions. <sup>e</sup> Refers to the capital and financial balance (including errors and omissions), minus net foreign direct investment. <sup>f</sup> A minus sign (-) denotes an increase in reserves. <sup>g</sup> Includes the use of IMF credit and loans and exceptional financing. <sup>h</sup> Annual average, weighted by the value of merchandise exports and imports. <sup>i</sup> Refers to net investment income as a percentage of exports of goods and services as shown on the balance of payments. <sup>j</sup> Economically active population as a percentage of the working-age population. <sup>k</sup> Unemployment rate as a percentage of the economically active population. Includes hidden unemployment; nationwide total. <sup>l</sup> Average rates. <sup>m</sup> Includes grants. <sup>n</sup> Includes statistical discrepancy. <sup>o</sup> The monetary figures are annual averages. <sup>p</sup> Refers to net credit extended to the public and private sectors by commercial banks and other

partially neutralized by the reduction of the tax effort from 27% of GDP in 2004 to 25.6% in 2005. The deficit was financed through two Eurobond issues amounting to US\$ 550 million: one with maturities of 10 years and a rate of return of 9%, and the other with a 20-year maturity and a 9.2% rate of return.

The performance of tax revenues is attributable to various factors. First, inflows were interrupted by external shocks (in particular natural disasters), and this had a negative effect on tax receipts.

Second, the authorities were unable to put into effect all the tax measures contemplated in the Report of the Tax Policy Review Committee (November 2004). Also, modifications were made to the proposed measures, delaying their implementation. The measures included increases in the income tax threshold, the general consumption tax (from 15% to 16.5%), taxation on the tourism sector and the special consumption tax, plus a reduction in the corporate income tax.

Third, the decrease in interest payments and wage payments and the increase in the income tax threshold diminished receipts for taxes on interest and pensions. Lastly, revenues from the special consumption tax dropped owing to the closure of Jamaica's only cigarette factory.

The total expenditure result was attributable to the contraction of current expenditure, since capital expenditure increased due to reconstruction efforts aimed at alleviating the destructive effects of recent natural disasters.

Current expenditure reflected falling interest and wage payments. In the case of wages, this was primarily due to compliance with the Memorandum of Understanding between the government and the unions, which seeks to freeze the wage bill. Lower interest payments were the result of the expansionary monetary policy.

The government's fiscal efforts, coupled with a strategy aimed at financing its fiscal deficit through fixed-rate bonds with longer maturity periods, helped to reduce the public debt balance from 143% of GDP in 2004 to 133% in 2005.

For 2006, the government predicts a fiscal deficit of 2% of GDP. The government and unions are considering

a new wage agreement that includes a wage bill increase of between 13% and 26%.

### **(b) Monetary and exchange-rate policy**

In the first half of the year, favourable external conditions enabled the Bank of Jamaica to increase its stock of net international reserves and adopt an expansionary monetary stance, lowering interest rates on its main instruments. Returns on reverse repo bonds fell three times in a row during the year, with a total reduction of 120 basis points for 30-day bonds 190 basis points for 365-day bonds.

The Bank of Jamaica operated with greater caution in the second half of the year. During this period, natural disasters and high petroleum prices put pressure on financial and goods markets. Expectations of lower yields prompted investors to avoid potential capital losses by seeking refuge in instruments indexed to inflation.

The Bank of Jamaica abstained from reducing interest rates and intervened in the exchange market to curb the excess demand for foreign exchange. It also mopped up some of the domestic liquidity by means of sterilization operations. The consequent reduction in net foreign and domestic assets resulted in a reduction of the monetary base.

Between February and December, the weighted average rate of return on treasury bonds dropped from 13.83% to 13.34% for three-month bonds and from 14.4% to 13.55% for six-month bonds. The weighted commercial bank lending rate fell from 5.3% to 4.9% in real terms.

The drop in the interest rates of commercial banks resulted in a rise in demand for credit (from 0.5% in 2004 to 3.2% in 2005). Demand for loans was driven primarily by tourism (23%), construction (6%), and transport and communications (5%).

The nominal exchange rate depreciated by 4% between December 2004 and December 2005, in line with the downward trend in interest rates, which was in turn counteracted by central bank interventions in the foreign-exchange market.

### 3. The main variables

#### (a) Economic activity

The growth rate of the economy rose slightly. Mining, construction and tourism were the most dynamic sectors, while agriculture and manufacturing turned in sluggish performances.

Agriculture contracted by 8.9% in 2004 and 7.3% in 2005, owing primarily to adverse climate conditions and, to a lesser extent, rising production costs. The sector is expected to rebound in 2006 by 3% as it recovers from the destructive effects of natural disasters.

The poor performance of manufacturing (down 1% in 2005, compared with an increase of 3% in 2004) is attributable to the closure of the Petrojam petroleum refinery, the effects of flooding and rising production costs resulting from high international petroleum prices. A decline of 1.3% is expected for 2006 as a result of rising petroleum prices, an unstable industrial climate, the closing of the only cigarette factory in the country and a diminishing supply of cement.

In the mining sector (up 2.6% in 2004 and 2.8% in 2005), the positive effect of the expansion in bauxite production (6.2%) was partially offset by the slower growth in alumina production (1.6%). Bauxite benefited from an increase in production capacity, while alumina production suffered from the destruction caused by natural disasters and labour unrest. In 2006, the sector is expected to expand by 4.7%.

Expansion in the construction sector (up 5% in 2004 and 7% in 2005) was fuelled by reconstruction activities, robust tourism and increased public spending on infrastructure. The current economic growth rate for the sector is expected to carry over into 2006 despite constraints affecting the cement industry.

Growth in the tourism sector (up 4.6% in 2004 and 3.4% in 2005) slowed due to cooling external demand and the effects of natural disasters. Natural disasters in other countries, however, had the positive effect of directing tourism toward destinations located in Jamaica.

#### (b) Prices, wages and employment

Inflation fell slightly, but remained in double digits (13.7% in 2004 and 12.9% in 2005). Price patterns responded partly to external shocks such as rising international fuel prices, increased food prices and the effects of natural disasters. They were also attributable to the rise in controlled prices, including increases in

the minimum wage, the rates for general and special consumption taxes and public transport fares.

A breakdown of the consumer price index (CPI) reveals that the categories posting the most significant increases were food and beverages and transport, which represented 59% and 13% of total price movements respectively.

In 2005, wages climbed in both the public and private sectors. The minimum wage rose by 20% in January of that year, and an amendment to the Memorandum of Understanding between the government and unions was also approved. The amendment includes the payment of a temporary allowance (from 19 September 2005 to 31 March 2006) to compensate government employees for lost purchasing power. Wages in the private sector increased by 11% on average.

The unemployment rate fell relative to the previous year (from 11.7% in 2004 to 11.3% in 2005). This pattern reflected reductions in male and female unemployment rates (the former falling from 7.9% in 2004 to 7.6% in 2005, and the latter from 16.4% in 2004 to 15.8% in 2005).

Projections for 2006 suggest a return to single-digit inflation. This prediction is based on the standardization of agriculture prices and the adoption of a prudent monetary policy. The possibility of future hikes in international petroleum prices and the wage increases being contemplated in the Memorandum of Understanding may jeopardize this goal.

#### (c) The external sector

The global balance registered a positive result, as the widening of the current account deficit (from 6% of GDP in 2004 to 10% in 2005) was amply offset by the surplus in the capital and financial account. Consequently, net international reserves expanded (from 21.1% of GDP in 2004 to 21.5% in 2005).

The performance of the current account is due mainly to the widening of the deficits on the trade balance and the income account.

The trade balance result (-US\$ 1.945 billion in 2004 and -US\$ 2.587 billion in 2005) reflected expanding imports of petroleum, chemicals and agricultural commodities resulting from the rise in the prices of these products on international markets. Exports expanded only slightly, as the increase in external sales of bauxite and alumina (23% and 13%, respectively) was partially offset by the contraction in sugar and bananas (down 22% and 63%, respectively).

The balance of services figure (US\$ 572 million in 2004 and US\$ 670 million in 2005) was primarily due to the rise in the number of tourists (1.3% and 4% in 2004 and 2005, respectively). The number of long-stay visitors grew by 4.5%, while the number of cruise ship passengers grew by 3%. Factors contributing to this performance included the increased capacity of air transport, rising hotel capacity, marketing efforts by the authorities and the redirecting of visitors toward Jamaica in the face of natural disasters that struck other tourist destinations.

The negative income balance result (-US\$ 583 million and -US\$ 637 million in 2004 and 2005,

respectively) reflect increased debt-servicing payments (US\$ 66 million) and profit repatriation outflows. Current transfers (US\$ 1.446 billion and US\$ 1.580 billion in 2004 and 2005, respectively) reflected remittances to the private sector.

The surplus on the capital and financial account (US\$ 1.203 billion in 2004 and 2005) was due to official capital inflows from international markets (resulting from the placement of Eurobonds valued at US\$ 550 million), operations to finance Air Jamaica and inflows of private capital to the tourism and mining sectors (US\$ 479 million and US\$ 923 million in 2004 and 2005, respectively).



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## Suriname

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### 1. General trends

The indicators show a good level of macroeconomic stability in Suriname. GDP looks set to continue its rapid growth, driven by high commodity export prices and rising foreign direct investment in mining.<sup>1</sup> President Venetiaan was re-elected in August 2005 for a second consecutive five-year term, and the new Government's objectives are to strengthen economic strategy, reform the public sector and pave the way for poverty reduction.

The new administration is off to a slow start. By law, the Multiannual Development Plan must be approved by the National Assembly before the first annual budget may be submitted. The plan was sent to the Assembly in June 2006, so the Government is operating on an extended 2005 budget. Meanwhile, the country is enjoying a degree of fiscal and monetary stability,

thanks to a conservative approach to spending and increased revenues.

Heavy rainfall in May 2006 caused rivers in the south to burst their banks. This natural disaster, unusual in Suriname, reflected the lack of development in the interior of the country and the plight of indigenous and Maroon communities.

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### 2. Economic policy

The most complex issue facing the new Government relates to the size, functions and efficiency of the public sector. A draft of the five-year plan dated March 2006 acknowledges that 40% of the economically active population is employed by the State and that the efficiency of public services is unsatisfactory. Social subsidies and transfers weigh heavily on the budget but fail to target the most vulnerable groups. Lastly, the existence of many of the State-owned corporations (which number more than 100) has been called into question. Three Inter-American Development Bank projects are under way to address public-sector reform.

In the field of economic policy, the private sector should promote growth and job creation. The Caribbean Single Market and Economy (CSME) took effect on 1 January 2006, but the private sector is showing little interest. A new investment law has been adopted, in order to harmonize conditions within CARICOM and improve the investment climate.

The Suriname Debt Management Office (SDMO), which began operating in 2004, has improved the transparency of information on public debt, and this has strengthened the country's position in international credit ratings. Preparations are under way for negotiations on arrears on certain bilateral loans, which have been detrimental to the country's access conditions for entering international capital markets.

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<sup>1</sup> GDP data are released in July each year. The National Planning Office projects 5.7% GDP growth for 2005 and 6.4% for 2006. IMF forecasts 5% and 4.5%, respectively.

Table 1  
**SURINAME: MAIN ECONOMIC INDICATORS**

	1997	1998	1999	2000	2001	2002	2003	2004	2005 <sup>a</sup>
	<b>Annual growth rates<sup>b</sup></b>								
<b>Gross domestic product</b>	2.2	3.1	-2.4	4.0	5.9	1.9	6.1	7.7	5.7
<b>Per capita gross domestic product</b>	1.3	2.1	-3.3	3.0	5.1	1.2	5.4	7.0	5.0
<b>Gross domestic product, by sector</b>									
Agriculture, livestock, hunting, forestry and fishing	-2.8	-6.4	4.4	5.9	11.4	-3.9	4.3	1.5	...
Mining	12.2	6.5	5.5	-8.8	25.0	-8.6	0.0	31.2	...
Manufacturing	0.2	2.1	-9.0	58.8	13.3	-3.6	5.6	9.5	...
Electricity, gas and water	3.3	7.1	-5.6	-7.7	2.1	10.3	-1.7	9.2	...
Construction	-20.6	16.6	-14.8	-11.8	4.5	0.6	17.0	10.1	...
Wholesale and retail commerce, restaurants and hotels	11.2	2.2	-5.6	-15.7	-14.5	8.4	32.2	6.0	...
Transport, storage and communications	6.7	5.6	1.8	25.0	28.7	12.6	-0.4	14.0	...
Financial institutions, insurance, real estate and business services	-1.6	1.8	-1.7	2.9	0.2	5.4	3.5	1.6	...
Community, social and personal services	0.3	3.1	0.0	2.0	2.0	1.1	0.2	1.3	...
	<b>Millions of dollars</b>								
<b>Balance of payments</b>									
Current account balance	-68	-155	-29	-34	-116	-60	-141	-59	-144
Merchandise trade balance	36	-27	44	13	16	52	-30	167	22
Exports, f.o.b.	402	350	342	514	449	529	639	871	1 212
Imports, f.o.b.	366	377	298	501	434	477	669	703	1 189
Services trade balance	-102	-125	-72	-115	-115	-128	-133	-130	-148
Income balance	-3	-1	0	-2	-80	-44	-49	-161	-40
Net current transfers	1	-2	-2	69	63	59	71	64	22
Capital and financial balance <sup>c</sup>	87	163	25	33	203	62	140	90	163
Net foreign direct investment	-9	9	-62	-148	-27	-74	-76	-37	-37
Financial capital <sup>d</sup>	96	154	86	181	230	136	216	128	200
Overall balance	19	8	-4	-1	87	2	-1	32	19
Variation in reserve assets <sup>e</sup>	-19	-8	4	1	-87	-2	1	-32	-19
<b>Other external-sector indicators</b>									
Net resource transfer (percentage of GDP)	10.9	17.3	3.3	4.0	18.5	1.9	8.1	-5.5	8.3
Gross external public debt (millions of dollars)	...	...	...	291	349	371	382	383	382
Gross external public debt (percentage of GDP)	...	...	...	37.6	52.5	38.9	34.1	29.8	25.8
Net profits and interest (percentage of exports) <sup>i</sup>	-0.5	-0.1	0.1	-0.2	-15.7	-7.7	-7.0	-15.9	-2.9
	<b>Average annual rates</b>								
<b>Employment</b>									
Unemployment rate <sup>f</sup>	11.0	11.0	12.0	14.0	14.0	10.0	7.0	...	...
	<b>Annual percentages</b>								
<b>Prices</b>									
Variation in consumer prices (December-December)	17.4	22.9	112.9	76.1	4.9	28.4	14.0	9.3	15.8
Variation in nominal exchange rate (December-December)	0.0	0.0	146.3	120.6	0.0	15.4	4.4	3.5	0.8
Nominal deposit rate <sup>g</sup>	...	16.0	15.6	15.5	11.9	9.0	8.3	8.3	8.0
Nominal lending rate <sup>h</sup>	...	27.1	27.4	29.0	25.7	22.2	21.0	20.4	18.1
	<b>Percentages of GDP</b>								
<b>Central government</b>									
Total income	...	...	...	...	37.1	26.6	27.2	27.7	28.1
Current income	...	...	...	...	34.1	25.5	25.9	26.3	27.2
Tax revenue	...	...	...	...	29.7	21.0	21.7	21.6	22.1
Capital income	...	...	...	...	13.9	9.1	9.2	10.3	11.4
Total expenditure	...	...	...	...	36.7	31.0	26.5	28.5	30.2
Current expenditure	...	...	...	...	31.0	28.0	23.6	24.7	26.2
Interest	...	...	...	...	2.0	2.3	2.0	1.7	1.8
Capital expenditure	...	...	...	...	5.0	2.9	2.6	3.8	4.0
Primary balance	...	...	...	...	2.3	-2.1	2.6	0.8	-0.3
Overall balance	...	...	...	...	0.4	-4.4	0.7	-0.8	-2.1
Public sector debt	...	...	...	...	55.3	48.7	42.5	41.5	38.9
Domestic	...	...	...	...	7.8	13.9	12.1	15.2	15.6
External	...	...	...	...	47.5	34.9	30.3	26.3	23.3
<b>Money and credit</b>									
Domestic credit	18.5	24.2	26.5	25.2	22.9	19.8	24.3	24.5	26.3
To the public sector <sup>i</sup>	1.0	5.3	11.7	15.7	15.6	8.1	9.5	8.3	8.4
To the private sector	17.6	18.9	14.7	9.4	7.2	11.6	14.7	15.9	17.8
Other	0.0	0.0	0.1	0.0	0.0	0.0	0.1	0.3	0.2
M1	...	...	...	22.8	19.0	17.6	15.9	14.9	15.3
M2	...	...	...	36.9	30.7	25.6	23.1	21.5	22.5

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

<sup>a</sup> Preliminary figures. <sup>b</sup> Based on figures in local currency at constant 1990 prices (1996-1998: guilders; 1999-2004: Suriname dollars, new currency in circulation since January 2004). <sup>c</sup> Includes errors and omissions. <sup>d</sup> Refers to the capital and financial balance (including errors and omissions), minus net foreign direct investment. <sup>e</sup> A minus sign (-) denotes an increase in reserves. <sup>f</sup> Unemployment rate as a percentage of the economically-active population, nationwide total. <sup>g</sup> Deposit rate published by IMF. <sup>h</sup> Lending rate published by IMF. <sup>i</sup> Refers to net credit extended to the public and private sectors by commercial banks and other financial and banking institutions.

**(a) Fiscal policy**

In 2005 the overall fiscal deficit widened by 1.3 percentage points to 2.1% of GDP.<sup>2</sup> Despite strict control of public-sector employment and wages, higher spending on goods and services more than offset the growth of tax receipts. The deficit was financed with an increased issue of treasury bonds.

The budget for 2006 anticipates a still higher deficit, but actual spending, particularly capital spending, usually falls well short of what is planned.

Fiscal revenue will continue to depend mainly on the prices of commodities such as bauxite, alumina, gold and oil. In 2005, the State Oil Company of Suriname (Staatsolie) contributed US\$ 80 million to the treasury, almost 17% of total revenue and about three times the previous year's amount.

Another factor in the vulnerability of fiscal revenues as of September 2005 was the fuel taxing mechanism. Fixed retail price for fuels were in place, and had not been revised since March 2003. Distribution margins were also fixed, and the difference between costs and the retail price accrued to the Government. This represented a positive contribution to the State, equivalent to 4% of GDP in 2003; by mid-2005, however, rising fuel costs meant that the Government was no longer receiving revenue from that tax, but paying a subsidy equivalent to 1% of GDP. In September 2005, the new Government was forced to double domestic fuel prices, and in December 2005 a new pricing and taxation mechanism came into effect.

In the area of fiscal policy, the five-year plan's main proposals on the revenue side relate to the creation of a Tax Authority and the introduction of value-added tax instead of the sales tax.

Fiscal expenditure rose by more than one percentage point of GDP owing to the strong increase (2.2 percentage points of GDP) in spending on goods and services, for which the authorities have offered no explanation. Expenditure on public-sector wages and social subsidies did not grow as fast as GDP; they have not been adjusted since late 2004, except for the introduction of an allowance to compensate for increased fuel prices.

The current-account fiscal balance is still positive, but less so than in previous years. The global deficit is due to increased capital spending and diminishing grants, and was financed by the issue of treasury bonds. The 2002 legislation on public debt established a ceiling of 15% of GDP for domestic public debt, but the actual ratio is higher (15.6% according to ECLAC estimates) and is trending

upwards. A revision of the ceiling is being considered. Since the external debt has practically not increased, total public debt as a percentage of GDP has been declining rapidly in recent years.

**(b) Monetary and exchange-rate policy**

Monetary policy has been aimed at providing liquidity in response to the needs of the economy. In this context, the draft five-year plan provides for a maximum M2/GDP ratio of 25%. The ratio is currently lower but trending upward.

Monetary policy was expansionary in terms of the local-currency market, but not in foreign currency. The cash reserve requirement in local currency was lowered from 30% to 27%, and the part of that requirement that may be fulfilled with long-term mortgage loans for social housing was expanded from 7% to 8%. Consequently, domestic credit to the private sector increased by almost one percentage point of GDP. In foreign currency, however, reserve requirements were increased from 22.5% to 33.5%.

Treasury bonds have become an instrument of monetary policy. In early 2006, the interest rate on the bonds was reduced from 12.5% to 10%. The draft five-year plan proposes the establishment of an auction system for treasury bonds, to improve the functioning of the domestic capital market.

As for its exchange-rate policy, Suriname has moved closer to a fixed exchange-rate system. The authorities increased the exchange rate from 2.75 to 2.78 Surinamese dollars to the United States dollar, and imposed a "code of conduct" instructing exchange houses not to exceed a rate of SRD 2.80. This exchange-rate policy is intended to restore public confidence in the national currency and contain inflationary expectations.

**(c) Other policies**

The March 2006 draft of the five-year plan offers a gamut of policy proposals. Together with sectoral plans to channel and coordinate international aid, such as the "Vision 2020" project, a medium- and long-term development strategy is emerging based around the Millennium Development Goals.

In the energy sector, electricity prices do not cover the cost of production, so resources for investment and maintenance are scarce. A national energy advisory committee was established in January 2006 to review the pricing policy.

<sup>2</sup> The fiscal data are preliminary, and GDP figures are only projections.

The transport and communications sector has seen positive developments, mostly owing to intensifying regional and international integration. The Government has pledged to build roads in the interior of the country during the five-year planning period, as well as improving land transport linkages with South America. An integrated master plan for the development of waterways has also been announced.

In addition, an air transport authority will be set up

and the air travel sector will be further liberalized. As of 1 May 2006, the air route between Amsterdam and Paramaribo was opened up to competition.

Lastly, mining is another essential sector for the country's economic growth. A new draft mining law was submitted to the National Assembly, providing for increased taxation, shortened concession periods, and a reduction of maximum concession areas. A Minerals Institute will be established, to guide policy in the sector.

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### 3. The main variables

#### (a) Economic activity

The economy grew at a rate of 5.7% in 2005. A figure of about 6.4% is expected for 2006, depending on fluctuations in commodity export prices.

International prices for oil, gold and alumina continued their upward trend in 2005. The first half of 2006 should see increased exploration activities, greater demand for mining-related services and higher tax revenue.

Crude oil production at Staatsolie was 5.5% higher in 2005 than in 2004. Gold production at Cambior's Gross Rosebel mine was 25% higher and, in January 2005, the Suriname Aluminum Company (Suralco) boosted its capacity by 15% by expanding the alumina refinery in Paranam.

Service sectors showed considerable growth, boosted by the strong performance of the commodities sector. Projections from the National Planning Office show that after mining (15.4%), the sectors with the strongest growth were transport and communications (10.6%) and construction (10.3%). Basic services, hotels, restaurants and commerce also enjoyed above-average growth.

The agriculture, fisheries and manufacturing sectors averaged 3.4% growth. Prospects vary for these sectors: the rice industry is looking at a new organizational set-up based on commodity boards (productschappen), and solutions are being considered for the debts inherited from the former State company. Rice production was down 18% in the last four months of 2005, compared with the same period in 2004.

The privatization of the banana company is pending confirmation of new arrangements for accessing the European market. In the same four months, production was up 50% compared with the year-earlier period. The fisheries sector, which includes shrimp fisheries, has been going through a severe crisis (-9%), owing to high fuel

costs, obsolete equipment and inadequate organizational and regulatory structures.

The number of visitors to the country rose by 20% in the first seven months of 2005 compared with the same period in 2004, but the emerging ecotourism sector was hit by the floods that struck the country in May 2006.

#### (b) Prices, wages and employment

Consumer prices were pushed upwards (15.8% in 2005, compared with 9.1% in 2004) by the fuel price rise of 1 September 2005. Nonetheless, inflation has fallen since November 2005.

Public-sector wages have not been adjusted since November 2004. Since January 2006, however, public servants have been receiving a bonus to compensate for rising fuel prices. The average gross labour cost per worker for large employers, including State bodies, was 18% higher from May to August 2005 than in the same period in 2004. Wages in the banking sector climbed steeply, and other upswings are reported in insurance companies and hotels and restaurants.

Little information is available on employment and unemployment. In his New Year speech, the President mentioned a figure of 8% for unemployment in 2005. Such a figure would be very close to the 8.4% rate recorded in 2004.

#### (c) The external sector

The current-account deficit (US\$ 144 million) was mostly due to the deficit in the services account (US\$ 148 million), made up of the deficit on the transport services account (US\$ 65 million) and on the other services account (US\$ 111 million), which relates to mining industry operations. The income account remained negative owing to the repatriation of mining-industry profits.

The balance of goods account posted a slight surplus. Merchandise exports exceeded US\$ 1.2 billion in 2005, whereas in the early 2000s they barely reached US\$ 500 million. The difference was due to rising commodity prices and the beginning of operations at the large-scale gold mine at Rosebel.

The import bill also doubled over the same period. On the one hand, the country's exports are very import-intensive and, on the other, imports were affected by rising oil prices because Suriname depends on a number

of types of imported fuel. Imports of consumer goods were also boosted by higher incomes.

The external debt has not risen in nominal terms since 2003. With three years of fast GDP growth, the debt/output ratio declined from 30% in 2002 to 25% in 2005. Arrears on the servicing of certain large bilateral loans have had a negative effect on the country's rating with international credit agencies. Net international reserves were up by US\$ 19 million, although import coverage remained below the two-month mark.



## Trinidad and Tobago

### 1. General trends

The economic growth rate in Trinidad and Tobago remained high, as in the previous year (6.5% and 7% in 2004 and 2005, respectively), helped by the strong performance of the energy sector. The upward trend in oil prices had a positive impact on construction, manufacturing, government revenue and external sales. Growth in 2006 is expected to be close to 10%.

The government increased its fiscal surplus (2.5% and 5.5% in 2004 and 2005, respectively) thanks to a marked increase in tax revenue from oil companies, and this helped to finance higher public spending. The fiscal surplus was used to create a petroleum stabilization fund to protect the economy from fluctuations in world oil prices.

Increased liquidity resulting from higher foreign exchange inflows, increased public expenditure and rising inflation (5.6% and 7.2% in 2004 and 2005, respectively)

led the authorities to adopt a contractionary policy. The central bank based its policy mainly on the discount rate, complementing it with open-market operations.

The overall balance of the external sector was positive (6% and 13.7% of GDP in 2004 and 2005, respectively), which boosted international reserves. The current-account surplus, strengthened by exports of oil and petroleum products, was accompanied by a downturn in the capital and financial account deficit.

### 2. Economic policy

#### (a) Fiscal policy

Central government showed a higher positive balance than in the previous year thanks to increased current income (29% and 35% of GDP in 2004 and 2005, respectively), which exceeded the rise in public spending (26% and 29% of GDP). The authorities prepared the Government spending budget on the basis of oil prices standing at US\$ 35 per barrel, considerably below the market price (US\$ 65 per barrel).

Increased State revenue was mostly due to the positive impact of rising oil prices. On the other hand, tax receipts from the non-energy sector stagnated, and this situation is expected to worsen as a result of the Government's tax reforms, which came into effect in 2006 and have led to significant cuts for most taxpayers.

Among other things, the reforms involve increased personal allowances and tax exemptions. A single rate of 25% was introduced for individuals' incomes, and the rate for legal persons was cut from 30% to 25%, except for petrochemical and energy companies, which will continue to be taxed at 33% and 55%, respectively. As of 1 January 2006, small and medium-sized enterprises may, in certain circumstances, benefit from a five-year tax exemption regime.

The growth of overall spending was mostly influenced by increases in transfers and subsidies (11% and 13% of GDP in 2004 and 2005, respectively) and capital expenditure (2.1% and 3.4%). Resources allocated to transfers and subsidies, amounting to half the total, were mostly spent on reforming State-owned corporations and improving their infrastructure. Other expenditure items

Table 1  
**TRINIDAD AND TOBAGO: MAIN ECONOMIC INDICATORS**

	1997	1998	1999	2000	2001	2002	2003	2004	2005 <sup>a</sup>
	<b>Annual growth rates<sup>b</sup></b>								
<b>Gross domestic product</b>	7.7	8.1	8.0	6.9	4.2	7.9	13.4	6.5	7.0
<b>Per capita gross domestic product</b>	7.2	7.7	7.7	6.5	3.8	7.6	13.0	6.2	6.7
<b>Gross domestic product, by sector</b>									
Agriculture, livestock, hunting, forestry and fishing	13.1	-7.2	2.3	-2.4	8.7	8.7	-18.2	-21.1	-0.5
Mining <sup>c</sup>	0.9	8.9	21.6	12.5	5.6	13.5	31.3	7.9	10.9
Manufacturing	7.9	11.5	-7.2	6.0	9.8	3.8	4.2	9.5	8.6
Electricity, gas and water	10.0	6.7	0.3	5.5	4.1	8.7	2.7	4.4	5.3
Construction <sup>d</sup>	-0.7	14.2	6.0	7.6	10.3	-5.1	22.4	14.5	8.1
Wholesale and retail commerce, restaurants and hotels	17.7	7.4	8.7	5.4	-2.5	1.4	1.6	3.4	3.7
Transport, storage and communications	18.3	15.6	0.8	8.9	7.7	9.4	3.9	1.5	6.4
Financial institutions, insurance, real estate and business services	22.5	-0.4	11.7	12.4	0.8	11.5	7.3	9.7	0.5
Community, social and personal services	0.9	3.6	-3.3	-4.3	-0.4	4.3	0.6	1.7	1.1
	<b>Millions of dollars</b>								
<b>Balance of payments</b>									
Current account balance	-614	-644	31	544	416	76	985	1 623	2 741
Merchandise trade balance	-529	-741	64	969	718	238	1 293	1 509	2 648
Exports, f.o.b.	2 448	2 258	2 816	4 290	4 304	3 920	5 205	6 403	8 373
Imports, f.o.b.	2 977	2 999	2 752	3 322	3 586	3 682	3 912	4 894	5 725
Services trade balance	292	416	329	166	204	264	314	512	596
Income balance	-381	-341	-400	-629	-539	-480	-681	-450	-554
Net current transfers	4	22	38	38	33	55	59	53	53
Capital and financial balance <sup>e</sup>	807	724	131	-103	86	39	-576	-889	-848
Net foreign direct investment	999	730	379	654	685	684	1 034	600	599
Financial capital <sup>f</sup>	-192	-6	-248	-757	-599	-645	-1 609	-1 489	-1 447
Overall balance	194	80	162	441	502	116	409	734	1 893
Variation in reserve assets <sup>g</sup>	-175	-76	-162	-441	-502	-116	-409	-734	-1 893
Other financing <sup>h</sup>	-18	-4	0	0	0	0	0	0	0
<b>Other external-sector indicators</b>									
Real effective exchange rate (index: 2000=100) <sup>i</sup>	107.9	105.3	102.2	100.0	94.5	91.1	91.8	93.2	91.8
Net resource transfer (percentage of GDP)	6.8	6.0	-3.9	-9.0	-5.1	-4.9	-11.8	-11.0	-10.2
Gross external public debt (millions of dollars)	1 565	1 471	1 585	1 680	1 666	1 549	1 553	1 351	1 281
Gross external public debt (percentage of GDP)	26.1	23.3	23.3	20.6	18.9	17.2	14.5	11.1	9.3
Net profits and interest (percentage of exports) <sup>j</sup>	-12.7	-11.6	-11.7	-13.0	-11.1	-10.5	-11.6	-6.1	-6.0
	<b>Average annual rates</b>								
<b>Employment</b>									
Labour force participation rate <sup>k</sup>	...	...	60.8	61.2	60.7	60.9	61.6	63.0	63.7
Unemployment rate <sup>l</sup>	15.0	14.2	13.2	12.2	10.8	10.4	10.5	8.4	8.0
	<b>Annual percentages</b>								
<b>Prices</b>									
Variation in consumer prices (December-December)	3.5	5.6	3.4	5.6	3.2	4.3	3.0	5.6	7.2
Variation in nominal exchange rate (December-December)	1.7	-0.2	0.2	0.0	-0.3	0.3	0.0	-0.4	-0.2
Nominal deposit rate <sup>m</sup>	...	5.4	5.3	5.3	5.3	3.5	2.9	2.4	1.7
Nominal lending rate <sup>m</sup>	...	17.0	17.1	16.5	15.6	13.4	11.0	9.4	9.1
	<b>Percentages of GDP</b>								
<b>Central government</b>									
Total income	...	...	22.6	25.4	24.4	25.7	26.5	28.6	34.6
Current income	...	...	22.4	25.3	24.3	25.6	26.5	28.6	34.6
Tax revenue <sup>n</sup>	...	...	15.7	14.9	15.5	16.0	14.7	16.3	15.6
Capital income	...	...	0.2	0.1	0.1	0.1	0.0	0.0	0.0
Total expenditure	...	...	25.8	23.8	24.5	25.0	23.8	26.1	29.1
Current expenditure	...	...	24.6	21.4	22.9	23.7	22.6	24.0	25.7
Interest	...	...	5.5	4.7	4.0	4.1	3.7	3.3	2.7
Capital expenditure and net lending	...	...	1.2	2.4	1.6	1.3	1.3	2.1	3.4
Primary balance	...	...	2.3	6.3	4.0	4.8	6.4	5.8	8.2
Overall balance	...	...	-3.2	1.6	-0.1	0.6	2.7	2.5	5.5
Public-sector external debt	27.3	24.3	23.3	20.6	18.9	16.3	14.4	12.6	1.7
<b>Money and credit<sup>o</sup></b>									
Domestic credit <sup>p</sup>	39.9	36.1	36.5	28.6	25.1	26.6	22.7	19.3	15.5
To the public sector	9.7	7.9	7.9	0.6	-2.5	-2.0	-2.6	-7.3	-10.5
To the private sector	30.2	28.2	28.6	28.0	27.6	28.6	25.3	26.5	26.0
Liquidity (M3)	37.4	40.9	39.7	34.6	36.3	39.6	34.4	33.3	33.8
Currency in circulation and local-currency deposits (M2)	29.3	31.1	30.2	25.8	26.8	30.0	26.6	24.7	25.8
Foreign-currency deposits	8.1	9.8	9.5	8.8	9.5	9.7	7.8	8.6	...

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

<sup>a</sup> Preliminary figures. <sup>b</sup> Based on figures in local currency at constant 2000 prices. <sup>c</sup> Refers only to the oil sector. <sup>d</sup> Includes quarrying. <sup>e</sup> Includes errors and omissions. <sup>f</sup> Refers to the capital and financial balance (including errors and omissions), minus net foreign direct investment. <sup>g</sup> A minus sign (-) denotes an increase in reserves. <sup>h</sup> Includes the use of IMF credit and loans and exceptional financing. <sup>i</sup> Annual average, weighted by the value of merchandise exports and imports. <sup>j</sup> Refers to net investment income as a percentage of exports of goods and services as shown on the balance of payments. <sup>k</sup> Economically active population as a percentage of the working-age population. Nationwide total. <sup>l</sup> Unemployment rate as a percentage of the economically active population. Includes hidden unemployment. Nationwide total. <sup>m</sup> Weighted average. <sup>n</sup> Includes interest. <sup>o</sup> The monetary figures are annual averages. <sup>p</sup> Refers to net credit extended to the public and private sectors by commercial banks and other financial and banking institutions.

remained at the previous year's levels.

To enhance spending capacity and efficiency, many State-owned corporations were created or strengthened. These include the Urban Development Corporation of Trinidad and Tobago Limited (UDeCOTT), which is involved in a number of projects. Other recently-established corporations include the Educational Facilities Company Limited (March 2005), responsible for building schools, and the Rural Development Company of Trinidad and Tobago Limited (May 2005), which is mostly involved in public investment projects in rural areas.

The growing fiscal imbalance in the non-energy sector is giving rise to increasing concern. If oil is excluded from Government accounts, the fiscal balance is strongly negative (-8% and -11% of GDP for 2004 and 2005, respectively). The non-energy fiscal deficit will grow still further when measures to reduce the tax burden for the non-energy sector come into force and fiscal expenditure on development projects is increased. This will greatly increase the dependency of spending and of the overall orientation of fiscal policy on the surplus generated by the energy sector.

#### **(b) Monetary and exchange-rate policy**

The country's economy showed a considerable increase in liquidity in 2005, mostly owing to rising international reserves and the monetization of oil revenue, which were reflected in expansion of the monetary base and money supply.

Growing liquidity, inflationary pressure, the narrowing of the gap between internal and external interest rates and the resulting pressure on the foreign-exchange market, and the scarcity of certain foodstuffs led the monetary authorities to adopt a contractionary policy. As a result, the central bank applied eight 25-basis-point increases to its benchmark rate, bringing it up from 5% in early 2005 to 7% in May 2006.

The central bank strengthened its monetary position by means of open-market operations in local and foreign currency, in order to sterilize liquidity. In keeping with that measure, it abolished the interest rate for bank deposits with the central bank, seeking to deter the placement of commercial banks' excess liquidity in that type of deposits and encouraging them to purchase central bank securities. The legal reserve requirement was not reduced as had been planned for 2005, but remained at 11%. Lastly, in December, the central bank adopted an unusual measure, requiring the commercial banks to deposit one billion Trinidad and Tobago dollars (TT\$) in a one-year interest-bearing account.

These measures, however, were not sufficient to decisively influence fluctuations in the range of the

commercial banks' nominal interest rates, in real interest rates, which actually fell, and in demand for credit, which grew, mostly owing to rising demand for personal loans.

Monetary policy had a limited impact in terms of controlling liquidity and inflationary expectations, but it boosted demand for long-term government bonds. Investors showed a preference for six- and twelve-month bonds rather than the more usual three-month ones, and this steepened the yield curve for such investments.

On the foreign-exchange market, the pressure for devaluation increased because of higher demand for foreign exchange resulting from the narrowing of the gap between internal and external interest rates, rising prices, stronger demand for imported construction materials, and foreign-currency purchases. The central bank intervened heavily, given its high level of reserves, and was able to protect the stability of the nominal exchange rate (6.29 and 6.33 Trinidad and Tobago dollars for one United States dollar). Nonetheless, the real exchange rate rose because of the increased price differential between tradables (external inflation) and non-tradables (internal inflation).

#### **(c) Other policies**

The authorities hope to make Trinidad and Tobago a regional financial centre. Owing to the banking crises of the past, it is recognized that achieving that goal will require the regulation of the financial system to adapt to the rapid development of local financial activities in recent years.

In 2005, efforts continued to strengthen the financial-sector supervision and regulation regime in order to improve compliance with international standards and best practices. One of the pillars of the regulatory reform is the replacement of regulation based on compliance with established standards and auditing services with a system based on risk estimation. This would aim to identify as quickly as possible the early signs of potential problems in financial institutions, and to restrict their spread to other institutions in the sector. The Financial Institutions Act, 1993, has been amended in order to centralize the regulatory function, the promotion of financial efficiency and the prevention of unfair practices. The monetary authorities are also taking measures to ensure that the commercial banks comply with the Basel Core Principles, including the changes to regulatory and supervisory frameworks, in preparation for the signature of the New Basel Capital Accord (Basel II).

The central bank also has the power to supervise financial conglomerates engaging in interlinked transactions, and ensure improved supervision of insurance companies and non-banking financial institutions, particularly credit

unions. As of 2005, insurance companies are required to produce quarterly reports, and guidelines were adopted for the financing of pension funds and the presentation of their financial statements. All this is essential to prevent any mismatch of assets and liabilities, and inappropriate risks which might affect consumers. As for the capital market, the Securities Industry Act has been updated to

bring the regulatory system into line with international standards, and an independent credit rating agency has been established. In 2004, Caribbean Information and Credit Rating Services Limited (CARICRIS) was set up, to evaluate other financial institutions. Subsequently, in 2005, a clearing house was set up to process high-volume electronic payments.

### 3. The main variables

#### (a) Economic activity

The economic growth rate in Trinidad and Tobago was similar to the previous year's (6.5% and 7% in 2004 and 2005, respectively). The energy sector was the main engine of growth, contributing over 40% of the country's GDP. Construction, manufacturing and transport services also contributed to growth.

The energy sector (8% in 2004 and 11% in 2005) benefited from rising world oil prices and expanding production capacity, with the launching in 2005 of the world's biggest methanol plant (leading to a 38% increase in methanol exports), and Atlantic LNG's fourth natural-gas plant. Trinidad and Tobago is currently the world's fifth largest exporter of liquefied natural gas (LNG). Lastly, a new discovery of crude oil reserves boosted the production rate (17% in 2005).

Manufacturing was strengthened by growing demand for cement from the construction sector, whose growth figure of 8.1% was due to increased private- and public-sector spending, especially through expansion in productive capacity in the energy sector and in infrastructure.

The downturn in agriculture was very slight compared with the previous year (-21% and -0.5% in 2004 and 2005). The sugar subsector, however, lost about 25% for raw sugar and 15% for refined sugar, and citrus fruits slumped by 35%. The agricultural sector was faced with rising production costs, adverse weather conditions which hit the sugar industry hardest, and technical difficulties.

#### (b) Prices, wages and employment

Inflation continued to rise (5.6% and 7.2% in 2004 and 2005, respectively). This trend was due to increased liquidity, rising world oil prices, insufficient supply of

certain staple foods, and rising demand for cement in the construction sector. A breakdown of the consumer price index shows that the most significant increase was in the food component, making up 70% of the total. There were also marked increases in construction materials and housing costs.

The unemployment rate dipped slightly (8.4% and 8.0% in 2004 and 2005, respectively), reflecting the upswing of employment in certain sectors such as construction and energy. This improvement made up for falls in other activities, including manufacturing (with the adoption of more capital-intensive methods) and agriculture. The labour force participation rate rose from 63% in 2004 to 63.7% in 2005.

#### (c) The external sector

The overall balance of payments result was positive, and higher than the 2004 figure. The current-account surplus (13.3% and 19.9% of GDP in 2004 and 2005, respectively) more than made up for the deficit on the capital and financial account (11% and 1% of GDP). As a result, the country's international reserves increased (23% and 33% of GDP in 2004 and 2005, respectively).

The performance of the current account was basically due to rising exports of goods and, more specifically, to increases in both the price and the volume of the country's main exports (31%, 15% and 38% for crude oil, petroleum products and methanol, respectively). Imports rose by 17%, mainly owing to economic growth, especially rising demand for raw materials and intermediate goods. The balance of the capital and financial account was due to reduced net flows from commercial banking and regional bond issues, and net foreign direct investment remained stagnant.

## Turks and Caicos Islands<sup>1</sup>

### 1. General trends

In 2005, the Turks and Caicos Islands turned in a strong performance with growth of 12% (compared to 11.6% in 2004).<sup>2</sup> The economy was driven by tourism, which is the mainstay of the economy. The expansion of the tourism industry was a catalyst for the other sectors, especially construction and communications and, to a lesser extent, manufacturing.

The authorities managed to reduce the fiscal deficit from 3.6% of GDP in fiscal 2004 to 1% in fiscal 2005<sup>3</sup> despite unforeseen increases in expenditure on health and education. The deficit was financed with external resources, which led to an increase in the external debt stock. Inflation rose slightly, reaching 3.7% in 2005.

The balance of payments posted a positive result, both in the current account and in the capital account. The current account surplus was due to the increase in tourism income, which amply compensated for the significant rise in the energy bill. The trend in the capital and financial account reflected larger flows of foreign direct investment and official aid.

In 2006, the authorities hope to maintain the current economic growth and inflation rates (11% and 3.5%, respectively). Projections include an increase in the fiscal deficit to a figure close to 4% of GDP and a public debt stock of 25% of GDP. One of the government's main medium- and long-term goals is to diversify productive activity (which hitherto has been concentrated geographically in Providenciales Island) in order to achieve more balanced economic development and to create a stable framework that will be conducive to tourism development and will help to attract adequate inflows of foreign exchange.

### 2. Economic policy

#### (a) Fiscal policy

The government reduced its fiscal deficit, thanks to the significant increase in current income, from 24% of GDP in fiscal 2004 to 28% in fiscal 2005. This result was due to the rise in the collection of revenues from import duties, stamp duties, work permits and residency fees, as well as the high level of economic growth, the buoyancy of the tourism sector and the increase in commercial and residential construction.

Government expenditure, which was equivalent to 25% of GDP, climbed by 17% in 2005 owing to the increase in overseas medical costs, student grants and disbursements relating to public security, which amounted to 70% of current expenditure for fiscal 2005. The government increased the police budget by 50%, police wages rose by 30% and 40 new officers were recruited.

Fiscal accounts will probably show a deficit equivalent to 4% of GDP in fiscal 2006. The government plans to

<sup>1</sup> In its resolution 628(XXXI), ECLAC granted the Turks and Caicos Islands the status of associated member of the Commission.

<sup>2</sup> This corresponds to growth of GDP at basic prices.

<sup>3</sup> The Turks and Caicos Islands record their government accounts on the basis of a fiscal year that runs from 1 April to 31 March of the following year.

Table 1  
**TURKS AND CAICOS ISLANDS: MAIN ECONOMIC INDICATORS**

	2000	2001	2002	2003	2004	2005 <sup>a</sup>
			<b>Annual growth rates<sup>b</sup></b>			
<b>Gross domestic product</b>	...	7.3	-0.3	8.6	11.6	12.0
<b>Per capita gross domestic product</b>	...	-0.5	-3.7	-9.1	1.9	2.3
<b>Gross domestic product, by sector</b>						
Agriculture, livestock, hunting, forestry and fishing	...	5.9	-20.9	20.5	10.4	7.2
Mining	...	6.6	-7.6	11.2	28.2	24.6
Manufacturing	...	-10.8	-14.6	11.0	1.6	9.1
Electricity, gas and water	...	3.0	22.4	0.0	26.2	5.3
Construction	...	6.6	-7.6	11.2	28.2	24.6
Wholesale and retail commerce, restaurants and hotels	...	2.8	5.9	9.4	16.2	10.4
Transport, storage and communications	...	9.2	-7.4	6.6	6.5	15.5
Financial institutions, insurance, real estate and business services	...	5.4	2.1	0.5	17.3	5.4
Community, social and personal services	...	4.3	3.2	6.3	13.4	11.7
	...	10.5	8.8	9.3	7.0	13.0
			<b>Millions of dollars</b>			
<b>Balance of payments</b>						
Current account balance	89	97	105	97	85	32
Merchandise trade balance	-140	-149	-147	-161	-209	-289
Exports, f.o.b.	9	7	9	10	12	15
Imports, f.o.b.	149	156	156	170	221	304
Services trade balance	228	246	253	257	293	322
Net foreign direct investment	84	93	85	103	150	222
<b>Other external-sector indicators</b>						
Total gross external debt (millions of dollars) <sup>c</sup>	3.6	3.6	13.9	13.9	37.2	40.4
Total gross external debt (percentage of GDP) <sup>c</sup>	1.1	1.0	3.8	7.7	10.0	17.0
			<b>Average annual rates</b>			
<b>Employment</b>						
Labour force participation rate <sup>d</sup>	...	79.4	80.3	80.4	80.1	79.3
Unemployment rate <sup>e</sup>	...	9.7	6.2	7.8	9.9	8.0
			<b>Annual percentages</b>			
<b>Prices</b>						
Variation in consumer prices (December-December)	3.4	1.6	2.4	1.9	3.3	3.7
			<b>Percentages of GDP</b>			
<b>State income and expenditure</b>						
Current income	22.5	20.9	22.9	25.5	24.2	28.1
Current expenditure	20.3	21.2	21.5	22.9	25.1	25.1
Current balance	2.2	-0.3	1.4	2.5	-0.9	3.0
Net capital expenditure	-4.7	-3.9	-2.2	-2.7	-2.9	-3.8
Overall balance <sup>f</sup>	-0.9	-2.5	-0.8	0.1	-3.6	-0.8
<b>Money and credit<sup>g</sup></b>						
Net domestic credit <sup>h</sup>	62.5	63.1	68.7	65.7	65.1	70.2
To the public sector	0.0	0.0	0.0	0.0	0.1	1.3
To the private sector	62.5	63.0	68.7	65.7	65.0	68.8
Liquidity	198.4	173.6	156.5	150.0	151.8	163.7

Source: Comisión Económica para América Latina y el Caribe (CEPAL), sobre la base de cifras oficiales.

<sup>a</sup> Preliminary figures. <sup>b</sup> Based on figures in local currency at constant 1996 prices. <sup>c</sup> Includes the use of IMF credit and loans and exceptional financing. <sup>d</sup> Economically active population as a percentage of the working-age population. <sup>e</sup> Unemployment rate as a percentage of the economically active population, nationwide total. Includes hidden unemployment. <sup>f</sup> Includes grants. <sup>g</sup> The monetary figures are annual averages. <sup>h</sup> Refers to net credit extended to the public and private sectors by commercial banks and other financial and banking institutions.

raise its tax revenues by 20%. The main sources, which account for 58% of tax receipts, include import fees, stamp duties on transactions, hotel taxes and fees for work permits. Expenditure will probably increase by 40% owing to outlays on health and education.

The public debt stock represented 17% of GDP in fiscal 2005, with maturities ranging between 12 and 15

years and a fixed interest rate. The debt servicing and net debt ratios in relation to GDP were lower than the limits agreed upon between the Government of the Turks and Caicos Islands and the United Kingdom in 2002 (8% and 80%, respectively). In 2006, public debt is expected to reach 25% of GDP, in line with the planned expansion of expenditure.

### 3. The main variables

#### (a) Economic activity

The economy maintained its high growth rate thanks to the buoyancy of tourism, construction and telecommunications. With regard to expenditure, consumption and gross capital formation accounted for the bulk of economic growth (amounting to 60% and 39% in 2004 and 2005, respectively).

The expansion of tourism (15% in 2005 compared with 6.5% in 2004) reflected an increase in air transport capacity, improved marketing initiatives and higher levels of investment in ports and infrastructure. Higher numbers of cruise ship arrivals and long-stay tourists were also recorded (increases of 6% and 16% in 2004 and 2005, respectively). Hotel occupancy rates showed a rising trend in 2005 and were over 65% on average.

As part of the continuing effort to develop the tourism sector, the government completed the construction of the first cruise-ship port in the Islands, which will be operational in the first half of 2006. The first port on a Caribbean beach was also finalized. In 2006, the authorities projected a growth rate of 18% for the sector and an increase of 20% in tourist arrivals.

The main goods-producing sector, fishing, moderated its growth rate, which was 8% in 2005 compared with 16% in 2004. This was attributable to the decline in the volume of lobster and conch catches, which were down by 13% and 7%, respectively, between January-October 2004 and January-October 2005. These items account for 55% and 45% of total exports of goods. The performance of the fishery sector was hurt by illegal fishing practices, which are a cause of concern to the authorities in view of their detrimental effect on marine resources. An additional 5% drop in the growth rate for this activity is forecast for 2006.

Construction, which grew by 28% and 25% in 2004 and 2005, respectively, benefited from the expansion of the tourist sector and from public spending on infrastructure works, health and sports. An increase of 8% is projected for 2006 thanks to the completion of a number of infrastructure projects.

The telecommunications industry returned to its past trend and expanded by 8% in 2005, following an unprecedented upswing of 25% in 2004, owing to the expectations created by the imminent liberalization of the sector in 2005. During the year, four new telecommunications licenses were issued, which put an end to the monopoly

within that sector. Greater competition has brought lower prices and more efficient provision of services. Growth of 7% is forecast for 2006.

The financial sector expanded by 24% and 19% in 2004 and 2005, respectively, as a result of greater confidence in the economy, increased capital flows and product diversification. In December 2005, the country opened its first locally-owned bank, which increased the number of financial institutions to seven. Growth of 14% is projected for this sector in 2006.

#### (b) Prices, wages and employment

The inflation rate rose from 3.3% in 2004 to 3.7% in 2005, mainly as a result of the rise in international oil prices and, to a lesser extent, the higher cost of construction materials and food items. Price rises were tempered, however, by the drop in the cost of telecommunications services. No change in the inflation rate is expected in 2006.

In 2005, wages for the police force were raised by 30%. For 2006, the government plans a restructuring of public-sector employment, which will include a reclassification of existing posts. As a result, a retroactive increase effective as of April 2006 is expected in the wage levels for reclassified posts.

The public sector is the largest employer in the Turks and Caicos Islands and accounts for over one third of the workforce. During the year, 159 new posts were created, which represents an increase of 6% in relation to the previous year. The expansion of public employment benefited the police force, the immigration department and health facilities, which received 26%, 19% and 9% of the total, respectively. In 2006, the authorities plan to increase the number of work permits by 6% in order to alleviate the current labour shortage.

#### (c) The external sector

The external sector posted a positive result, as both the current account and the capital and financial account recorded surpluses. These results also helped to increase the country's stock of international reserves.

The decline in the current account surplus from 20% of GDP in 2004 to 7% in 2005 was basically the result of the increase in merchandise imports from 52% to 62% of GDP for those same years. The boom in external purchases was a response to the buoyancy of the economy,

especially tourism and construction, as well as the rise in international oil prices, construction materials and food items. Merchandise exports were 20% higher.

Non-factor services registered a surplus equivalent to 75% of GDP, as in 2004, thanks to the increase in passenger flows. As in previous years, this offset the structural deficit in the trade balance for goods, which was 43% and 51% of GDP in 2004 and 2005, respectively.

The capital and financial account balance, which

rose from 35% of GDP in 2004 to 45% in 2005, reflected official aid and foreign direct investment in the tourism sector amounting to US\$ 222 million, as well as the increase in external borrowing.

In 2006, the country is expected to post a surplus on its overall balance of payments as a result of surpluses on its current account and its capital and its financial account of 12% and 45% of GDP, respectively, while a deficit equivalent to 57% of GDP is forecast for the trade balance.

## Member countries of the Organisation of Eastern Caribbean States (OECS)<sup>1</sup>

### 1. General trends

The countries members of the Organisation of Eastern Caribbean States (OECS) posted a higher growth rate in 2005 (5.4%) than the previous year (4.1%), despite rising international petroleum prices and adverse weather conditions.<sup>2</sup>

Economic activity was driven by the buoyancy of the construction sector, which benefited from high levels of investment in preparation for the Cricket World Cup (2007). The manufacturing sector showed signs of recovery, while agriculture contracted.

Fiscal performance varied. Some economies took advantage of increased tax revenues while controlling expenditure in order to close the fiscal gap (Anguilla, Dominica, Montserrat, and Saint Kitts and Nevis). Others chose instead to raise public expenditure in order to improve their infrastructure and basic services and stimulate economic growth by increasing aggregate demand (Antigua and Barbuda, Saint Lucia, and Saint Vincent and the Grenadines).

The overall result of the balance of payments was negative, as the current-account deficit was greater than the

surplus in the capital and financial account. The current-account deficit widened due to rising international fuel and food prices and the loss of competitiveness in traditional exports. The performance of the capital and financial account reflected higher investment in the tourism sector, greater flows of government transfers and the completion of infrastructure projects.

In 2006, the OECS economies will continue to benefit from preparations for the Cricket World Cup. Economic growth will be fuelled by tourism and construction. It is hoped that activities linked to these two sectors will serve to attract foreign direct investment. At the fiscal level, the OECS countries plan to modernize their tax systems with the introduction of a value-added tax (VAT) and then adapt them to current economic circumstances by eliminating the gasoline subsidy.

### 2. Economic policy

#### (a) Fiscal policy

The OECS member States reduced the government deficit from 6.0% of GDP in 2004 to 5.7% in 2005.<sup>3</sup> The fiscal performance varied between countries, however, as the fiscal gap closed in Anguilla, Dominica, Montserrat

and Saint Kitts and Nevis, while it widened in Antigua and Barbuda, Saint Lucia, and Saint Vincent and the Grenadines.

The budget result for Anguilla (-4.6% of GDP in 2004 and -4.4% in 2005) was attributable to the decrease in capital expenditure, which more than compensated for the decline in current revenue.

<sup>1</sup> The members of the Organisation of Eastern Caribbean States (OECS) are Anguilla, Antigua and Barbuda, Dominica, Grenada, the British Virgin Islands, Montserrat, Saint Kitts and Nevis, Saint Lucia, and Saint Vincent and the Grenadines. The analysis presented in this section refers to all the member territories, with the exception of the British Virgin Islands, which have a monetary union administered by the Eastern Caribbean Central Bank.

<sup>2</sup> The aggregate growth rate at basic prices.

<sup>3</sup> Excluding donations.

Table 1  
**ORGANISATION OF EASTERN CARIBBEAN STATES (OECs): MAIN ECONOMIC INDICATORS**

	1997	1998	1999	2000	2001	2002	2003	2004	2005 <sup>a</sup>
	<b>Annual growth rates<sup>b</sup></b>								
<b>Gross domestic product</b>	3.2	4.0	4.5	3.9	-1.3	0.5	3.0	4.1	5.4
<b>Per capita gross domestic product</b>	2.6	3.4	4.0	3.4	-2.0	-0.1	2.4	3.4	4.7
<b>Gross domestic product, by sector</b>									
Agriculture, livestock, hunting, forestry and fishing	-7.1	1.1	-4.7	0.4	-8.4	5.3	-4.7	0.4	-12.1
Mining	7.0	2.1	6.5	21.5	-6.3	-1.5	6.7	-7.1	17.3
Manufacturing	2.7	2.3	3.3	-0.1	-1.4	-1.3	0.8	-1.4	5.4
Electricity, gas and water	6.7	6.2	9.0	14.3	5.6	2.0	2.9	1.3	3.6
Construction	7.9	11.5	8.3	4.9	-1.5	-2.5	2.9	5.1	21.1
Wholesale and retail commerce, restaurants and hotels	5.5	2.4	4.2	1.5	-5.3	-0.4	8.4	4.9	5.8
Transport, storage and communications	6.1	5.9	9.2	2.6	-1.2	-0.6	3.7	7.2	4.9
Financial institutions, insurance, real estate and business services	6.9	6.1	5.5	15.3	0.8	3.3	2.0	5.7	4.3
Community, social and personal services	-5.7	-2.9	-2.4	84.4	2.0	2.8	1.2	2.9	2.9
	<b>Millions of dollars</b>								
<b>Balance of payments</b>									
Current account balance	-402	-366	-450	-460	-516	-595	-681	-564	-739
Merchandise trade balance	-948	-982	-1 056	-1 076	-1 004	-1 004	-1 176	-1 268	-1 424
Exports, f.o.b.	298	316	327	349	260	271	259	298	256
Imports, f.o.b.	1 246	1 299	1 383	1 426	1 264	1 275	1 435	1 566	1 680
Services trade balance	576	629	642	668	573	524	604	744	710
Income balance	-131	-147	-170	-217	-194	-215	-238	-260	-231
Net current transfers	100	134	133	165	110	100	129	221	206
Capital and financial balance <sup>c</sup>	427	426	479	480	581	659	722	679	713
Net foreign direct investment	261	313	335	312	370	343	553	435	450
Financial capital <sup>d</sup>	166	114	144	168	211	317	169	244	263
Overall balance	25	61	28	21	65	64	41	115	-27
Variation in reserve assets <sup>e</sup>	-24	-63	-28	-21	-65	-63	-41	-115	27
Other financing <sup>f</sup>	-1	2	-0	0	0	-1	0	0	0
<b>Other external-sector indicators</b>									
Gross external public debt (millions of dollars)	885	1 061	1 212	1 283	1 462	1 764	2 008	1 964	...
Gross external public debt (percentage of GDP)	36.6	37.6	46.1	46.5	53.1	63.7	67.6	59.9	...
	<b>Annual percentages</b>								
<b>Prices</b>									
Variation in consumer prices (December-December)	...	...	...	...	2.4	-0.1	1.0	2.7	4.2
Nominal deposit rate <sup>g</sup>	4.2	4.2	4.2	4.4	4.3	3.7	4.6	...	...
Nominal lending rate <sup>g</sup>	11.6	11.3	11.8	11.6	11.4	11.0	12.8	...	...
	<b>Percentages of GDP</b>								
<b>Central government</b>									
Total income <sup>h</sup>	27.5	29.0	28.4	27.8	27.7	29.0	29.6	30.6	36.2
Current income	24.9	25.2	25.7	25.4	24.9	25.8	26.1	26.7	26.7
Tax revenue	21.3	21.7	21.6	21.6	21.3	22.1	22.6	23.4	23.9
Capital income	0.6	0.6	0.3	0.2	0.1	0.5	0.4	0.4	0.5
Total expenditure	30.1	30.6	31.4	32.1	34.9	37.9	34.8	33.9	33.5
Current expenditure	23.7	23.6	24.1	24.4	26.9	28.0	27.1	27.4	26.4
Interest	1.9	1.8	2.1	2.6	3.4	4.1	4.1	4.4	3.9
Capital expenditure and net lending	6.4	7.1	7.3	7.7	8.0	9.9	7.7	6.5	7.1
Primary balance <sup>h</sup>	-0.7	0.2	-0.9	-1.7	-3.9	-4.8	-1.0	1.1	6.5
Overall balance <sup>h</sup>	-2.6	-1.6	-3.0	-4.3	-7.3	-9.0	-5.1	-3.4	2.7
Public-sector external debt	36.6	37.6	46.1	46.5	53.1	63.7	67.6	59.9	...
<b>Money and credit</b>									
Domestic credit	70.2	71.9	74.3	78.9	85.5	87.4	87.6	83.8	84.5
Public	-1.5	-1.6	-2.5	-3.4	-1.5	-1.3	-3.5	-1.5	-1.6
Private	76.3	78.1	80.8	85.7	90.4	91.0	88.9	87.8	87.1
Liquidity (M3)	66.8	68.1	73.1	78.4	83.7	87.2	90.0	93.2	105.8
Currency in circulation and local-currency deposits (M2)	60.5	61.5	65.6	69.1	72.6	75.6	78.0	80.2	81.6
Foreign-currency deposits	6.3	6.6	7.5	9.3	11.1	11.6	11.9	13.0	24.2

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

<sup>a</sup> Preliminary figures. <sup>b</sup> Based on figures in local currency at constant 1990 prices. <sup>c</sup> Includes errors and omissions. <sup>d</sup> Refers to the capital and financial balance (including errors and omissions), minus net foreign direct investment. <sup>e</sup> A minus sign (-) denotes an increase in reserves. <sup>f</sup> Includes the use of IMF credit and loans and exceptional financing. <sup>g</sup> Weighted averages. <sup>h</sup> Includes grants.

Antigua and Barbuda's performance (-5.1% of GDP in 2004 and -6.2% in 2005) reflected increased capital expenditure. The authorities approved a package of tax measures intended to reduce the fiscal deficit and the public debt balance. The measures include the reintroduction of the income tax, a 5% wholesale sales tax, and a special excise tax of 7%.

Dominica (-9.3% of GDP in 2004 and -0.4% in 2005) adjusted its public finances primarily by reducing capital expenditure and, to a lesser extent, by increasing tax efforts and containing current expenditure. Capital expenditure returned to its usual levels after posting a sharp increase due to reconstruction efforts to repair the damage caused by Hurricane Emily in 2004. Tax efforts were most visible in the rise in revenues from corporate taxes. The government controlled current spending by freezing public wages and implementing operations to restructure the public debt, thereby facilitating the reduction of interest payments. In 2006, the government of Dominica plans to reduce the public wage bill by 20% and introduce VAT.

Grenada (-10% of GDP in 2004 and 2005) continued its strategy for reconstruction and recovery in the wake of the devastation caused by Hurricane Ivan in 2004. Capital expenditure rose as a result of reconstruction efforts, but this effect was offset by increased revenues from taxes on companies and on international trade and by reduced spending on salaries and interest payments. The introduction of a special income tax for a five-year period and a more efficient tax system also contributed to this result. Like Antigua and Barbuda and Dominica, Grenada is in the process of restructuring its public debt.

Montserrat contained its government deficit, which remained very large nevertheless (-81% and -63% of GDP in 2004 and 2005, respectively) as a result of the drop in payments from transfers and subsidies.

The fiscal result for Saint Kitts and Nevis (-8.2% of GDP in 2004 and -6.6% in 2005) was partly attributable to increased tax revenues and lower capital expenditure. The rise in the tax yield responded to the strong performance of taxes on companies and on international trade. The reduction in capital expenditure was the result of the closing of the sugar industry. In 2006, the government plans to improve the efficiency of public administration and modify the system of assessing real estate properties for tax purposes. It will also generalize the tax on international telephone calls to include all calls. In order to make the tax system more progressive, the government intends to raise the social services levy from 8% to 10%. Finally, the authorities indicated their plans to introduce an excise tax on tobacco and alcoholic beverages.

Saint Lucia's fiscal balance (-3.3% and -3.9% of GDP in 2004 and 2005, respectively) responded to higher

capital expenditure, which offset the reduction in current expenditure. The rise in capital expenditure owed partly to the demand for construction in preparation for the Cricket World Cup in 2007, and partly to government efforts to stimulate aggregate demand and economic growth. The contraction of current expenditure was the result of the reduction in the wage bill, despite retroactive payments made to government employees. Tax revenues remained at the same level as the previous year despite the decrease in taxes on companies from 32% to 30%. For 2006, the government announced plans to reduce the excise tax on various goods in order to counteract the effects of inflation on consumer purchasing power.

The budget result for Saint Vincent and the Grenadines (-3.7% of GDP for 2004 and -5.8% for 2005) was influenced considerably by increased current expenditure and diminished tax receipts. Fiscal spending reflected the expansion of the wage bill and increased payments to service the external debt (which rose by 11% relative to 2004). Decreased revenues were attributable to the poor performance of taxes on goods and services and on external trade. In 2006, the government plans to pave the way for the introduction of VAT and a system of special excise taxes. In accordance with this objective, the government intends to discontinue a series of taxes including the general consumption tax and stamp duties. At the same time, the authorities plan to increase the tax base for excise taxes and taxes on foreign trade by halving exemptions.

#### **(b) Monetary and exchange-rate policy**

The economies that make up the Organisation of Eastern Caribbean States have been a monetary union since 1983 with their own currency, the Eastern Caribbean dollar, which is linked to the United States dollar at a fixed exchange rate of EC\$ 2.70. The monetary authority of this union, the Central Bank of the Eastern Caribbean, acts as a currency board and is required by its statutes to maintain reserves equivalent to 60% of its monetary liabilities. Since the creation of the monetary union, the institution has maintained a neutral monetary position and has changed the reference rate of interest only slightly. The monetary union has two characteristics that explain its neutral position: The first is that its management of foreign assets and liabilities has allowed it to maintain a reserve that far exceeds the statutory requirement. The second is that the commercial banking system is a closed circuit that strictly adheres to the obligation to maintain a balance between assets and liabilities.

In accordance with the regulations for currency boards, the financial system accommodated the demand for money, which expanded commensurately with economic

activity. Domestic credit (8% in 2004 and 15% in 2005) was driven by activities in the private sector and to a lesser extent by government operations (91% and 9% of the total, respectively).

Total loans, credit advances, and overdrafts increased from 8% to 13% between 2004 and 2005 owing to the demand for commercial lending (47% of the total). Of the productive sectors, transport and storage, tourism, financial services, and construction posted the strongest expansion (30%, 18%,

15%, and 11%, respectively). The largest borrowers were Anguilla, Saint Lucia, Saint Kitts and Nevis, and Montserrat (21%, 20%, 16%, and 15%, respectively).

In 2005, the discount rate of the Central Bank of the Eastern Caribbean held steady at 6.5%, as economic conditions did not justify an increase. Similarly, interest rates for commercial banks remained the same (the prime lending rate remained at 8.5% (minimum) and 12.0% (maximum)).

### 3. The main variables

#### (a) Economic activity

The OECS member States posted a higher growth rate in 2005 (5.4%) than the previous year (4.1%) due to the buoyancy of the construction sector. The highest rates were observed in Saint Kitts and Nevis (6.8%), Saint Lucia (6.5%), and Antigua and Barbuda (5.6%). Saint Vincent and the Grenadines posted a growth rate of 2.8% in 2005 (just over half the rate in 2004), while Montserrat fell by 3%.

Agriculture contracted in most of the OECS countries (0.4% in 2004 and -12% in 2005). The performance of the primary sector was attributable to adverse weather conditions, pests, the accumulative effects of past natural disasters, high production costs, and limited access to financing. Traditional crops reflected the drop in banana production (-26% for the Windward Islands) and the destruction of nutmeg crops in Grenada caused by Hurricane Ivan. The contraction of sugarcane production (-24%) due to the shutting down of sugar industry operations in July 2005 also contributed to this result.

Despite the negative effect that the rise in international petroleum prices had on productive activity, manufacturing (-1.4% and 5.4% in 2004 and 2005, respectively) benefited from improved growth prospects due to the expansion of tourism and construction. At the country level, the manufacturing sector in Saint Kitts and Nevis turned in a positive performance (despite the decline in agricultural production) due to expanding productive capacity and the diversification of certain product lines in various national companies. In Saint Lucia, the food and beverage and paperboard sub-sectors benefited from the increase in long-term visitors and more buoyant commercial activity. In Saint Vincent and the Grenadines, beverage production surged while flour production contracted. Lastly, in Grenada the manufacturing sector showed signs of recovering from the damage caused by Hurricane Ivan.

In aggregate terms, growth in tourism activity was more moderate. Contributing to this result were the rise in petroleum prices (which drove up hotel rates and air-transport costs), a severe hurricane season, and faltering external demand.

Saint Kitts and Nevis, Saint Lucia, and Saint Vincent and the Grenadines posted the highest rates of expansion in the tourism sector (24%, 12%, and 18%, respectively) thanks to an energetic campaign to create market niches, the expansion of hotel and air-transport capacity, the hosting of sporting and musical events and greater efforts to attract cruise ship passengers.

The construction sector (5% and 21% in 2004 and 2005, respectively) benefited from preparations for the Cricket World Cup (2007). The sector experienced some difficulties, however, such as a cement shortage and the rising international prices of construction materials.

The OECS member States initiated plans to construct sports facilities, improve the infrastructure of ground, sea, and air transport, and expand hotel capacity. Also, tax concessions offered for activities related to the Cricket World Cup have attracted some investments in fixed capital. The majority of the construction activities for this event have been financed with foreign direct investment. In the case of Antigua and Barbuda and Grenada, these activities have been made possible by donations from the People's Republic of China.

#### (b) Prices, wages and employment

Inflation rose (2.7% in 2004 and 4.1% in 2005) owing to higher international petroleum and food prices, faltering agricultural production and the resulting increase in freight charges, rising costs for construction materials and higher mark-ups.

Breaking down the consumer price index into individual components reveals that the categories showing the most

significant hikes were fuel, food and electricity, and transport and communications. The rise in the consumer price index did not fully reflect the increase in international petroleum prices, as energy consumption is subsidized in OECS countries.

Real wages retreated in the majority of the countries, as increases in nominal wages did not keep pace with rising prices. The fiscal adjustment implemented by some economies contributed to this result.

Employment expanded along with economic activity. Tourism and construction posted notable increases, while employment in agriculture declined.

### (c) The external sector

The overall result for the balance of payments was negative (3.7% of GDP in 2004 and -0.8% in 2005), as the widening of the current-account deficit (from 18% of GDP in 2004 to 22% in 2005) exceeded the surplus in the capital and financial account (22% and 21% of GDP).

The result for the current account was attributable to poor export performance and the expansion of imports. The performance of external sales reflected faltering aggregate demand, the contraction of banana, sugar, rice, and flour production, and the detrimental effects of natural disasters on the productive capacity of the agricultural sector in Grenada.

The increase in external purchases was the result of the rising international prices of petroleum, construction materials, and food products. The buoyancy of domestic demand (particularly for construction) also contributed.

The balance of non-factorial services fell (24% of GDP in 2004 and 21% in 2005) as tourism stagnated in a context of external conditions that were unfavourable to development in that sector. The total number of visitors remained at lower levels than in 2004, as did tourist spending.

The balance of the income account (-9.5% and -7.9% of GDP in 2004 and 2005, respectively) reflected debt payments and the repatriation of profits. Debt-service payments dropped in some countries due to efforts to restructure (Antigua and Barbuda, Dominica and Grenada) and reduce (Saint Kitts and Nevis and Saint Lucia) the external debt.

The surplus in the capital and financial account reflected a lower level of official flows (5.2% and 4.9% of GDP in 2004 and 2005, respectively) due to the implementation of new procedures for obtaining official financing from the European Union and the completion of infrastructure projects. Antigua and Barbuda (2.6% of GDP in 2004 and 24.4% in 2005) and Grenada (9.1% of GDP in 2004 and 9.5% in 2005) are exceptions, having received donations from the People's Republic of China for the expansion of sports infrastructure. Grenada benefited as well from continued international assistance for reconstruction activities. Flows of foreign direct investment remained were similar to levels recorded in the previous year (13.9% of GDP in 2004 and 13.3% in 2005), amid favourable expectations for the tourism and construction sectors and for the financial and monetary stability of OECS in general.



## **Statistical Annex**



Table A-1  
**LATIN AMERICA AND THE CARIBBEAN: MAIN ECONOMIC INDICATORS**

	1997	1998	1999	2000	2001	2002	2003	2004	2005 <sup>a</sup>
<b>Annual rates of variation</b>									
Gross domestic product <sup>b</sup>	5.5	2.6	0.4	3.9	0.3	-0.8	2.0	5.9	4.5
Per capita gross domestic product <sup>b</sup>	3.8	0.9	-1.2	2.3	-1.3	-2.3	0.5	4.4	3.0
Consumer prices <sup>c</sup>	10.7	10.0	9.7	9.0	6.1	12.2	8.5	7.4	6.1
<b>Percentages</b>									
Urban open unemployment rate <sup>d</sup>	9.3	10.3	11.0	10.4	10.2	11.0	11.0	10.2	9.1
Total gross external debt / GDP <sup>e</sup>	33.6	36.5	42.2	36.9	38.3	42.5	42.2	37.0	26.8
Total gross external debt / exports of goods and services	198	216	211	172	181	177	168	138	101
<b>Millions of dollars</b>									
<b>Balance of payments</b>									
Current account balance	-64 412	-88 218	-54 843	-46 939	-51 385	-13 658	8 757	19 364	35 325
Merchandise trade balance	-13 134	-34 981	-6 853	3 174	-3 831	24 022	44 804	58 828	80 627
Export of goods, f.o.b.	286 680	283 369	299 364	358 732	343 532	347 082	378 347	465 239	559 668
Import of goods, f.o.b.	299 813	318 350	306 216	355 559	347 362	323 060	333 544	406 411	479 041
Services trade balance	-18 997	-18 973	-16 248	-17 113	-18 910	-14 171	-13 291	-14 467	-18 519
Income balance	-47 653	-51 295	-51 143	-53 716	-53 811	-51 989	-57 567	-66 368	-75 476
Net current transfers	15 371	17 032	19 401	20 716	25 166	28 480	34 811	41 371	48 694
Capital and financial balance <sup>f</sup>	89 213	63 400	42 540	61 788	33 957	-12 096	1 937	-6 974	21 652
Net foreign direct investment	57 599	63 677	79 921	70 308	64 606	44 443	34 661	43 790	47 886
Financial capital <sup>g</sup>	31 614	-277	-37 382	-8 521	-30 649	-56 538	-32 724	-50 700	-26 235
Overall balance	24 801	-24 818	-12 303	14 848	-17 428	-25 753	10 694	12 390	56 977
Variation in reserve assets <sup>h</sup>	-15 800	9 085	6 207	-6 930	997	3 109	-29 397	-20 781	-35 265
Other financing <sup>i</sup>	-9 001	15 733	6 096	-7 919	16 431	22 644	18 703	8 391	-21 712

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

<sup>a</sup> Preliminary figures.

<sup>b</sup> Based on official figures expressed in constant 2000 dollars.

<sup>c</sup> December - December variation.

<sup>d</sup> The data for Argentina, Brazil and Mexico have been adjusted to allow for changes in methodology in 2003, 2002 and 2005 respectively.

<sup>e</sup> Estimates based on figures denominated in dollars at current prices.

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

<sup>g</sup> Refers to the capital and financial balance (including errors and omissions), minus net foreign direct investment.

<sup>h</sup> A minus sign (-) indicates an increase in reserve assets.

<sup>i</sup> Includes the use of IMF credit and loans and exceptional financing.

Table A-2  
**LATIN AMERICA AND THE CARIBBEAN: GROSS DOMESTIC PRODUCT**  
*(Annual growth rates)*

	1997	1998	1999	2000	2001	2002	2003	2004	2005 <sup>a</sup>
<b>Latin America and the Caribbean</b>	<b>5.5</b>	<b>2.6</b>	<b>0.4</b>	<b>3.9</b>	<b>0.3</b>	<b>-0.8</b>	<b>2.0</b>	<b>5.9</b>	<b>4.5</b>
<b>Latin America</b>	<b>5.5</b>	<b>2.5</b>	<b>0.3</b>	<b>4.0</b>	<b>0.3</b>	<b>-0.8</b>	<b>1.9</b>	<b>6.0</b>	<b>4.5</b>
Argentina	8.1	3.9	-3.4	-0.8	-4.4	-10.9	8.8	9.0	9.2
Bolivia	5.0	5.0	0.4	2.5	1.7	2.5	2.9	3.9	4.1
Brazil	3.3	0.1	0.8	4.4	1.3	1.9	0.5	4.9	2.3
Chile	6.6	3.2	-0.8	4.5	3.4	2.2	3.9	6.2	6.3
Colombia	3.4	0.6	-4.2	2.9	1.5	1.9	3.9	4.8	5.1
Costa Rica	5.6	8.4	8.2	1.8	1.1	2.9	6.4	4.1	5.9
Cuba	2.7	0.2	6.3	6.1	3.0	1.5	2.9	4.5	...
Cuba <sup>b</sup>	...	...	...	...	3.0	1.8	3.8	5.4	11.8
Ecuador	4.1	2.1	-6.3	2.8	5.3	4.2	3.6	7.6	3.9
El Salvador	4.2	3.7	3.4	2.2	1.7	2.3	2.3	1.8	2.8
Guatemala	4.4	5.0	3.8	3.6	2.3	2.2	2.1	2.7	3.2
Haiti	2.7	2.2	2.7	0.9	-1.0	-0.3	0.4	-3.5	1.8
Honduras	5.0	2.9	-1.9	5.7	2.6	2.7	3.5	5.0	4.1
Mexico	6.8	5.0	3.8	6.6	0.0	0.8	1.4	4.2	3.0
Nicaragua	4.0	3.7	7.0	4.1	3.0	0.8	2.5	5.1	4.0
Panama	6.4	7.4	4.0	2.7	0.6	2.2	4.2	7.6	6.4
Paraguay	3.0	0.6	-1.5	-3.3	2.1	0.0	3.8	4.1	2.9
Peru	6.9	-0.7	0.9	3.0	0.2	5.2	3.9	5.2	6.4
Dominican Republic	8.1	8.3	6.1	7.9	2.3	5.0	-0.4	2.7	9.2
Uruguay	5.0	4.5	-2.8	-1.4	-3.4	-11.0	2.2	11.8	6.6
Venezuela (Bolivarian Republic of)	6.4	0.3	-6.0	3.7	3.4	-8.9	-7.7	17.9	9.3
<b>Caribbean</b>	<b>3.5</b>	<b>4.1</b>	<b>3.9</b>	<b>3.5</b>	<b>1.7</b>	<b>3.6</b>	<b>6.1</b>	<b>3.8</b>	<b>4.2</b>
Antigua and Barbuda	4.9	4.4	4.1	1.5	2.3	3.0	4.7	5.2	5.6
Bahamas	4.9	6.8	4.0	1.9	0.8	2.3	1.4	1.8	2.7
Barbados	4.6	6.2	0.5	2.3	-2.6	0.5	2.0	4.8	3.9
Belize	3.6	3.7	8.7	13.0	4.6	4.7	9.2	4.6	3.1
Dominica	2.0	2.8	1.6	1.3	-4.2	-5.1	0.1	3.1	3.6
Grenada	5.4	8.2	7.0	7.0	-4.9	0.4	7.5	-3.0	5.2
Guyana	6.2	-1.7	3.8	-1.4	2.3	1.1	-0.7	1.6	-3.0
Jamaica	-1.0	-1.2	1.0	0.7	1.5	1.1	2.3	0.9	1.4
Saint Kitts and Nevis	7.4	0.9	3.6	4.3	2.0	1.0	2.2	6.5	7.0
Saint Vincent and the Grenadines	2.9	5.2	4.4	1.8	0.8	3.9	4.1	5.4	2.8
Saint Lucia	-0.4	6.2	2.3	3.6	-9.6	1.9	4.3	3.6	7.3
Suriname	2.2	3.1	-2.4	4.0	5.9	1.9	6.1	7.7	5.7
Trinidad and Tobago	7.7	8.1	8.0	6.9	4.2	7.9	13.4	6.5	7.0

**Source:** Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures expressed in constant 2000 dollars.

<sup>a</sup> Preliminary figures.

<sup>b</sup> Based on new national accounts calculations from the National Statistical Office of Cuba.

Table A-3  
**LATIN AMERICA AND THE CARIBBEAN: PER CAPITA GROSS DOMESTIC PRODUCT**  
*(Annual growth rates)*

	1997	1998	1999	2000	2001	2002	2003	2004	2005 <sup>a</sup>
<b>Latin America and the Caribbean</b>	<b>3.8</b>	<b>0.9</b>	<b>-1.2</b>	<b>2.3</b>	<b>-1.3</b>	<b>-2.3</b>	<b>0.5</b>	<b>4.4</b>	<b>3.0</b>
<b>Latin America</b>	<b>3.8</b>	<b>0.9</b>	<b>-1.3</b>	<b>2.3</b>	<b>-1.3</b>	<b>-2.3</b>	<b>0.4</b>	<b>4.4</b>	<b>3.0</b>
Argentina	6.9	2.7	-4.4	-1.8	-5.4	-11.7	7.8	8.0	8.2
Bolivia	2.5	2.5	-1.9	0.1	-0.6	0.2	0.7	1.6	1.8
Brazil	1.7	-1.4	-0.7	2.8	-0.2	0.5	-0.9	3.4	0.9
Chile	5.1	1.9	-2.0	3.2	2.2	1.0	2.8	5.0	5.2
Colombia	1.5	-1.3	-6.0	1.1	-0.3	0.2	2.1	3.1	3.4
Costa Rica	2.9	5.7	5.7	-0.5	-1.0	0.9	4.4	2.2	4.1
Cuba	2.3	-0.3	5.9	5.7	2.6	1.2	2.6	4.2	...
Cuba <sup>b</sup>	...	...	...	...	2.9	1.7	3.7	5.3	11.7
Ecuador	2.4	0.6	-7.6	1.3	3.8	2.8	2.2	6.1	2.5
El Salvador	2.1	1.6	1.4	0.2	-0.2	0.4	0.5	0.0	1.0
Guatemala	2.0	2.6	1.5	1.2	-0.1	-0.2	-0.4	0.1	0.7
Haiti	0.8	0.3	0.8	-1.0	-2.8	-2.1	-1.4	-5.2	0.0
Honduras	2.1	0.1	-4.5	3.0	0.0	0.1	0.9	2.5	1.6
Mexico	5.0	3.3	2.1	5.0	-1.5	-0.7	0.0	2.7	1.6
Nicaragua	1.9	1.7	4.9	2.0	0.9	-1.3	0.5	3.1	1.9
Panama	4.3	5.3	2.0	0.8	-1.3	0.4	2.3	5.7	4.5
Paraguay	0.3	-2.0	-4.0	-5.8	-0.5	-2.5	1.3	1.6	0.5
Peru	5.0	-2.3	-0.8	1.3	-1.3	3.6	2.4	3.7	4.9
Dominican Republic	6.3	6.4	4.3	6.1	0.6	3.3	-2.0	1.1	7.6
Uruguay	4.3	3.8	-3.6	-2.2	-4.1	-11.7	1.5	11.0	5.9
Venezuela (Bolivarian Republic of)	4.3	-1.6	-7.8	1.8	1.5	-10.5	-9.3	15.8	7.5
<b>Caribbean</b>	<b>2.7</b>	<b>3.3</b>	<b>3.2</b>	<b>2.8</b>	<b>1.1</b>	<b>3.0</b>	<b>5.5</b>	<b>3.2</b>	<b>3.7</b>
Antigua and Barbuda	2.8	2.4	2.3	-0.2	0.8	1.7	3.5	4.0	4.4
Bahamas	3.3	5.2	2.5	0.4	-0.6	0.8	0.1	0.4	1.4
Barbados	4.2	5.9	0.2	2.0	-2.9	0.2	1.8	4.5	3.6
Belize	1.0	1.2	6.2	10.4	2.3	2.4	6.9	2.4	1.0
Dominica	1.1	2.0	1.0	0.8	-4.5	-5.2	-0.1	2.9	3.1
Grenada	4.8	7.7	6.6	6.7	-5.1	0.4	7.4	-3.3	4.6
Guyana	5.9	-2.0	3.5	-1.7	2.0	0.9	-0.8	1.4	-3.1
Jamaica	-1.8	-2.0	0.2	0.0	0.9	0.6	1.8	0.5	1.0
Saint Kitts and Nevis	7.5	0.9	3.4	3.8	1.2	-0.1	1.0	5.2	5.7
Saint Vincent and the Grenadines	2.3	4.6	3.9	1.3	0.3	3.4	3.6	4.8	2.2
Saint Lucia	-1.3	5.3	1.5	2.8	-10.3	1.1	3.5	2.8	6.4
Suriname	1.3	2.1	-3.3	3.1	5.1	1.2	5.4	7.0	5.0
Trinidad and Tobago	7.2	7.7	7.7	6.5	3.8	7.6	13.0	6.2	6.7

**Source:** Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures expressed in constant 2000 dollars.

<sup>a</sup> Preliminary figures.

<sup>b</sup> Based on new national accounts calculations from the National Statistical Office of Cuba.

Table A-4  
**LATIN AMERICA AND THE CARIBBEAN: GROSS FIXED CAPITAL FORMATION**  
*(Percentages of GDP)*

	1997	1998	1999	2000	2001	2002	2003	2004	2005 <sup>a</sup>
<b>Latin America and the Caribbean</b>	<b>20.2</b>	<b>20.6</b>	<b>19.3</b>	<b>19.3</b>	<b>18.8</b>	<b>17.7</b>	<b>17.3</b>	<b>18.5</b>	<b>19.6</b>
Argentina	18.6	19.1	17.2	16.2	14.3	10.2	12.9	15.9	17.9
Bolivia	19.4	23.9	20.1	17.9	13.8	16.0	13.9	13.2	13.1
Brazil	21.0	20.9	19.3	19.3	19.2	18.1	17.1	18.0	17.9
Chile	24.5	24.2	20.0	20.7	20.9	20.8	21.2	22.2	25.8
Colombia	20.7	19.3	13.2	12.6	13.4	14.5	16.1	17.6	21.6
Costa Rica	17.8	20.6	18.3	17.8	18.0	18.7	18.8	18.0	18.2
Cuba	12.0	12.5	12.5	12.9	12.1	10.9	9.9	10.1	...
Cuba <sup>b</sup>	...	...	...	11.8	11.1	9.9	8.9	9.1	...
Ecuador	23.9	24.3	18.8	20.5	24.0	27.4	26.3	25.9	26.1
El Salvador	16.2	17.2	16.4	16.9	16.9	17.1	17.1	15.9	16.4
Guatemala	16.1	18.0	18.3	16.1	16.0	16.4	15.3	15.1	15.6
Haiti	20.4	19.3	23.3	27.3	27.3	28.0	28.8	28.9	28.8
Honduras	25.7	27.6	29.9	26.1	23.5	21.6	22.3	25.3	22.4
Mexico	18.8	19.7	20.5	21.4	20.2	19.9	19.7	20.3	21.3
Nicaragua	26.7	27.6	35.0	29.9	27.4	25.5	25.0	25.8	26.4
Panama	20.6	22.0	23.5	21.2	15.7	14.4	17.1	17.7	17.3
Paraguay	22.6	19.2	17.1	17.5	16.1	15.0	15.5	15.6	15.8
Peru	25.0	24.9	21.9	20.2	18.5	17.4	17.8	18.4	19.6
Dominican Republic	18.1	22.7	19.4	20.7	19.5	19.5	14.7	13.4	13.8
Uruguay	15.3	15.8	14.9	13.2	12.4	9.4	8.1	9.5	11.0
Venezuela (Bolivarian Republic of)	22.5	23.6	21.2	21.0	23.1	20.7	14.2	17.2	20.9

**Source:** Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures expressed in constant 2000 dollars.

<sup>a</sup> Preliminary figures.

<sup>b</sup> Based on new national accounts calculations from the National Statistical Office of Cuba.

Table A-5  
**LATIN AMERICA AND THE CARIBBEAN: FINANCING OF GROSS DOMESTIC INVESTMENT<sup>a</sup>**  
*(Percentages of GDP)*

	1997	1998	1999	2000	2001	2002	2003	2004	2005 <sup>b</sup>
1. Domestic saving	21.1	19.8	19.4	20.6	19.0	20.1	21.1	23.2	23.6
2. Net factor income	-2.4	-2.6	-2.9	-2.8	-2.9	-3.1	-3.3	-3.3	-3.1
3. Net transfers	0.8	0.9	1.1	1.1	1.3	1.7	2.0	2.1	2.0
4. Gross national saving	19.5	18.1	17.6	18.9	17.5	18.7	19.8	22.0	22.4
5. External saving <sup>c</sup>	3.3	4.4	3.1	2.4	2.7	0.8	-0.5	-1.0	-1.5
6. Gross domestic investment	22.7	22.5	20.7	21.3	20.2	19.5	19.3	21.0	21.0

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

<sup>a</sup> Based on coefficients calculated in local currency expressed in current dollars.

<sup>b</sup> Preliminary figures.

<sup>c</sup> These figures (with the opposite sign) are the same as those given for the current account balance in table A-7.

Table A-6  
**LATIN AMERICA AND THE CARIBBEAN: BALANCE OF PAYMENTS**  
*(Millions of dollars)*

	Exports of goods, f.o.b.			Imports of goods, f.o.b.			Goods balance, f.o.b.			Services balance		
	2003	2004	2005 <sup>d</sup>	2003	2004	2005 <sup>d</sup>	2003	2004	2005 <sup>d</sup>	2003	2004	2005 <sup>d</sup>
<b>Latin America and the Caribbean</b>	<b>378 347</b>	<b>465 239</b>	<b>559 668</b>	<b>333 544</b>	<b>406 411</b>	<b>479 041</b>	<b>44 804</b>	<b>58 828</b>	<b>80 627</b>	<b>-13 291</b>	<b>-14 467</b>	<b>-18 519</b>
Argentina	29 939	34 550	40 013	13 134	21 311	27 300	16 805	13 239	12 714	-1 397	-1 666	-1 666
Bolivia	1 598	2 146	2 671	1 616	1 844	2 341	-18	302	329	-69	-71	-74
Brazil	73 084	96 475	118 308	48 290	62 835	73 560	24 794	33 641	44 748	-4 931	-4 678	-8 146
Chile	21 664	32 215	40 574	17 979	23 020	30 394	3 685	9 195	10 180	-646	-689	-588
Colombia	13 812	17 224	21 727	13 258	15 878	20 132	555	1 346	1 594	-1 439	-1 679	-2 089
Costa Rica	6 163	6 370	7 100	7 252	7 791	9 242	-1 089	-1 421	-2 142	776	857	1 140
Ecuador	6 381	7 910	9 888	6 294	7 497	9 297	86	413	591	-734	-969	-1 193
El Salvador	3 153	3 337	3 432	5 439	5 999	6 440	-2 287	-2 662	-3 008	-107	-78	-72
Guatemala	3 060	3 430	3 855	6 176	7 189	8 127	-3 116	-3 760	-4 272	-68	-115	-194
Haiti	333	378	459	1 116	1 210	1 308	-783	-833	-850	-166	-203	-185
Honduras	2 090	2 398	2 652	3 035	3 677	4 188	-945	-1 278	-1 536	-163	-150	-176
Mexico	164 766	187 999	214 233	170 546	196 810	221 820	-5 779	-8 811	-7 587	-4 601	-4 649	-4 768
Nicaragua	1 050	1 365	1 552	2 021	2 440	2 865	-972	-1 075	-1 314	-106	-101	-117
Panama	5 072	6 133	7 188	6 274	7 722	8 546	-1 202	-1 588	-1 358	1 195	1 275	1 433
Paraguay	2 170	2 864	3 393	2 446	3 167	4 002	-276	-303	-609	245	261	237
Peru	9 091	12 617	17 247	8 255	9 824	12 084	836	2 793	5 163	-854	-843	-913
Dominican Republic	5 471	5 936	6 133	7 627	7 888	9 614	-2 156	-1 952	-3 481	2 249	2 291	2 495
Uruguay	2 281	3 145	3 758	2 098	2 992	3 826	183	153	-69	167	365	439
Venezuela (Bolivarian Republic of)	27 170	38 748	55 487	10 687	17 318	23 955	16 483	21 430	31 532	-2 644	-3 626	-4 082

Table A-6 (continued)

	Trade balance			Income balance			Current transfers balance			Current account balance		
	2003	2004	2005 <sup>d</sup>	2003	2004	2005 <sup>d</sup>	2003	2004	2005 <sup>d</sup>	2003	2004	2005 <sup>d</sup>
<b>Latin America and the Caribbean</b>	<b>31 513</b>	<b>44 361</b>	<b>62 108</b>	<b>-57 567</b>	<b>-66 368</b>	<b>-75 476</b>	<b>34 811</b>	<b>41 371</b>	<b>48 694</b>	<b>8 757</b>	<b>19 364</b>	<b>35 325</b>
Argentina	15 407	11 573	11 048	-7 970	-8 922	-6 312	545	627	671	7 982	3 278	5 407
Bolivia	-87	231	256	-302	-385	-373	451	491	584	62	337	467
Brazil	19 863	28 963	36 602	-18 552	-20 520	-25 967	2 867	3 236	3 558	4 177	11 679	14 193
Chile	3 039	8 507	9 591	-4 608	-7 999	-10 624	605	1 079	1 735	-964	1 586	703
Colombia	-885	-333	-495	-3 398	-4 332	-5 525	3 309	3 727	4 089	-974	-938	-1 930
Costa Rica	-313	-564	-1 002	-776	-444	-227	209	212	270	-880	-796	-960
Ecuador	-648	-556	-602	-1 465	-1 493	-1 609	1 772	1 894	2 075	-340	-155	-136
El Salvador	-2 394	-2 739	-3 080	-423	-460	-571	2 114	2 568	2 865	-702	-632	-786
Guatemala	-3 183	-3 875	-4 466	-318	-319	-329	2 462	3 006	3 492	-1 039	-1 188	-1 303
Haiti	-949	-1 036	-1 034	-14	-12	-37	918	993	1 138	-45	-56	67
Honduras	-1 108	-1 429	-1 712	-258	-359	-314	1 106	1 388	1 984	-260	-399	-42
Mexico	-10 380	-13 460	-12 354	-12 103	-10 200	-12 919	13 858	17 044	20 484	-8 625	-6 616	-4 789
Nicaragua	-1 078	-1 177	-1 431	-191	-192	-119	519	673	750	-749	-696	-800
Panama	-7	-313	75	-742	-1 042	-1 136	246	228	243	-503	-1 127	-818
Paraguay	-31	-42	-372	-8	-71	45	165	194	223	125	82	-105
Peru	-18	1 950	4 250	-2 144	-3 421	-5 011	1 227	1 461	1 791	-935	-10	1 030
Dominican Republic	93	339	-986	-1 393	-1 724	-1 886	2 336	2 528	2 730	1 036	1 142	-143
Uruguay	350	518	370	-491	-588	-578	82	113	120	-58	43	-88
Venezuela (Bolivarian Republic of)	13 839	17 804	27 450	-2 411	-3 885	-1 984	20	-89	-107	11 448	13 830	25 359

Table A-6 (concluded)

	Capital and financial balance <sup>a</sup>			Overall balance			Reserve assets (variation) <sup>b</sup>			Other financing <sup>c</sup>		
	2003	2004	2005 <sup>d</sup>	2003	2004	2005 <sup>d</sup>	2003	2004	2005 <sup>d</sup>	2003	2004	2005 <sup>d</sup>
<b>Latin America and the Caribbean</b>	<b>1 937</b>	<b>-6 974</b>	<b>21 652</b>	<b>10 694</b>	<b>12 390</b>	<b>56 977</b>	<b>-29 397</b>	<b>-20 781</b>	<b>-35 265</b>	<b>18 703</b>	<b>8 391</b>	<b>-21 712</b>
Argentina	-17 019	-10 230	2 312	-9 037	-6 952	7 718	-3 581	-5 319	-8 857	12 618	12 271	1 139
Bolivia	15	-211	26	77	126	493	-93	-138	-504	16	13	11
Brazil	-451	-5 073	13 398	3 726	6 607	27 590	-8 496	-2 244	-4 319	4 769	-4 363	-23 271
Chile	598	-1 772	1 013	-366	-186	1 716	366	186	-1 716	0	0	0
Colombia	790	3 480	3 659	-184	2 541	1 729	184	-2 541	-1 729	0	0	0
Costa Rica	1 219	876	1 350	339	80	391	-339	-80	-391	0	0	0
Ecuador	461	436	645	120	281	510	-152	-277	-495	32	-4	-14
El Salvador	1 019	579	728	316	-53	-59	-316	53	59	0	0	0
Guatemala	1 589	1 797	1 553	550	609	250	-550	-609	-250	0	0	0
Haiti	37	91	-16	-8	35	51	25	-50	-22	-17	15	-29
Honduras	33	772	259	-227	373	216	88	-504	-372	139	131	156
Mexico	18 063	10 674	11 953	9 438	4 058	7 164	-9 438	-4 058	-7 164	0	0	0
Nicaragua	280	617	766	-470	-78	-34	-69	-169	-46	538	247	80
Panama	236	732	1 493	-267	-395	675	267	396	-521	1	-1	-154
Paraguay	106	186	222	231	268	117	-301	-179	-129	70	-89	13
Peru	1 459	2 336	498	525	2 326	1 528	-516	-2 352	-1 628	-9	26	100
Dominican Republic	-1 583	-596	813	-546	546	670	358	-542	-1 103	189	-4	433
Uruguay	1 092	263	884	1 033	306	796	-1 380	-454	-620	347	149	-175
Venezuela (Bolivarian Republic of)	-6 005	-11 932	-19 902	5 443	1 898	5 457	-5 454	-1 898	-5 457	11	0	0

**Source:** Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of figures from the International Monetary Fund (IMF) and national agencies.

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

<sup>b</sup> A minus sign (-) indicates an increase in reserve assets.

<sup>c</sup> Includes the use of IMF credit and loans and exceptional financing.

<sup>d</sup> Preliminary figures.

Table A-7

**LATIN AMERICA AND THE CARIBBEAN: CURRENT ACCOUNT OF THE BALANCE OF PAYMENTS<sup>a</sup>**  
(Percentages of GDP)

	1997	1998	1999	2000	2001	2002	2003	2004	2005 <sup>b</sup>
<b>Latin America and the Caribbean</b>	<b>-3.3</b>	<b>-4.4</b>	<b>-3.1</b>	<b>-2.4</b>	<b>-2.7</b>	<b>-0.8</b>	<b>0.5</b>	<b>1.0</b>	<b>1.5</b>
Argentina	-4.2	-4.9	-4.2	-3.2	-1.2	8.5	6.2	2.1	2.9
Bolivia	-7.0	-7.8	-5.9	-5.3	-3.4	-4.4	0.8	3.8	4.9
Brazil	-3.8	-4.3	-4.7	-4.0	-4.6	-1.7	0.8	1.9	1.8
Chile	-4.4	-4.9	0.1	-1.2	-1.6	-0.9	-1.3	1.7	0.6
Colombia	-5.4	-4.9	0.8	0.9	-1.3	-1.7	-1.2	-1.0	-1.6
Costa Rica	-3.7	-3.7	-4.2	-4.3	-3.7	-5.1	-5.0	-4.3	-4.8
Ecuador	-1.9	-9.0	5.5	5.8	-3.3	-5.6	-1.2	-0.5	-0.4
El Salvador	-0.9	-0.8	-1.9	-3.3	-1.1	-2.8	-4.7	-4.0	-4.6
Guatemala	-3.6	-5.4	-5.6	-5.4	-6.0	-5.3	-4.2	-4.4	-4.1
Haiti	-1.5	-1.0	-1.4	-3.0	-3.8	-2.8	-1.6	-1.5	1.6
Honduras	-5.8	-2.8	-4.4	-3.9	-4.7	-3.6	-3.7	-5.3	-0.5
Mexico	-1.9	-3.8	-2.9	-3.2	-2.8	-2.1	-1.4	-1.0	-0.6
Nicaragua	-24.8	-19.2	-24.8	-20.1	-19.3	-19.1	-18.3	-15.5	-16.3
Panama	-5.0	-9.3	-10.1	-5.8	-1.4	-0.8	-3.9	-7.9	-5.3
Paraguay	-7.3	-2.0	-2.3	-2.3	-4.1	1.8	2.3	1.2	-1.4
Peru	-5.7	-5.9	-2.8	-2.9	-2.1	-1.9	-1.5	0.0	1.3
Dominican Republic	-0.9	-1.7	-2.0	-4.4	-3.0	-3.2	5.3	5.3	-0.4
Uruguay	-1.3	-2.1	-2.4	-2.8	-2.7	3.1	-0.5	0.3	-0.5
Venezuela (Bolivarian Republic of)	4.3	-4.9	2.2	10.1	1.6	8.2	13.7	12.6	18.1

**Source:** Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of figures from the International Monetary Fund (IMF) and national agencies.

<sup>a</sup> These figures (with the opposite sign) are the same as those given for external saving in table A-5.

<sup>b</sup> Preliminary figures.

Table A-8  
**LATIN AMERICA AND THE CARIBBEAN: EXPORTS AND IMPORTS OF GOODS, F.O.B.**  
*(Annual growth rates)*

	Exports			Imports		
	Value	Volume	Unit value	Value	Volume	Unit value
1997	11.4	11.3	0.1	18.9	21.7	-2.3
1998	-1.2	7.3	-7.9	6.2	10.9	-4.3
1999	5.6	6.5	-0.8	-3.8	0.3	-4.1
2000	19.8	11.2	7.7	16.1	14.0	1.9
2001	-4.2	2.6	-6.6	-2.3	0.7	-3.0
2002	1.0	0.9	0.2	-7.0	-6.8	-0.2
2003	9.0	3.9	4.9	3.2	0.5	2.7
2004	23.0	9.8	12.0	21.8	14.6	6.3
2005 <sup>a</sup>	20.3	7.7	11.7	17.9	10.8	6.4

**Source:** Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures and data from the International Monetary Fund (IMF).

<sup>a</sup> Preliminary figures.

Table A-9  
**LATIN AMERICA AND THE CARIBBEAN: EXPORTS OF GOODS, F.O.B.**  
*(Indices: 2000 = 100)*

	Value			Volume			Unit value		
	2003	2004	2005 <sup>a</sup>	2003	2004	2005 <sup>a</sup>	2003	2004	2005 <sup>a</sup>
<b>Latin America and the Caribbean</b>	<b>105.5</b>	<b>129.7</b>	<b>156.0</b>	<b>107.5</b>	<b>118.0</b>	<b>127.1</b>	<b>98.1</b>	<b>109.9</b>	<b>122.7</b>
Argentina	113.7	131.2	151.9	112.6	118.1	134.8	101.0	111.0	112.7
Bolivia	128.2	172.2	214.3	127.8	151.9	164.4	100.4	113.4	130.4
Brazil	132.7	175.1	214.8	137.7	163.8	178.5	96.3	106.9	120.3
Chile	112.8	167.7	211.2	117.5	134.4	138.8	96.0	124.8	152.2
Colombia	100.5	125.4	158.2	107.5	109.9	120.5	93.5	114.1	131.2
Costa Rica	106.0	109.6	122.1	114.2	115.7	129.0	92.8	94.7	94.7
Ecuador	124.2	154.0	192.5	136.7	158.4	162.3	90.9	97.2	118.6
El Salvador	106.4	112.6	115.8	111.7	113.6	111.3	95.3	99.1	104.0
Guatemala	99.3	111.3	125.1	108.2	112.3	116.8	91.8	99.1	107.1
Haiti	100.4	113.9	138.3	100.1	108.0	126.2	100.4	105.4	109.6
Honduras	103.9	119.2	131.8	133.3	143.0	145.1	77.9	83.4	90.9
Mexico	99.2	113.2	129.0	99.5	105.1	112.0	99.7	107.6	115.2
Nicaragua	119.2	155.0	176.2	139.9	171.6	179.8	85.2	90.3	98.0
Panama	86.9	105.1	123.1	88.8	104.3	118.6	97.8	100.8	103.8
Paraguay	93.2	123.0	145.7	94.9	113.9	136.3	98.1	107.9	106.9
Peru	130.7	181.4	248.0	127.2	150.1	173.9	102.8	120.9	142.6
Dominican Republic	95.4	103.5	106.9	96.0	100.5	99.8	99.3	103.0	107.1
Uruguay	95.7	131.9	157.6	97.6	124.6	144.5	98.1	105.9	109.1
Venezuela (Bolivarian Republic of)	81.0	115.6	165.5	81.2	90.5	95.2	99.8	127.8	173.8

**Source:** Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of figures from the International Monetary Fund (IMF) and national agencies.

<sup>a</sup> Preliminary figures.

Table A-10  
**LATIN AMERICA AND THE CARIBBEAN: IMPORTS OF GOODS, F.O.B.**  
*(Indices: 2000 = 100)*

	Value			Volume			Unit value		
	2003	2004	2005 <sup>a</sup>	2003	2004	2005 <sup>a</sup>	2003	2004	2005 <sup>a</sup>
<b>Latin America and the Caribbean</b>	<b>93.8</b>	<b>114.3</b>	<b>134.7</b>	<b>94.3</b>	<b>108.1</b>	<b>119.8</b>	<b>99.4</b>	<b>105.7</b>	<b>112.5</b>
Argentina	55.0	89.2	114.3	58.4	87.7	108.4	94.2	101.7	105.5
Bolivia	100.4	114.5	145.4	98.5	105.1	124.7	101.9	109.0	116.6
Brazil	86.6	112.6	131.9	87.1	103.1	108.7	99.3	109.3	121.3
Chile	105.2	134.7	177.8	112.6	134.8	163.3	93.4	99.9	108.9
Colombia	119.6	143.2	181.5	121.7	136.2	162.9	98.3	105.1	111.5
Costa Rica	120.4	129.3	153.4	123.8	125.5	143.1	97.2	103.1	107.2
Ecuador	168.2	200.3	248.4	166.1	188.5	214.4	101.2	106.3	115.9
El Salvador	115.7	127.6	136.9	118.6	124.5	127.3	97.5	102.4	107.5
Guatemala	130.2	151.6	171.4	132.0	140.9	146.2	98.7	107.6	117.3
Haiti	102.7	111.4	120.4	101.0	101.4	101.5	101.7	109.8	118.6
Honduras	113.7	137.7	156.9	128.4	144.0	150.4	88.6	95.7	104.3
Mexico	97.8	112.8	127.1	96.9	106.5	114.4	100.8	105.9	111.2
Nicaragua	112.2	135.4	159.1	110.7	123.7	132.1	101.4	109.5	120.4
Panama	89.9	110.6	122.4	89.3	104.7	110.3	100.7	105.7	111.0
Paraguay	85.3	110.5	139.6	88.2	106.7	127.3	96.7	103.5	109.7
Peru	112.1	133.4	164.1	111.5	122.8	137.4	100.5	108.6	119.4
Dominican Republic	80.5	83.2	101.4	79.3	78.1	90.7	101.4	106.5	111.8
Uruguay	63.4	90.4	115.6	69.4	92.4	107.5	91.4	97.8	107.5
Venezuela (Bolivarian Republic of)	63.4	102.7	142.0	62.7	94.9	126.2	101.1	108.2	112.5

**Source:** Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of figures from the International Monetary Fund (IMF) and national agencies.

<sup>a</sup> Preliminary figures.

Table A-11  
**LATIN AMERICA AND THE CARIBBEAN: TERMS OF TRADE FOR GOODS, F.O.B./F.O.B.**  
*(Indices: 2000 = 100)*

	1997	1998	1999	2000	2001	2002	2003	2004	2005 <sup>a</sup>
<b>Latin America and the Caribbean</b>	<b>95.0</b>	<b>91.5</b>	<b>94.6</b>	<b>100.0</b>	<b>96.3</b>	<b>96.6</b>	<b>98.7</b>	<b>103.9</b>	<b>109.1</b>
Argentina	102.2	96.6	90.9	100.0	99.3	98.7	107.2	109.2	106.9
Bolivia	107.9	102.0	97.1	100.0	95.8	96.2	98.5	104.1	111.8
Brazil	113.6	111.9	97.0	100.0	99.6	98.4	97.0	97.9	99.2
Chile	94.5	91.0	94.2	100.0	93.3	97.2	102.8	124.9	139.8
Colombia	93.3	81.2	87.2	100.0	94.2	92.5	95.2	108.5	117.7
Costa Rica	125.9	117.5	106.9	100.0	98.4	96.9	95.5	91.9	88.3
Ecuador	89.1	75.8	89.1	100.0	84.6	86.8	89.8	91.5	102.4
El Salvador	95.0	95.8	99.6	100.0	102.5	101.6	97.7	96.8	96.8
Guatemala	97.9	115.3	101.9	100.0	96.7	95.8	93.0	92.1	91.3
Haiti	101.4	107.6	104.2	100.0	101.2	100.2	98.7	96.0	92.4
Honduras	125.5	108.9	107.5	100.0	94.8	92.0	88.0	87.2	87.2
Mexico	89.5	90.6	99.3	100.0	97.4	97.9	98.8	101.6	103.6
Nicaragua	82.0	79.6	95.3	100.0	88.4	87.0	84.1	82.5	81.4
Panama	103.9	104.7	104.6	100.0	102.7	101.6	97.2	95.3	93.5
Paraguay	106.2	108.0	101.7	100.0	100.2	96.7	101.4	104.3	97.4
Peru	115.5	103.4	100.8	100.0	95.6	98.4	102.2	111.3	119.4
Dominican Republic	106.1	108.0	105.7	100.0	100.9	101.5	97.9	96.7	95.8
Uruguay	110.2	116.7	106.2	100.0	103.8	104.8	107.4	108.4	101.5
Venezuela (Bolivarian Republic of)	70.1	51.2	66.1	100.0	82.2	87.6	98.7	118.1	154.4

**Source:** Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of figures from the International Monetary Fund (IMF) and national agencies.

<sup>a</sup> Preliminary figures.

Table A-12  
**LATIN AMERICA AND THE CARIBBEAN: NET RESOURCE TRANSFERS**<sup>a</sup>  
*(Millions of dollars)*

	1997	1998	1999	2000	2001	2002	2003	2004	2005 <sup>b</sup>
<b>Latin America and the Caribbean</b>	<b>32 559</b>	<b>27 837</b>	<b>-2 507</b>	<b>153</b>	<b>-3 423</b>	<b>-41 441</b>	<b>-36 926</b>	<b>-64 950</b>	<b>-75 536</b>
Argentina	9 309	10 559	5 678	993	-16 030	-20 668	-12 372	-6 881	-2 862
Bolivia	447	637	324	182	34	-130	-271	-584	-336
Brazil	5 863	7 222	-1 227	4 078	6 778	-10 252	-14 234	-29 955	-35 841
Chile	4 362	-162	-3 079	-1 621	-2 022	-1 985	-4 010	-9 771	-9 611
Colombia	3 703	1 763	-2 339	-2 200	-304	-1 370	-2 608	-853	-1 866
Costa Rica	448	-97	-674	-714	-63	580	443	432	1 123
Ecuador	-316	467	-2 715	-2 020	-776	28	-972	-1 061	-978
El Salvador	297	231	165	132	-293	-42	595	119	156
Guatemala	653	1 118	696	1 494	1 642	938	1 271	1 478	1 224
Haiti	85	56	80	45	129	26	5	94	-82
Honduras	368	173	528	218	280	258	-86	545	100
Mexico	6 073	5 371	1 691	6 491	11 161	8 502	5 960	475	-965
Nicaragua	749	471	888	573	442	652	627	672	727
Panama	718	479	652	3	202	-39	-506	-311	203
Paraguay	478	189	287	-30	237	-134	168	27	279
Peru	3 037	975	-633	-324	318	458	-693	-1 059	-4 413
Dominican Republic	-593	-453	-352	-85	168	-880	-2 787	-2 324	-640
Uruguay	486	793	480	728	707	-2 601	948	-176	131
Venezuela (Bolivarian Republic of)	-3 606	-1 955	-2 957	-7 792	-6 035	-14 782	-8 405	-15 817	-21 886

**Source:** Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of figures from the International Monetary Fund (IMF) and national agencies.

<sup>a</sup> The net transfer of resources is equal to total net capital inflows minus the income balance (net payments of profits and interest). Total net capital inflows correspond to the capital and financial accounts, plus errors and omissions, and the use of IMF credit and loans and exceptional financing. Negative figures indicate net outward resource transfers..

<sup>b</sup> Preliminary figures.

Table A-13  
**LATIN AMERICA AND THE CARIBBEAN: TOTAL NET CAPITAL INFLOWS  
 AND NET RESOURCE TRANSFERS<sup>a</sup>**  
*(Billions of dollars and percentages)*

	Total net capital inflows			Balance on income account <sup>b</sup>	Net resources transfers  (5) = (3) + (4) (5)	Exports of goods and services  (6)	Net resource transfer as a percentage of exports of goods and services (7) = (5) / (6) (7)
	Autonomous <sup>c</sup>	Non-autonomous <sup>d</sup>	Total				
	(1)	(2)	(3)				
1980	29.2	1.7	30.9	-18.9	12.0	106.9	11.3
1981	38.4	1.8	40.1	-29.1	11.1	115.6	9.6
1982	3.3	17.2	20.5	-38.9	-18.4	105.2	-17.5
1983	-22.3	30.1	7.9	34.5	42.4	105.4	40.2
1984	-10.9	23.9	13.0	-37.5	-24.5	117.5	-20.8
1985	-16.4	20.3	3.9	-35.5	-31.6	112.8	-28.1
1986	-12.4	21.9	9.4	-32.7	-23.3	99.2	-23.4
1987	-13.2	25.6	12.4	-31.0	-18.6	113.4	-16.4
1988	-19.8	22.8	3.0	-34.6	-31.6	130.6	-24.2
1989	-18.8	29.0	10.2	-39.0	-28.8	145.8	-19.7
1990	-5.5	21.6	16.1	-34.2	-18.1	162.0	-11.2
1991	23.3	11.8	35.1	-31.4	3.7	164.2	2.3
1992	48.6	7.5	56.1	-30.1	26.1	177.5	14.7
1993	68.5	-1.9	66.6	-34.5	32.1	194.1	16.5
1994	41.5	5.8	47.3	-36.1	11.2	223.0	5.0
1995	29.3	31.6	61.0	-40.8	20.2	265.9	7.6
1996	63.9	0.9	64.8	-42.7	22.0	295.0	7.5
1997	89.2	-9.0	80.2	-47.7	32.6	327.3	9.9
1998	63.4	15.7	79.1	-51.3	27.8	327.1	8.5
1999	42.5	6.1	48.6	-51.1	-2.5	342.9	-0.7
2000	61.8	-7.9	53.9	-53.7	0.2	408.2	0.0
2001	34.0	16.4	50.4	-53.8	-3.4	391.7	-0.9
2002	-12.1	22.6	10.5	-52.0	-41.4	394.0	-10.5
2003	1.9	18.7	20.6	-57.6	-36.9	428.6	-8.6
2004	-7.0	8.4	1.4	-66.4	-65.0	523.2	-12.4
2005 <sup>e</sup>	21.7	-21.7	-0.1	-75.5	-75.5	628.0	-12.0

**Source:** Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of figures from the International Monetary Fund (IMF) and national agencies.

<sup>a</sup> Includes information from 19 Latin American and Caribbean countries: Argentina, Bolivarian Republic of Venezuela, Bolivia, Brazil, Chile, Colombia, Costa Rica, Dominican Republic, Ecuador, El Salvador, Guatemala, Haiti, Honduras, Mexico, Nicaragua, Panama, Paraguay, Peru, and Uruguay.

<sup>b</sup> Corresponds to net payments of profits and interest.

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

<sup>d</sup> Includes the use of IMF credit and loans and exceptional financing, which includes transactions such as external debt forgiveness and accumulation of arrears.

<sup>e</sup> Preliminary figures.

Table A-14  
**LATIN AMERICA AND THE CARIBBEAN: RATIO OF TOTAL ACCRUED INTEREST  
 TO EXPORTS OF GOODS AND SERVICES <sup>a</sup>**  
 (Percentages)

	1997	1998	1999	2000	2001	2002	2003	2004	2005 <sup>b</sup>
<b>Latin America and the Caribbean</b>	<b>15.5</b>	<b>16.8</b>	<b>16.4</b>	<b>14.5</b>	<b>14.7</b>	<b>12.8</b>	<b>11.7</b>	<b>9.8</b>	<b>10.0</b>
Argentina	28.9	34.4	41.0	39.9	39.4	35.8	29.2	24.6	14.3
Bolivia	14.8	15.0	15.7	14.3	21.3	19.2	18.5	17.6	15.5
Brazil	26.0	30.5	31.6	26.5	26.4	21.9	18.9	15.3	13.4
Chile	7.3	8.2	7.9	8.2	7.7	5.5	4.0	3.5	25.7
Colombia	18.7	19.8	18.3	16.8	17.1	17.6	15.3	12.8	12.0
Costa Rica	4.6	3.6	3.2	4.1	4.0	3.0	3.0	2.6	2.3
Ecuador	15.8	21.1	21.1	19.9	19.0	16.9	15.4	13.1	10.6
El Salvador	8.2	8.0	8.7	8.6	9.3	9.8	11.1	11.1	11.9
Guatemala	4.6	4.2	3.7	4.7	5.6	6.2	5.3	5.4	5.3
Haiti	3.6	2.4	2.4	1.8	2.1	3.2	3.0	2.3	6.1
Honduras	9.2	8.0	8.6	7.3	6.5	5.7	4.9	3.8	3.5
Mexico	10.5	9.7	9.3	8.4	8.0	7.4	7.2	6.2	5.6
Nicaragua	25.1	16.2	17.2	14.8	15.9	12.1	9.2	7.4	3.2
Panama	15.7	19.0	20.6	20.1	17.6	13.6	11.6	9.9	11.1
Paraguay	2.4	2.0	3.1	5.3	6.2	4.7	4.2	3.2	2.9
Peru	19.5	23.7	23.0	21.6	19.7	14.7	12.6	10.0	8.7
Dominican Republic	3.1	2.8	2.7	2.8	3.0	3.4	3.6	4.5	4.6
Uruguay	16.6	18.0	20.9	20.6	24.5	24.5	20.2	17.3	17.2
Venezuela (Bolivarian Republic of)	12.9	14.7	12.6	8.6	9.7	8.5	7.9	5.4	4.6

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

<sup>a</sup> Includes interest paid (without deducting interest received) and interest due but not paid.

<sup>b</sup> Preliminary figures.

Table A-15  
**LATIN AMERICA AND THE CARIBBEAN: RATIO OF PROFIT PAYMENTS  
 TO EXPORTS OF GOODS AND SERVICES <sup>a</sup>**  
 (Percentages)

	1997	1998	1999	2000	2001	2002	2003	2004	2005 <sup>b</sup>
<b>Latin America and the Caribbean</b>	<b>6.1</b>	<b>6.4</b>	<b>5.0</b>	<b>5.3</b>	<b>5.0</b>	<b>4.5</b>	<b>5.5</b>	<b>6.4</b>	<b>5.6</b>
Argentina	8.8	8.9	7.5	7.9	2.5	0.4	3.1	6.4	7.9
Bolivia	5.7	6.0	10.9	10.1	...	...	...	...	...
Brazil	10.3	11.0	9.3	6.6	7.4	8.5	7.2	6.3	8.2
Chile	10.0	6.9	7.0	10.9	10.0	10.8	17.3	21.0	...
Colombia	4.0	-0.2	-2.1	4.3	6.2	7.5	9.7	12.8	15.0
Costa Rica	3.4	5.6	20.9	14.7	8.3	4.9	7.9	3.8	1.8
Ecuador	3.2	4.6	4.7	4.7	5.9	5.0	5.0	4.1	4.6
El Salvador	...	1.0	3.5	1.6	2.0	2.3	2.1	1.9	4.1
Guatemala	5.1	3.7	4.3	5.8	4.4	5.7	6.6	5.2	5.7
Honduras	3.2	2.9	2.0	2.8	4.3	4.3	6.5	9.3	8.6
Mexico	3.1	4.1	2.4	3.3	3.2	1.9	1.9	1.7	2.3
Nicaragua	5.9	6.2	6.5	6.3	6.9	6.3	5.9	4.8	...
Panama	6.1	7.8	10.1	7.2	7.1	2.6	8.6	10.8	10.1
Paraguay	3.8	4.3	3.6	2.9	3.6	1.6	2.2	4.3	1.3
Peru	11.0	2.9	0.2	4.1	1.5	5.2	10.3	15.9	20.4
Dominican Republic	10.1	11.1	12.1	11.9	13.0	14.0	15.6	17.1	18.3
Uruguay	0.9	1.4	2.0	2.4	3.1	-11.7	3.6	5.1	5.1
Venezuela (Bolivarian Republic of)	6.6	11.4	3.9	4.1	6.7	7.0	6.7	8.2	5.1

**Source:** Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of figures from the International Monetary Fund (IMF) and national agencies.

<sup>a</sup> Includes reinvestment of profits.

<sup>b</sup> Preliminary figures.

Table A-16  
**LATIN AMERICA AND THE CARIBBEAN: NET FOREIGN DIRECT INVESTMENT<sup>a</sup>**  
*(Millions of dollars)*

	1997	1998	1999	2000	2001	2002	2003	2004	2005 <sup>b</sup>
<b>Latin America and the Caribbean</b>	<b>57 599</b>	<b>63 677</b>	<b>79 921</b>	<b>70 308</b>	<b>64 606</b>	<b>44 443</b>	<b>34 661</b>	<b>43 790</b>	<b>47 886</b>
Argentina <sup>c</sup>	5 507	4 965	22 257	9 517	2 005	2 776	878	3 832	3 505
Bolivia	728	947	1 008	734	703	674	195	63	-280
Brazil	18 608	29 192	26 886	30 498	24 715	14 108	9 894	8 339	12 550
Chile	3 809	3 144	6 203	873	2 590	2 207	2 701	5 646	4 764
Colombia	4 753	2 033	1 392	2 069	2 509	1 283	820	2 975	5 569
Costa Rica	404	608	614	400	451	625	548	557	696
Ecuador	724	870	648	720	1 330	1 275	1 555	1 160	1 530
El Salvador <sup>d</sup>	59	1 103	162	178	289	496	123	430	300
Guatemala	84	673	155	230	456	111	131	155	198
Haiti	4	11	30	13	4	6	14	6	10
Honduras	122	99	237	282	193	176	247	325	272
Mexico <sup>e</sup>	12 831	11 897	13 631	17 588	22 747	17 384	12 930	14 242	11 884
Nicaragua	203	218	337	267	150	204	201	250	230
Panama	1 299	1 203	864	624	467	99	771	1 012	1 027
Paraguay	230	336	89	98	78	12	22	45	113
Peru	2 054	1 582	1 812	810	1 070	2 156	1 275	1 816	2 519
Dominican Republic	421	700	1 338	953	1 079	917	613	758	899
Uruguay	113	155	238	274	291	180	401	315	605
Venezuela (Bolivarian Republic of)	5 645	3 942	2 018	4 180	3 479	-244	1 341	1 866	1 497

**Source:** Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of figures from the International Monetary Fund (IMF) and national agencies.

<sup>a</sup> Refers to direct investment in the reporting economy, minus direct investment abroad by reporting-economy residents (both excluding disinvestment). Includes reinvested profits.

<sup>b</sup> Preliminary figures.

<sup>c</sup> For 1999, includes the value of the investment by REPSOL in Yacimientos Petrolíferos Fiscales. Part of this amount corresponds to the purchase of shares in the company held by non-residents. In the balance of payments, the value of those shares is reflected as a debit under the portfolio investment item.

<sup>d</sup> From 1998 onward the figures are not comparable, since up to 1997 no official records were kept.

<sup>e</sup> For 2001, includes the value of the investment by Citigroup in BANAMEX; for 2004, includes investment in Bancomer.

Table A-17  
**LATIN AMERICA AND THE CARIBBEAN: INTERNATIONAL BOND ISSUES<sup>a</sup>**  
*(Millions of dollars)*

	1997	1998	1999	2000	2001	2002	2003	2004	2005 <sup>b</sup>
<b>Latin America and the Caribbean</b>	<b>55 635</b>	<b>40 406</b>	<b>44 107</b>	<b>40 255</b>	<b>38 503</b>	<b>20 208</b>	<b>37 906</b>	<b>36 383</b>	<b>45 054</b>
Argentina	15 571	15 931	14 900	13 468	2 711		100	200	540
Barbados				200	150				325
Belize						125	100		
Bolivia								108	
Brazil	15 839	8 380	11 180	12 068	13 010	6 857	19 364	11 603	15 334
Chile	1 800	1 063	1 765	676	1 515	1 694	3 200	2 350	1 000
Colombia	1 605	1 385	1 676	1 622	4 329	695	1 545	1 545	2 435
Costa Rica		200	300	250	250	250	490	310	
Ecuador	625								650
El Salvador			150	50	354	1 252	349	286	375
Grenada						100			
Guatemala	150				325		300	380	
Jamaica	225	250		422	812	300		814	1 050
Mexico	15 250	8 914	11 441	9 777	11 016	6 505	7 979	13 312	11 703
Panama	1 146	325	500	350	1 100	1 030	275	770	1 530
Paraguay			400						
Peru	450	150				1 000	1 250	1 305	2 675
Dominican Republic	200				500		600		160
Trinidad and Tobago			230	250					100
Uruguay	479	550	350	641	856	400		350	1 062
Venezuela (Bolivarian Republic of)	2 295	3 259	1 215	482	1 575		2 354	3 050	6 115

**Source:** International Monetary Fund Research Department, Emerging Markets Studies Division and Merrill Lynch.

<sup>a</sup> Includes sovereign, bank and corporate bonds.

<sup>b</sup> Does not include US\$ 784 million issued jointly by the Andean Development Corporation (ADC) and the Central American Bank for Economic Integration (CABEI).

Table A-18  
**LATIN AMERICA AND THE CARIBBEAN: TOTAL GROSS EXTERNAL DEBT<sup>a</sup>**  
*(Millions of dollars)*

	1997	1998	1999	2000	2001	2002	2003	2004	2005 <sup>b</sup>
<b>Latin America and the Caribbean</b>	<b>680 417</b>	<b>742 876</b>	<b>762 649</b>	<b>738 587</b>	<b>744 598</b>	<b>733 118</b>	<b>757 618</b>	<b>761 147</b>	<b>658 013<sup>c</sup></b>
<b>Latin America</b>	<b>672 476</b>	<b>734 699</b>	<b>754 691</b>	<b>729 515</b>	<b>734 352</b>	<b>722 406</b>	<b>746 719</b>	<b>749 302</b>	<b>645 939<sup>c</sup></b>
Argentina	129 964	147 634	152 563	155 015	166 272	156 748	164 645	171 115	113 518
Bolivia <sup>d</sup>	4 532	4 659	4 574	4 460	4 497	4 400	5 142	5 045	4 942
Brazil	199 998	223 792	225 610	216 921	209 934	210 711	214 930	201 373	169 450
Chile	29 034	32 591	34 758	37 177	38 527	40 504	43 067	43 517	45 014
Colombia	34 409	36 681	36 733	36 130	39 101	37 329	38 012	39 445	38 350
Costa Rica <sup>d</sup>	2 640	2 872	3 057	3 151	3 175	3 281	3 733	3 884	3 626
Cuba <sup>d</sup>	10 146	11 209	11 078	10 961	10 893	10 900	11 300	12 000	...
Ecuador <sup>e</sup>	15 099	16 401	16 282	13 564	14 411	16 288	16 595	17 010	18 926
El Salvador <sup>d</sup>	2 689	2 646	2 789	2 831	3 148	3 987	4 717	4 778	4 976
Guatemala <sup>d</sup>	2 135	2 368	2 631	2 644	2 925	3 119	3 467	3 844	3 723
Haiti <sup>d</sup>	1 025	1 104	1 162	1 170	1 189	1 212	1 287	1 316	1 335
Honduras	4 073	4 369	4 691	4 711	4 757	4 922	5 242	5 912	5 223
Mexico	149 028	160 258	166 381	148 652	144 526	134 979	132 271	130 922	127 089
Nicaragua <sup>d</sup>	6 001	6 287	6 549	6 660	6 374	6 363	6 596	5 391	5 348
Panama <sup>d</sup>	5 051	5 349	5 568	5 604	6 263	6 349	6 504	7 219	7 580
Paraguay	2 029	2 235	2 741	2 869	2 653	2 900	2 952	2 894	2 805
Peru	28 864	30 142	28 586	27 981	27 196	27 873	29 587	31 117	28 605
Dominican Republic	3 572	3 546	3 661	3 682	4 177	4 536	5 987	6 380	6 756
Uruguay <sup>f</sup>	4 945	5 467	8 261	8 895	8 937	10 548	11 013	11 593	11 441
Venezuela (Bolivarian Republic of)	37 242	35 087	37 016	36 437	35 398	35 460	39 672	44 546	47 233
<b>Caribbean</b>	<b>7 941</b>	<b>8 177</b>	<b>7 958</b>	<b>9 072</b>	<b>10 246</b>	<b>10 711</b>	<b>10 899</b>	<b>11 845</b>	<b>12 074</b>
Antigua and Barbuda <sup>d</sup>	347	395	398	391	405	434	494	527	313
Bahamas <sup>d</sup>	335	323	338	349	328	310	363	343	335
Barbados <sup>d</sup>	382	391	436	578	746	733	738	788	874
Belize <sup>d</sup>	...	230	254	430	486	577	754	851	933
Dominica <sup>d</sup>	89	91	132	150	175	202	219	207	208
Grenada <sup>d</sup>	101	103	113	137	153	260	278	330	400
Guyana <sup>d</sup>	1 513	1 507	1 211	1 193	1 197	1 247	1 085	1 071	1 096
Jamaica <sup>d</sup>	3 278	3 306	3 024	3 375	4 146	4 348	4 192	5 120	5 376
Saint Kitts and Nevis <sup>d</sup>	106	124	152	162	216	261	315	304	284
Saint Vincent and the Grenadines	90	102	163	165	175	175	203	227	242
Saint Lucia <sup>d</sup>	134	134	152	170	204	246	324	344	350
Suriname <sup>d</sup>	...	...	...	291	349	371	382	383	382
Trinidad and Tobago <sup>d</sup>	1 565	1 471	1 585	1 680	1 666	1 549	1 553	1 351	1 281

**Source:** Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of figures from the International Monetary Fund (IMF) and national agencies.

<sup>a</sup> Total gross external debt includes debt owed to the International Monetary Fund.

<sup>b</sup> Preliminary figures.

<sup>c</sup> Does not include Cuba.

<sup>d</sup> Public external debt.

<sup>e</sup> For 2005, includes private external debt up to September.

<sup>f</sup> For 1997 and 1998, figures refer to public external debt. From 1999 onwards, figures refer to total external debt (including the private sector but not memorandum items).

Table A-19  
**LATIN AMERICA AND THE CARIBBEAN: RATIO OF TOTAL GROSS EXTERNAL DEBT<sup>a</sup>  
 TO EXPORTS OF GOODS AND SERVICES**  
 (Percentages)

	1997	1998	1999	2000	2001	2002	2003	2004	2005 <sup>b</sup>
<b>Latin America and the Caribbean</b>	<b>198</b>	<b>216</b>	<b>211</b>	<b>172</b>	<b>181</b>	<b>178</b>	<b>168</b>	<b>139</b>	<b>101<sup>c</sup></b>
<b>Latin America</b>	<b>203</b>	<b>222</b>	<b>217</b>	<b>177</b>	<b>185</b>	<b>182</b>	<b>172</b>	<b>142</b>	<b>103<sup>c</sup></b>
Argentina	420	473	546	496	533	542	482	430	245
Bolivia <sup>d</sup>	321	344	349	303	296	283	262	197	158
Brazil	338	381	409	336	311	301	257	185	126
Chile	133	161	165	160	172	179	162	114	94
Colombia	242	273	263	229	260	263	242	202	157
Costa Rica <sup>d</sup>	49	42	37	41	46	46	46	45	37
Cuba <sup>d</sup>	255	271	257	229	260	282	243	213	...
Ecuador <sup>e</sup>	250	328	305	227	255	268	228	193	175
El Salvador <sup>d</sup>	92	87	88	77	88	105	115	108	109
Guatemala <sup>d</sup>	67	68	76	69	75	79	84	83	73
Haiti <sup>d</sup>	270	230	219	232	267	288	275	258	219
Honduras	186	180	210	189	196	196	195	190	152
Mexico	123	124	112	83	84	78	75	65	55
Nicaragua <sup>d</sup>	666	666	680	604	570	557	505	327	287
Panama <sup>d</sup>	60	65	78	72	78	84	86	81	73
Paraguay	51	54	95	98	109	120	108	84	70
Peru	345	400	372	330	321	301	274	214	147
Dominican Republic	51	47	46	41	50	55	67	68	67
Uruguay <sup>f</sup>	117	132	238	243	274	392	357	270	224
Venezuela (Bolivarian Republic of)	148	183	166	105	126	127	141	112	83
<b>Caribbean</b>	<b>68</b>	<b>68</b>	<b>61</b>	<b>57</b>	<b>69</b>	<b>73</b>	<b>65</b>	<b>61</b>	<b>54</b>
Antigua and Barbuda <sup>d</sup>	78	85	84	84	92	98	108	101	62
Bahamas <sup>d</sup>	18	17	15	12	15	12	15	13	11
Barbados <sup>d</sup>	31	30	33	42	56	57	52	52	50
Belize <sup>d</sup>	...	70	62	99	112	119	143	157	151
Dominica <sup>d</sup>	65	60	84	104	144	163	185	159	165
Grenada <sup>d</sup>	73	62	52	58	77	151	155	170	243
Guyana <sup>d</sup>	204	219	180	177	181	187	155	143	163
Jamaica <sup>d</sup>	96	98	87	94	124	135	119	131	131
Saint Kitts and Nevis <sup>d</sup>	76	85	104	108	141	168	191	157	142
Saint Vincent and the Grenadines	61	65	93	92	99	98	117	123	126
Saint Lucia <sup>d</sup>	37	34	42	45	62	77	83	72	69
Suriname <sup>d</sup>	...	...	...	48	69	65	55	38	27
Trinidad and Tobago <sup>d</sup>	52	50	46	35	34	34	26	18	14

**Source:** Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of figures from the International Monetary Fund (IMF) and national agencies.

<sup>a</sup> Total gross external debt includes debt owed to the International Monetary Fund.

<sup>b</sup> Preliminary figures.

<sup>c</sup> Does not include Cuba.

<sup>d</sup> Public external debt.

<sup>e</sup> For 2005, includes private external debt up to September.

<sup>f</sup> For 1997 and 1998, figures refer to public external debt. From 1999 onwards, figures refer to total external debt (including the private sector but not memorandum items).

Table A-20  
**LATIN AMERICA AND THE CARIBBEAN: STOCK EXCHANGE INDICES IN DOLLARS**<sup>a</sup>  
*(Indices: December 2000 = 100)*

	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006 <sup>b</sup>
<b>Latin America and the Caribbean</b>	<b>121.5</b>	<b>75.1</b>	<b>118.0</b>	<b>100.0</b>	<b>93.9</b>	<b>72.6</b>	<b>122.5</b>	<b>168.6</b>	<b>242.7</b>	<b>267.5</b>
Argentina	139.7	100.0	133.3	100.0	69.1	34.8	79.4	97.4	140.3	177.7
Brazil	113.9	65.4	109.2	100.0	77.7	51.9	105.9	141.8	212.7	248.9
Chile	122.9	86.0	116.4	100.0	94.8	80.7	145.9	176.9	202.4	202.1
Colombia	402.3	227.0	181.5	100.0	125.1	137.3	174.7	376.4	783.0	580.6
Mexico	114.2	69.9	125.6	100.0	112.2	93.6	123.5	182.8	262.7	269.2
Peru	189.9	114.5	138.5	100.0	112.3	146.9	263.1	294.9	366.1	497.2
Venezuela (Bolivarian Republic of)	187.8	90.5	79.0	100.0	79.9	51.8	59.2	88.9	69.4	98.7

**Source:** Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of figures from the International Finance Corporation (IFC).

<sup>a</sup> Year-end values; overall index.

<sup>b</sup> Figures up to June.

Table A-21  
**LATIN AMERICA AND THE CARIBBEAN: REAL EFFECTIVE EXCHANGE RATES**<sup>a</sup>  
*(Index: 2000 = 100, deflated by CPI)*

	1997	1998	1999	2000	2001	2002	2003	2004 <sup>b</sup>	2005 <sup>b</sup>	2006 <sup>b,c</sup>
<b>Latin America and the Caribbean<sup>d</sup></b>	<b>99.5</b>	<b>97.2</b>	<b>99.9</b>	<b>100.0</b>	<b>99.3</b>	<b>108.2</b>	<b>114.1</b>	<b>114.9</b>	<b>112.3</b>	<b>111.3</b>
Argentina	112.7	108.8	99.6	100.0	95.6	221.9	204.8	214.9	215.4	220.7
Bolivia	103.8	98.5	98.6	100.0	101.0	95.4	104.1	111.6	119.9	122.2
Brazil	69.9	72.3	108.0	100.0	119.7	130.5	130.6	124.6	101.5	90.5
Chile	90.8	92.5	98.2	100.0	111.2	109.1	114.5	107.1	101.6	96.5
Colombia	78.0	83.1	91.3	100.0	104.0	105.3	119.3	108.5	96.1	97.1
Costa Rica	101.1	99.8	101.8	100.0	97.0	97.4	103.4	106.8	108.4	108.1
Ecuador	65.7	65.5	89.1	100.0	71.7	62.6	61.0	63.7	66.4	66.3
El Salvador	104.0	101.9	100.4	100.0	99.6	99.6	100.1	100.3	101.7	102.3
Guatemala	88.3	88.1	98.7	100.0	95.7	88.5	88.6	86.0	79.9	77.7
Honduras	119.0	108.8	104.5	100.0	97.1	96.9	98.4	100.0	100.1	99.1
Jamaica	100.7	96.0	97.7	100.0	101.6	101.1	115.9	114.3	105.6	106.4
Mexico	119.9	119.0	108.8	100.0	93.4	92.9	104.5	109.5	106.1	106.2
Nicaragua	101.2	101.3	101.9	100.0	101.1	103.1	106.8	108.9	108.3	107.8
Panama	102.5	100.1	100.7	100.0	103.0	100.8	101.8	107.0	109.6	110.4
Paraguay	93.3	99.2	96.6	100.0	102.4	106.3	112.5	108.3	118.7	111.2
Peru	90.7	91.7	101.5	100.0	97.8	95.6	99.8	101.3	101.9	103.8
Uruguay	108.5	107.0	98.3	100.0	101.2	117.0	150.3	151.8	137.0	136.3
Venezuela (Bolivarian Republic of)	141.4	116.5	102.6	100.0	95.2	123.7	136.8	143.2	143.4	140.6

**Source:** Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures and data from the International Monetary Fund (IMF).

<sup>a</sup> Annual averages. A country's real effective exchange rate index is calculated by weighting its real bilateral exchange rate indices with each of its trading partners by their shares in the country's total trade flows in terms of exports and imports. A currency depreciates in effective real terms when this index rises and appreciates when it falls.

<sup>b</sup> Preliminary figures, provisionally weighted by trade in 2003.

<sup>c</sup> January-June average.

<sup>d</sup> Simple average.

Table A-22  
**LATIN AMERICA AND THE CARIBBEAN: URBAN UNEMPLOYMENT**  
*(Average annual rates)*

	1997	1998	1999	2000	2001	2002	2003	2004	2005 <sup>a</sup>	
<b>Latin America and the Caribbean<sup>b</sup></b>	<b>9.3</b>	<b>10.3</b>	<b>11.0</b>	<b>10.4</b>	<b>10.2</b>	<b>11.0</b>	<b>11.0</b>	<b>10.2</b>	<b>9.1</b>	
Argentina <sup>c</sup>	Urban areas	14.9	12.9	14.3	15.1	17.4	19.7	17.3	13.6	11.6
Barbados <sup>d</sup>	Nationwide total	14.5	12.3	10.4	9.2	9.9	10.3	11.0	9.8	9.1
Belize <sup>d</sup>	Nationwide total	12.7	14.3	12.8	11.1	9.1	10.0	12.9	11.6	11.0
Bolivia	Urban total <sup>e</sup>	4.4	6.1	7.2	7.5	8.5	8.7	9.2	6.2	...
Brazil <sup>f</sup>	Six metropolitan areas	5.7	7.6	7.6	7.1	6.2	11.7	12.3	11.5	9.8
Chile	Nationwide total	6.1	6.4	9.8	9.2	9.1	9.0	8.5	8.8	8.0
Colombia <sup>d</sup>	13 metropolitan areas <sup>g</sup>	12.4	15.3	19.4	17.2	18.2	17.6	16.7	15.4	14.0
Costa Rica	Urban total	5.9	5.4	6.2	5.3	5.8	6.8	6.7	6.7	6.9
Cuba	Nationwide total	7.0	6.6	6.3	5.5	4.1	3.3	2.3	1.9	1.9
Ecuador <sup>d</sup>	Cuenca, Guayaquil and Quito <sup>h</sup>	9.3	11.5	15.1	14.1	10.4	8.6	9.8	11.0	10.7
El Salvador	Urban total	7.5	7.6	6.9	6.5	7.0	6.2	6.2	6.5	7.3
Guatemala	Urban total <sup>i</sup>	5.1	3.8	...	...	...	5.4	5.2	4.4	...
Honduras	Urban total	5.8	5.2	5.3	...	5.9	6.1	7.6	8.0	6.5
Jamaica <sup>d</sup>	Nationwide total	16.5	15.5	15.7	15.5	15.0	14.2	11.4	11.7	11.3
Mexico <sup>j</sup>	Urban areas	5.4	4.7	3.7	3.4	3.6	3.9	4.6	5.3	4.7
Nicaragua	Urban total <sup>k</sup>	14.3	13.2	10.7	7.8	11.3	11.6	10.2	9.3	7.0
Panama <sup>d</sup>	Urban total <sup>l</sup>	15.4	15.5	13.6	15.2	17.0	16.5	15.9	14.1	12.0
Paraguay	Urban total	7.1	6.6	9.4	10.0	10.8	14.7	11.2	10.0	7.6
Peru	Metropolitana Lima	9.2	8.5	9.2	8.5	9.3	9.4	9.4	9.4	9.6
Dominican Republic <sup>d</sup>	Nationwide total	16.0	14.4	13.8	13.9	15.6	16.1	16.7	18.4	18.0
Trinidad and Tobago <sup>d</sup>	Nationwide total	15.0	14.2	13.2	12.2	10.8	10.4	10.5	8.4	8.0
Uruguay	Urban total	11.5	10.1	11.3	13.6	15.3	17.0	16.9	13.1	12.2
Venezuela (Bolivarian Republic of)	Nationwide total	11.4	11.3	15.0	13.9	13.3	15.8	18.0	15.3	12.4

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

<sup>a</sup> Preliminary figures.

<sup>b</sup> The data for Argentina, Brazil and Mexico have been adjusted to allow for changes in methodology in 2003, 2002 and 2005, respectively.

<sup>c</sup> New measurements have been used from 2003 on; these data are not comparable with the preceding series.

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

<sup>e</sup> Up to 1999, the figures refer to departmental capitals.

<sup>f</sup> New measurements have been used from 2002 on; these data are not comparable with the preceding series.

<sup>g</sup> Up to 1999, the figures refer to seven metropolitan areas.

<sup>h</sup> Up to 1999, the figures refer to the total for urban areas.

<sup>i</sup> Up to 1998, the figures are official estimates of nationwide totals.

<sup>j</sup> Data based on new methodology and are therefore not comparable with data in previous editions of the Economic Survey.

<sup>k</sup> Up to 1999, the figures refer to nationwide totals.

<sup>l</sup> Up to 1999, the figures refer to the metropolitan region.

Table A-23  
**LATIN AMERICA AND THE CARIBBEAN: CONSUMER PRICES**  
*(Percentage variations, December-December)*

	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006 <sup>a</sup>
<b>Latin America and the Caribbean<sup>b</sup></b>	<b>10.7</b>	<b>10.0</b>	<b>9.7</b>	<b>9.0</b>	<b>6.1</b>	<b>12.2</b>	<b>8.5</b>	<b>7.4</b>	<b>6.1</b>	<b>5.5</b>
Antigua and Barbuda	...	...	...	...	...	2.5	1.8	2.8	2.5	...
Argentina	0.3	0.7	-1.8	-0.7	-1.5	41.0	3.7	6.1	12.3	11.0
Bahamas	0.8	1.5	1.5	1.1	2.6	1.8	2.0	2.1	1.8	...
Barbados	3.6	1.7	2.9	3.8	-0.3	0.9	0.3	4.3	7.4	8.0 <sup>c</sup>
Bolivia	6.7	4.4	3.1	3.4	0.9	2.4	3.9	4.6	4.9	3.5
Brazil	5.2	1.7	8.9	6.0	7.7	12.5	9.3	7.6	5.7	4.0
Chile	6.0	4.7	2.3	4.5	2.6	2.8	1.1	2.4	3.7	3.9
Colombia	17.7	16.7	9.2	8.8	7.6	7.0	6.5	5.5	4.9	3.9
Costa Rica	11.2	12.4	10.1	10.2	11.0	9.7	9.9	13.1	14.1	12.4
Cuba	1.9	2.9	-2.9	-3.0	-0.5	7.0	-1.0	2.9	4.2	...
Dominica	2.3	1.4	0.0	1.1	1.1	-1.2	2.8	0.8	2.7	2.8 <sup>d</sup>
Ecuador	30.6	43.4	60.7	91.0	22.4	9.3	6.1	1.9	3.1	2.8
El Salvador	1.9	4.2	-1.0	4.3	1.4	2.8	2.5	5.4	4.3	4.4
Grenada	0.9	1.2	1.1	3.4	-0.7	-0.4	1.1	2.5	5.8	...
Guatemala	7.1	7.5	4.9	5.1	8.9	6.3	5.9	9.2	8.6	7.6
Guyana	4.2	4.7	8.7	5.8	1.5	6.0	5.0	5.5	8.2	...
Haiti	15.7	7.4	9.7	19.0	8.1	14.8	40.4	20.2	14.8	14.1 <sup>d</sup>
Honduras	12.8	15.7	10.9	10.1	8.8	8.1	6.8	9.2	7.7	5.7
Jamaica	9.2	7.9	6.8	6.1	8.7	7.3	14.1	13.7	12.9	8.4
Mexico	15.7	18.6	12.3	9.0	4.4	5.7	4.0	5.2	3.3	3.2
Nicaragua	7.3	18.5	7.2	9.9	4.7	4.0	6.6	8.9	9.6	10.8
Panama	-0.5	1.4	1.5	0.7	0.0	1.9	1.5	1.5	3.4	3.0
Paraguay	6.2	14.6	5.4	8.6	8.4	14.6	9.3	2.8	9.9	8.4
Peru	6.5	6.0	3.7	3.7	-0.1	1.5	2.5	3.5	1.5	1.8
Dominican Republic	8.4	7.8	5.1	9.0	4.4	10.5	42.7	28.7	7.4	10.3
Saint Kitts and Nevis	11.3	0.9	3.2	...	...	1.7	3.1	1.7	7.2	...
Saint Vincent and the Grenadines	0.8	3.3	-1.8	1.4	-0.2	2.4	2.2	1.7	3.9	...
Saint Lucia	1.9	3.6	6.1	0.4	0.0	-0.7	0.5	3.5	6.7	...
Suriname	17.4	22.9	112.9	76.1	4.9	28.4	14.0	9.3	15.8	14.0 <sup>e</sup>
Trinidad and Tobago	3.5	5.6	3.4	5.6	3.2	4.3	3.0	5.6	7.2	8.0 <sup>d</sup>
Uruguay	15.2	8.6	4.2	5.1	3.6	25.9	10.2	7.6	4.9	6.7
Venezuela (Bolivarian Republic of)	37.6	29.9	20.0	13.4	12.3	31.2	27.1	19.2	14.4	11.8

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

<sup>a</sup> 12-month variation up to June 2006.

<sup>b</sup> The only English-speaking Caribbean countries included under this heading are Barbados, Jamaica and Trinidad and Tobago. In addition, the figure for 2005 does not include Cuba.

<sup>c</sup> 12-month variation up to March 2006.

<sup>d</sup> 12-month variation up to May 2006.

<sup>e</sup> 12-month variation up to April 2006.

Table A-24  
**LATIN AMERICA AND THE CARIBBEAN: AVERAGE REAL WAGES**  
*(Average annual indices: 2000 = 100)*

	1990	1997	1998	1999	2000	2001	2002	2003	2004	2005 <sup>a</sup>
Argentina <sup>b</sup>	93.3	95.0	95.0	97.8	100.0	99.2	85.4	83.8	92.2	97.8
Brazil <sup>c</sup>	99.7	105.7	105.8	101.1	100.0	95.1	93.1	84.9	85.5	85.2
Chile <sup>d</sup>	69.3	93.8	96.3	98.6	100.0	101.7	103.7	104.6	106.5	108.5
Colombia <sup>b</sup>	76.3	92.1	92.2	96.3	100.0	99.7	102.5	102.4	103.4	104.6
Costa Rica <sup>e</sup>	81.5	89.7	94.7	99.2	100.0	101.0	105.1	105.5	102.8	100.8
Mexico <sup>b</sup>	88.9	90.4	92.9	94.3	100.0	106.7	108.7	110.1	110.4	110.3
Nicaragua <sup>e</sup>	75.8	92.5	96.2	100.0	100.0	101.0	104.5	106.5	104.2	104.5
Paraguay	87.8	102.7	100.8	98.7	100.0	101.4	94.9	93.0	90.5	91.5
Peru <sup>f</sup>	93.7	103.5	101.4	99.3	100.0	99.1	103.7	105.3	106.5	104.5
Uruguay	89.1	98.0	99.7	101.3	100.0	99.7	89.0	77.9	77.9	81.5
Venezuela (Bolivarian Republic of) <sup>g</sup>	140.5	98.0	103.3	98.5	100.0	102.4	92.1	76.7	73.7	73.8

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

<sup>a</sup> Preliminary figures.

<sup>b</sup> Manufacturing.

<sup>c</sup> Workers covered by social and labour legislation. Private sector only from 2003 onwards.

<sup>d</sup> General index of hourly wages.

<sup>e</sup> Average wages declared by workers covered by social security.

<sup>f</sup> Private-sector manual workers in the Lima metropolitan area.

<sup>g</sup> Private sector.

Table A-25  
**LATIN AMERICA AND THE CARIBBEAN: PUBLIC-SECTOR DEFICIT (-) OR SURPLUS <sup>a</sup>**  
*(Percentages of GDP)*

	Coverage <sup>b</sup>	1997	1998	1999	2000	2001	2002	2003	2004	2005 <sup>c</sup>
<b>Latin America and the Caribbean <sup>d</sup></b>	<b>CG</b>	<b>-1.2</b>	<b>-2.3</b>	<b>-3.1</b>	<b>-2.7</b>	<b>-3.3</b>	<b>-3.2</b>	<b>-2.9</b>	<b>-1.9</b>	<b>-1.2</b>
Argentina	NA	-1.4	-1.8	-3.1	-2.1	-4.0	-0.6	0.2	2.0	0.4
	NFPS	-1.5	-2.4	-4.5	-3.3	-7.0	-0.8	1.6	3.5	...
Bolivia	CG	-3.0	-3.3	-3.6	-4.6	-7.0	-8.0	-7.1	-5.4	-3.5
	NFPS	-3.3	-4.7	-3.5	-3.7	-6.8	-8.8	-7.9	-5.5	-2.3
Brazil	CG <sup>e,f</sup>	-2.6	-5.4	-6.8	-3.1	-3.7	-6.4	-2.5	-1.3	-3.5
	CPS <sup>f</sup>	...	-7.5	-5.8	-3.6	-3.6	-4.6	-5.1	-2.7	-3.3
Chile	CG	2.1	0.4	-2.1	-0.6	-0.5	-1.2	-0.4	2.2	4.7
	NFPS	1.4	-1.4	-3.3	-1.0	-0.4	-2.5	-1.6	2.4	...
Colombia	GNC <sup>g</sup>	-3.7	-4.8	-6.1	-5.4	-5.3	-4.9	-4.7	-4.3	-4.8
	NFPS	-2.8	-3.7	-4.1	-4.0	-4.1	-3.5	-2.6	-0.9	-0.3
Costa Rica	CG	-2.9	-2.5	-2.2	-3.0	-2.9	-4.3	-2.9	-2.7	-2.1
	NFPS	-0.8	-0.6	-1.7	-1.6	-1.6	-3.9	-2.4	-2.0	-0.4
Ecuador	CG <sup>h</sup>	-1.2	-4.1	-2.9	0.1	-1.0	-0.7	-0.4	-1.0	-0.5
	NFPS <sup>h</sup>	-2.1	-5.2	-4.9	1.5	0.0	0.8	1.6	2.1	0.7
El Salvador	CG	-1.1	-2.0	-2.1	-2.3	-3.6	-3.1	-2.7	-1.1	-1.0
	NFPS	-1.8	-2.6	-2.8	-3.0	-3.6	-3.3	-2.1	-0.6	-1.1
Guatemala	CA	-0.8	-2.2	-2.8	-1.8	-1.9	-1.0	-2.3	-1.0	-1.5
Haiti	CG	-0.6	-1.2	-2.2	-2.3	-2.2	-2.7	-2.9	-3.3	-0.5
Honduras	CG	-2.5	-1.1	-3.6	-4.9	-5.3	-4.8	-5.6	-3.1	-2.4
	NFPS	-1.0	2.9	4.1	-2.3	-2.3	-1.8	-4.2	-1.7	-0.3
Mexico	CG <sup>i</sup>	-1.1	-1.4	-1.6	-1.3	-0.7	-1.8	-1.1	-1.0	-0.8
	PS	-0.7	-1.2	-1.1	-1.1	-0.7	-1.2	-0.6	-0.3	-0.1
Nicaragua	CG	-0.8	-1.1	-3.3	-4.8	-7.3	-2.5	-2.8	-2.2	-1.8
	NFPS	-1.0	0.4	-2.2	-4.5	-6.2	-1.9	-2.3	-1.3	-0.9
Panama	CG	-0.3	-4.2	-2.0	-1.1	-1.7	-1.9	-3.8	-5.4	-3.9
	NFPS	0.1	-2.3	-0.9	0.7	-0.4	-2.0	-4.8	-4.9	-2.5
Paraguay	CA	-1.6	-1.1	-3.8	-4.6	-1.2	-3.2	-0.4	1.6	0.8
	NFPS	-1.0	0.4	-3.1	-4.0	-0.1	-1.9	1.1	2.3	1.5
Peru	CG	-0.8	-1.1	-3.2	-2.8	-2.8	-2.1	-1.8	-1.3	-0.7
	NFPS	0.1	-1.0	-3.2	-3.4	-2.4	-2.3	-1.7	-1.0	-0.3
Dominican Republic	CG	-1.6	-1.0	-1.8	-2.1	-2.4	-2.7	-5.2	-4.0	-0.7
Uruguay	CG	-1.6	-1.2	-3.9	-3.5	-4.5	-4.9	-4.6	-2.5	-1.6
	NFPS <sup>j</sup>	-0.9	-0.5	-3.8	-3.7	-4.0	-3.8	-2.8	-0.8	-0.3
Venezuela (Bolivarian Republic of)	CG	2.0	-4.0	-1.7	-1.7	-4.4	-4.0	-4.4	-1.9	1.7
	RPS	3.7	-4.5	0.7	4.4	-4.6	-1.0	0.2	...	...

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

<sup>a</sup> Total income minus total expenditure, expressed in local currency.

<sup>b</sup> Abbreviations used: CA = Central administration; CG = Central government; CNG = Central national government; CPS = Consolidated public sector; NA = National administration; NFPS = Non-financial public sector; PS = Public sector; RPS = Narrowly defined public sector.

<sup>c</sup> Preliminary figures.

<sup>d</sup> Simple average.

<sup>e</sup> Includes the federal government and the central bank.

<sup>f</sup> Nominal balance.

<sup>g</sup> These results do not include adjustments for accruals, floating debt or the cost of financial restructuring.

<sup>h</sup> In 2003, does not include US\$ 130 million that the Office of the Under-Secretary of the National Treasury

<sup>i</sup> e-earmarked from central government accounts.

<sup>j</sup> Includes the federal government and social security.

<sup>k</sup> Does not include departmental governments.





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