

SOUTH AMERICA

Argentina

Argentina's GDP is estimated to have fallen by 3.5% in 1999. A drop in aggregate demand was accompanied by deflation, with consumer prices falling 1.7% in the first 11 months. Price and quantity trends thus reinforced each other, reducing nominal output and spending and hence also leading to diminished tax revenues. The terms of trade fell for the third year in a row, while external factor payments continued on an upward course, with a negative effect on national income. A decline in imports narrowed the trade deficit, more than offsetting the greater outflow for financial services. Thus, the current account shortfall diminished, though it was still of the order of 4.5% of GDP. Although loans from abroad contracted appreciably at some times during the year, financing needs were covered without undue difficulty. As to the public sector accounts, the deficit (not counting income from privatization operations) rose to more than 2% of GDP, so that as the year came to an end the reduction of this imbalance in the year 2000 became a major economic policy priority.

The contraction in the product in 1999 was comparable to that observed in the recession four years earlier, but other features of the situation differed. This time, the recession was less marked, though it lasted longer, having begun in the second half of 1998. Unemployment rose to over 14%, which, although high, is less than the level reached in the prior episode. Although there were moments of

great volatility, tensions in the financial markets never became as intense as in the most acute phase of the mid-1990s crisis. The demand for deposits shrank markedly and loan volume was flat, but the stability of the banking system was not compromised. The low level of international demand for exports also differentiated this recession from the previous one.

ARGENTINA: MAIN ECONOMIC INDICATORS

	1997	1998	1999 ^a
<i>Annual rate of variation</i>			
Gross domestic product	8.0	3.9	-3.5
Consumer prices	0.3	0.7	-1.7
Real wages	-0.5	-1.1	1.0
Money (M1)	14.7	0.9	-1.8
Real effective exchange rate ^b	-2.9	-2.2	-7.6
Terms of trade	0.4	-4.6	-3.2
<i>Percentages</i>			
Urban unemployment rate	14.9	12.9	14.3
Fiscal balance/GDP	-1.4	-1.2	-2.1
Real deposit rate	6.5	6.9	8.4
Real lending rate	13.5	13.4	18.1
<i>Millions of dollars</i>			
Exports of goods and services	30 940	31 093	27 300
Imports of goods and services	37 241	38 493	32 050
Current account	-12 036	-14 698	-12 600
Capital and financial account	15 342	18 790	14 100
Overall balance	3 306	4 092	1 500

Source: See the statistical appendix.

^aPreliminary estimates.

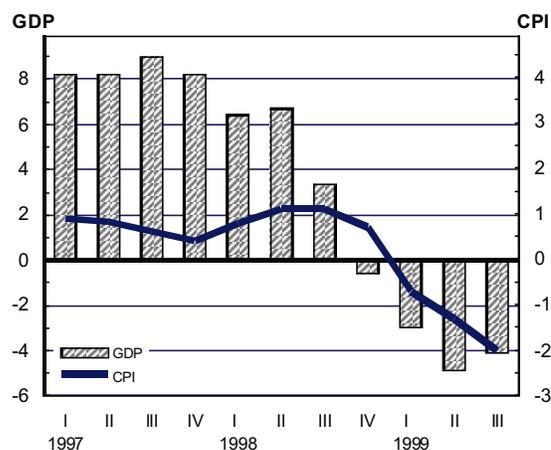
^bA negative rate signifies an appreciation of the currency in real terms.

Various disturbances were present at the same time in this state of affairs. There was a tightening of international credit, which intensified during the 1998 Russian crisis and following the Brazilian devaluation in early 1999, as well as, to a lesser extent, around the middle of the year. Export prices fell sharply, and demand from Brazil, which is Argentina's main trading partner, diminished. These factors had a direct effect on foreign sales, and also affected domestic demand by making credit tight and restraining the propensity to spend, so that all the main components of aggregate demand diminished. Despite the unfavourable conditions in foreign markets, export volume hardly fell, however. Investment declined more than the product, which was reflected in a considerable reduction in capital goods imports. Consumption decreased somewhat more than GDP in the first six months, and the fall in demand for consumer durables, especially automobiles, was very severe. The reduced output of motor vehicles, also influenced by declining sales to Brazil, contributed to the intense recession in

industry as a whole. By the third quarter, however, manufacturers experienced an upturn in demand, and production indices rose.

The value of exports is estimated to have fallen by approximately 13%, mostly because of lower prices. Prices of commodities, especially grains, fell significantly. The downward trend for manufactures based on agricultural products was less pronounced. Weaker Brazilian demand especially affected exports of other manufactured products, which fell 25% during the period in question. On aggregate, there was a clear change in the composition of exports by target markets. Brazil's 30% share in 1998 fell to 23% in 1999. For its part, the value of imports fell 19%, due to a price decline of 5% and a heavy reduction in volume (14%) resulting from the severe recession. In addition to the poor showing of trade within Mercosur, there were tensions between Argentina and Brazil in connection with trade in various goods (motor vehicles, iron and steel, dairy products, sugar, footwear, textiles). Besides sectoral issues, questions were raised about the functioning of Mercosur in terms of trade policy, investment incentives and –especially in the wake of the Brazilian devaluation– macroeconomic policy. The authorities of the Mercosur countries did, however, reaffirm that they considered continued integration to be a priority.

**ARGENTINA: GROSS DOMESTIC PRODUCT
AND INFLATION**
(Percentage variation)



Source: ECLAC on the basis of official figures.

In 1999 capital inflows were once again high, though not as high as the year before. There were significant changes in the composition of such inflows in the first half of the year. Direct investment was extraordinarily high, due in particular to the acquisition of YPF by a Spanish firm. An appreciable part of this operation represented an outflow in terms of portfolio investment, since much of the company's stock was already owned by non-residents. Not counting income from privatization operations, the non-financial public sector received net foreign credits of the order of US\$ 2.5 billion, equal to almost half the total capital inflow. Government debt placed on foreign markets totalled approximately US\$ 8.4 billion for the first 10 months of 1999.

The spread between the interest rates on Argentine Government paper and rates on United States securities was very wide early in the year but later fluctuated considerably as the year progressed. Immediately following the Brazilian devaluation, risk premiums implicit in the yields of the bonds in circulation rose to their peak for the period but later declined. In mid-year, uncertainty intensified, again widening the spread. Nevertheless, although credit remained tighter than in previous years, there were no major financial disturbances in the weeks around the presidential elections (in late October). This may be attributed to clear signals that the prevailing monetary system would be maintained and that in economic policy special attention would be given to remedying the fiscal imbalance.

When the targets for the 1999 deficit were originally set, some growth in GDP was anticipated. A limit of about 3 billion Argentine pesos (approximately 1% of GDP) was established to cover the financing needs of the public sector (not taking privatization operations into account). However, it soon became clear that this figure was not realistic, as subsequent estimates of the year's cash deficit were approximately twice what had first been projected. Tax receipts of governmental entities fell by

approximately 5% in nominal terms in the first 10 months, while the measures taken in 1998 to boost government income were more than offset by the economic slump and a reduction in the size of social security contributions. Collection of social security taxes fell markedly, as did taxes collected on foreign trade. Income from VAT also went down (by almost 10%), though revenue from taxes on profits and wealth continued to rise. Such growth as was registered in the national government's tax revenues was very significantly influenced by the fact that the proceeds from the granting of a telecommunications concession were included in them, as was the difference between the sale price and market price of the YPF oil company shares which remained in the hands of the State. Current national government outlays rose slightly during the period from January to September, especially for interest payments, which rose more than 20%. Social security payments and transfers to the provinces, on the other hand, went down slightly.

The situation with regard to the public finances and the fiscal regime in general were important subjects of economic debate. The allocative aspects of fiscal policy, especially in terms of its effect on the competitiveness of tradeable goods production, on employment and on the social variables, provoked heated controversy, though the debate was focused especially on how to increase the solvency of the government. There was broad political consensus on a measure designed to set a pattern of decreasing deficits for the coming years. The figure set for the year 2000 (somewhat over 1.5% of GDP) became a key point of reference in the budget debate. The authorities who took office on 10 December warned that the deficit would be substantially higher if corrective action was not taken. They therefore advocated a package of measures involving spending cuts and higher tax revenues, as well as the negotiation of an agreement on the distribution of resources between the national government and the provinces.

Bolivia

The Bolivian economy grew by only 1% in 1999: a major slowdown compared with the rate of almost 5% registered in the previous year and the annual average of more than 4% for the decade. This decline was associated with the international crisis, which particularly affected external sector transactions and kept domestic demand flat. While exports fell only slightly, imports dropped more significantly, bringing the current account deficit down by two percentage points, to around 6% of GDP. Inflation for the first 11 months was 2.4%: less than half of the goal set for 1999 and one of the lowest levels in the second half of the century.

Government and Central Bank authorities continued to take a cautious approach, attempting to preserve the essential features of the reigning economic policy of recent years, which is based on price stability, stable and competitive exchange rates and fiscal discipline. The government negotiated an increase in the fiscal deficit agreed upon with the IMF to 4.2% of GDP. The weaker current revenues obtained in 1999 seem to be associated with the effects of an unfavourable economic situation. Current expenditures registered considerable cuts in spending on goods and services as well as in transfers. The fiscal cost of the pension reform process remained very high because of the increase in payments to retirees who opted to remain under the old system.

The Central Bank took pains to adjust the money supply to demand, and there was a substantial contraction of the money supply. The monetary aggregates M1, M2 and M3 declined almost 20% between the end of December 1998 and the end of August 1999 in local currency terms. When foreign currency is included –a very important factor in a country with high rates of dollarization– the declines are somewhat less steep: 15% for M1 and 10% for M2, while M3 rose by 3%. Net international reserves fell from US\$ 1.064 billion the previous December to US\$ 946 million at the end of August.

National-currency interest rates remained stable, though in certain months (especially July) they reached over 40%, with an increase in the interbank rate.

Foreign-currency interest rates were slightly higher than in 1998.

Despite the unfavourable conditions in the external sector, there was no major change in the exchange rate. The rate of devaluation (5.5%) was comparable with the preceding year (4.9%), and there was a moderate rise (1%) in the real exchange rate for imports.

The commitments to the United States with regard to the elimination of coca plantations were completely fulfilled in 1999 in exchange for compensation to the affected communities for each hectare destroyed. No major disturbances occurred in the process. Notable events in the judicial sphere included the appointment of a national “Ombudsman”, adoption of new customs legislation, and progress in the complete reform of the customs system, with IMF support.

The negative impact of the international crisis had already been felt by the end of 1998 and became more pronounced in the course of 1999. In the final months of the year, however, an upturn in some of Bolivia’s important export products was perceived, especially in the case of soya, minerals and petroleum.

In terms of overall demand, exports fell while consumption was flat. Investment grew moderately, driven by public investment. On the overall supply side, a small increase in GDP (1%) was accompanied by a significant decline in imports. Foreign direct investment was somewhat lower than in the preceding year and continued to be associated with the process of the privatization or “capitalization” of public enterprises

BOLIVIA: MAIN ECONOMIC INDICATORS

	1997	1998	1999 ^a
<i>Annual rate of variation</i>			
Gross domestic product	4.1	4.6	1.0
Consumer prices	6.7	4.4	2.4
Real wages	8.1	0.1	...
Money (M1)	15.6	10.0	-10.2
Real effective exchange rate ^b	-2.5	-4.0	-0.6
Terms of trade	3.5	-4.9	-0.5
<i>Percentages</i>			
Urban unemployment rate	4.4	4.1	4.5
Fiscal balance/GDP	-3.4	-4.0	-4.2
Real deposit rate	9.6	4.8	10.0
Real lending rate	43.4	30.7	32.3
<i>Millions of dollars</i>			
Exports of goods and services	1 414	1 355	1 270
Imports of goods and services	2 062	2 200	1 880
Current account	-552	-675	-535
Capital and financial account	667	777	360
Overall balance	115	102	-175

Source: See the statistical appendix.

^a Preliminary estimates.

^b A negative rate signifies an appreciation of the currency in real terms.

begun under the previous Government. This process requires the purchasers of the privatized entities to make substantial investments, which are now in progress.

Mining was the sector most affected by the international crisis, the impact of which intensified in 1999. The sector shrank 19% in the first half of the year, though in the second half some signs of recovery began to show themselves, with an upturn in some metals prices.

Activity in the hydrocarbons sector fell as the contract for the export of natural gas to Argentina ended and natural gas sales to Brazil were postponed. These gas sales only began towards the end of the year, after a prolonged period needed to make the recently

built pipeline fully operational. The lower oil production is connected with depressed domestic demand.

The agricultural sector recovered from its 1998 setback thanks to a good harvest in the uplands. The Santa Cruz area, however, felt the impact of lower prices, especially for soya, though the price was rising again, albeit timidly, by the end of the year.

The electricity, gas and water sector remained fairly strong, thanks to a substantial increase in investments targeted both at the domestic and the export markets. On the other hand, the buoyancy of the construction sector failed to hold up, as work on the natural gas pipeline to Brazil came to an end and private construction failed to take up the slack. The leading growth sectors were transport and communications and financial services, both of which posted gains of more than 10% during the first half of 1999.

Inflation continued to fall. At mid-year it was only 0.4%, following negative rates in March and April. In subsequent months there was some resurgence of inflation, but the cumulative figure up to November was still only 2.4%.

Since imports fell more than exports, the trade deficit up to July 1999 was US\$ 350 million, which was less than the figure posted 12 months earlier. In the decline in external sales, the reduction in mineral exports, especially gold and silver, was especially large. Exports of oil and gas and agricultural commodities also declined. These reductions were the result of a combination of factors: falling prices for Bolivia's exports and weaker foreign demand for raw materials.

The reduction in imports was across the board. In the case of raw materials and capital goods, especially for industry, it seems to be associated with the end of construction work on the natural gas pipeline to Brazil. Imports of consumer durables and non-durables also shrank. According to Central Bank estimates, imports for the year will amount to around US\$ 1.8 billion, compared with US\$ 2.2 billion in 1998.

The Central Bank's net international reserves, which had increased in previous years, fell by more than US\$ 100 million in 1999. Foreign indebtedness went down slightly, with increased service on the outstanding debt offset by fewer new commitments.

Brazil

Serious problems due to high fiscal and external deficits, which made the Brazilian economy highly vulnerable to international turbulence, worsened in January 1999. The policy of gradual change in the exchange rate became unsustainable, and the currency-band system had to be replaced by a free float, which produced a sharp devaluation. Since the exchange rate was intended to serve as an anchor for domestic prices, this meant the collapse of one of the pillars of the Plano Real. Instability persisted until March, as there was fear that the government would not be able to meet its debt commitments and the Central Bank lacked resources to contain the rise of the dollar. The volatility began to abate in March with the IMF accord, the sharp rise in interest rates and the passage of new fiscal measures in Congress.

Because of the magnitude of the devaluation, there were predictions during the following weeks of a substantial drop in economic activity for 1999 (-4%), high levels of inflation (over 20%) and an increase in unemployment (to over 10%). The feasibility of achieving a primary fiscal surplus of more than 3% of GDP (not counting interest payments) was also called into question, as was the likelihood of meeting the goal of 27 billion reals in revenue from privatization operations (an amount comparable to the 1998 figure). There were some bright spots, however. After a slight drop in 1998, GDP should grow, albeit only by 0.5%, inflation should not exceed 9%, and unemployment should remain under 8%. On the other hand, the fiscal deficit remains very high, since devaluation has increased the public debt, the bulk of which is denominated in foreign currency or is indexed to the exchange rate. There was a primary surplus of 3% of GDP, but the nominal deficit was 9%, which brings public indebtedness close to 50% of GDP. The slowdown of the privatization process was also a factor, since it generated proceeds of only 7.6 billion reals: a mere third of the amount projected. The external accounts were also discouraging. The current

account deficit fell from US\$ 33.8 billion to US\$ 25.3 billion, but there was a merchandise trade deficit of US\$ 1.9 billion, which, though only 29% of the preceding year's figure, is far from the US\$ 11 billion surplus that had been set as a target.

Interest rates increased sharply in late February and fell gradually thereafter, so that the financial and credit markets exerted a restraining effect on domestic demand. The Central Bank's action on the currency market was the crucial factor, however. With the receipt of a significant portion of the foreign support package (close to US\$ 18 billion) provided by multilateral organizations and the agreement with the IMF on intervening in the currency market, the exchange rate fell 17% between March and May, after which it stabilized. In August, however, it began to rise again in response to uncertainty about external liquidity for emerging countries and questions about the sustainability of the fiscal adjustment. Towards the end of the year, the exchange rate settled down again as some of the fears about the future of the economy dissipated.

Federal Government revenue rose by almost 1% of GDP and spending fell, producing an improvement in

BRAZIL: MAIN ECONOMIC INDICATORS

	1997	1998	1999 ^a
<i>Annual rate of variation</i>			
Gross domestic product	3.8	0.0	0.5
Consumer prices	4.3	2.5	8.0
Real wages	2.6	0.1	-3.5
Money (M1)	58.9	7.1	7.4
Real effective exchange rate ^b	-1.1	4.8	49.5
Terms of trade	5.8	-2.1	-8.2
<i>Percentages</i>			
Urban unemployment rate	5.7	7.6	7.7
Fiscal balance/GDP	-6.1	-8.0	-9.0
Real deposit rate	17.8	24.1	22.2
Real lending rate	41.9	88.5	84.8
<i>Millions of dollars</i>			
Exports of goods and services	59 176	58 770	54 400
Imports of goods and services	75 139	74 412	62 580
Current account	-30 493	-33 825	-25 260
Capital and financial account	22 586	16 532	12 110
Overall balance	-7 907	-17 293	-13 150

Source: See the statistical appendix.

^a Preliminary estimates.

^b A negative rate signifies an appreciation of the currency in real terms.

the public sector's primary results. However, this was due to very specific alterations in the situation, such as revenue from concessions, profits of State enterprises and fuel taxes, which represented approximately 10% of total receipts. In contrast, revenue from new taxes rose more moderately.

The sustainability of the new levels of spending is in question, in view of social and political pressures. In 1999, nominal expenditure (excluding that related to wages and interest payments) fell more than 10%. Another source of concern is the growing deficit in the social security system. The government has attempted to turn this situation around by adjusting retirement pensions according to the length of time during which a worker has made contributions and the age at which he retires.

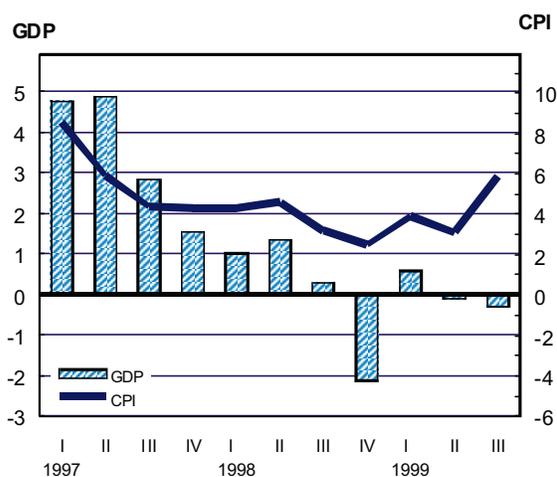
The Central Bank has tried to simplify its intervention in the financial market by substantially reducing its basic annual interest rate –from 40% in March to 19% in September. It has also introduced inflation goals (8% for 1999, 6% for 2000 and 4% for 2001) as guideposts for monetary policy and has begun to reduce the compulsory reserve requirements for bank deposits.

Legal and operational problems have limited the privatization process, which has been concentrated at the level of the individual states, with the sale of electricity distribution firms, which has brought in 6.9 billion reals. At the federal level, the sale of enterprises in the field of information processing and shares of companies already privatized generated revenue of almost 800 million reals.

Some fiscal reforms have begun to be implemented, while others are in the legislative pipeline. However, problems have arisen in introducing VAT and reforming the social security system for public employees, especially after a ruling by the Federal Supreme Court limiting the collection of contributions in respect of retired employees.

The level of economic activity, which suffered a severe downturn in the last quarter of 1998, began a gradual recovery in 1999, defying the most pessimistic expectations provoked by the currency crisis. Manufacturing, which had declined by 3.9% in the first quarter, will probably finish the year with a decline of only 2%, thanks to the success of intermediate goods and non-durable consumer goods, which benefited from improvements in competitiveness resulting from devaluation. Better credit conditions led to a mild upturn in sales of consumer durables, though these will still be the worst performers of the year, followed by capital goods. Mining and agriculture, however, had a

**BRAZIL: GROSS DOMESTIC PRODUCT
AND INFLATION**
(Percentage variation)



Source: ECLAC, on the basis of official figures.

good year and are both estimated to have grown more than 6%. The services sector is expected to show virtually no change.

As in 1998, unemployment remained in the vicinity of 7.5%. The second half of the year saw a slight improvement, due in particular to a recovery in the demand for labour by the construction sector and industry. Real per capita income fell 4%. Employers and own-account workers were most heavily affected, and wage-earners felt the impact more than informal workers.

Cumulative inflation as of November was around 8%, which is undoubtedly a good result in view of the January devaluation and the subsequent speculative attack. A slight upsurge began in August as a result of the increase in publicly controlled prices, food supply problems, rising international prices for primary products and higher profit margins in the oligopolistic industrial goods markets. At year's end, there were still fears that profit margins may continue widening and that the rise in wholesale prices (over 20%) will be passed on to consumers.

Because of the unfavourable conditions in the international market, the rise in the exchange rate in 1999 did not translate into a substantial improvement in the trade balance. The 11% drop in the value of exports during the first 11 months compared with the corresponding period in the previous year was due entirely to a decline in prices (-10%) from the already

very depressed 1998 level, since physical sales actually increased by 2.9%. Commodities prices fell 16.5%, for a rise in volume of 4.2%. Prices of semi-manufactured goods dropped 19%, while the volume sold rose by 14%. Prices of manufactured products fell (-8.9%), as did the volume (-3.5%), due to shrinking Latin American markets. Imports fell 15% after the sharp devaluation, principally as a result of the reduction in their volume, as prices went down by only 2%.

The deficit on the services account fell by 31%, while factor income went down by 2.2%, so that the current account deficit shrank by 25%. In the capital account, although direct investment went down it nevertheless remained at an extremely high level, with a net inflow of US\$ 26.5 billion. During the seven months following the devaluation, the international market was practically closed to new securities from Brazilian companies. The situation began to improve somewhat in September, but the overall balance for 1999 showed a deficit of US\$ 13.15 billion, which was covered by a reduction of US\$ 4.65 billion in the international reserves and a special one-time finance package from the IMF (US\$ 8.5 billion).

Negotiations within Mercosur were affected by the imposition of trade barriers by trading partners in 1999. In July, Brazil signed a preferential tariff agreement for 3,000 products with the members of the Andean Community.

Chile

After 15 years of uninterrupted strong growth, in late 1998 Chile entered on a recessive cycle that lasted almost 12 months. This led to a 1.5% decline in GDP in 1999 as a consequence of sharp drops in the prices and demand for Chile's main exports attributable to the Asian crisis, which hit the Chilean economy at a time when it was suffering from a pronounced exchange-rate lag and a high external deficit. The policies adopted in order to reduce the deficit intensified the recession, which became deeper and longer than had been expected.

CHILE: MAIN ECONOMIC INDICATORS

	1997	1998	1999 ^a
<i>Annual rate of variation</i>			
Gross domestic product	7.0	3.1	-1.5
Consumer prices	6.0	4.7	2.6
Real wages	2.4	2.7	2.4
Money (M1)	20.0	-8.3	15.9
Real effective exchange rate ^b	-6.7	2.7	2.8
Terms of trade	3.8	-13.6	-4.6
<i>Percentages</i>			
Unemployment rate	6.1	6.4	10.1
Fiscal balance/GDP	0.9	-0.8	-1.5
Real deposit rate	5.6	9.5	4.8
Real lending rate	9.0	14.5	8.7
<i>Millions of dollars</i>			
Exports of goods and services	20 772	18 949	19 250
Imports of goods and services	22 281	21 580	18 850
Current account	-3 728	-4 143	-1 000
Capital and financial account	6 913	2 003	700
Overall balance	3 185	-2 140	-300

Source: See the statistical appendix.

^a Preliminary estimates.

^b A negative rate signifies an appreciation of the currency in real terms.

At the end of June, the Central Bank and fiscal authorities announced a coordinated programme to stimulate economic reactivation. The Central Bank adjusted its growth projections from 2% to 0.5% and announced a cut in the base interest rate to 5%. It also lowered its projections of the trade and current account deficits and estimated that growth in the year 2000 would be between 4.5% and 5.5%.

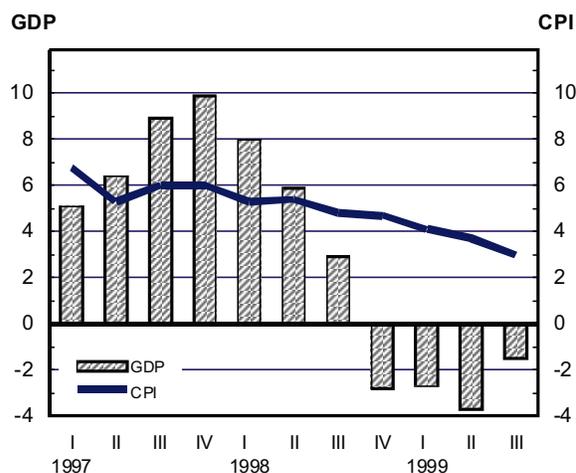
Reactivation measures included expanding programmes of public investment in labour-intensive activities, bringing forward investment programmes in State-owned enterprises and copper mining, tax incentives to stimulate housing purchases, and rescheduling debtors' obligations with the State-owned Banco del Estado and the public sector, including the condonation of interest due and penalties incurred on debts between 1 January 1998 and 31 May 1999.

The external outlook pushed up the value of the dollar in the second half of the year. There was also a private-sector portfolio adjustment as a result of changes in anticipated real returns compared with those on dollar-denominated assets. This was accentuated in early September when the Central Bank floated the currency. This move to a more flexible system was facilitated by the fact that inflation was under control, by the implementation of hedging operations, by the fact that the external situation had calmed down, and by

The economy had to make an abrupt adjustment in order to absorb the effects of unfavourable terms of trade and the after-effects of the tight money policy applied since the previous year. Thus, a moderately severe external crisis turned into a recession, with unemployment around 10%.

At the end of the first nine months, the public sector had a deficit of 0.6% of GDP, suggesting that for the first time in 12 years the sector would post a temporary deficit of the order of 1.5% of GDP. Initial budget estimates presented to the National Congress in October 1998 had been based on 3% growth in GDP and on higher copper prices than those that actually prevailed on the international market. Consequently, the 2.3% increase in spending that had been set as an upper limit in the context of GDP growth projections was considerably exceeded. On top of this circumstance came the need for an accelerated programme of public investment to foster the generation of jobs and compensate for the drop in private-sector expenditure.

CHILE: GROSS DOMESTIC PRODUCT AND INFLATION
(Percentage variation)



Source: ECLAC, on the basis of official figures.

the reduction of exchange-rate mismatch problems in business. Moderate devaluation resulted, with the value of the dollar expected to be around 530 Chilean pesos at year's end.

The recessionary cycle began in November 1998 and only eased in September, after 11 consecutive months of diminishing economic activity. The first half of the year saw a drastic 14.2% cut in expenditure, due basically to a reduction of almost 15% in the gross fixed capital formation and an 18% drop in imports. By the end of the third quarter, GDP had fallen 2.6% and domestic spending 12.3%. The most heavily affected sectors were construction (-10.7%), commerce (-4.4%) and industry (-2.7%). The high rate of growth in mining during this period (14.5%) moderated the total decline in GDP.

A number of sectoral difficulties combined to amplify the impact of macroeconomic conditions on the levels of economic activity and employment, especially in the first half of the year. The electricity rationing which had to be applied in April affected industry and commerce, the fishery catch was sharply reduced by the meteorological phenomena of El and La Niña, and a shortage of foreign financing led to the cancellation or postponement of important road infrastructure projects.

On the policy side, the emphasis placed on meeting inflation goals and neglect of the current account deficit in 1997 and 1998 created conditions that turned a moderate external crisis into a prolonged recessionary cycle.

Inflation in 1999 will be around 2.6%, which is 40% less than the original Central Bank projections. This difference is consistent with the adjustment in expenditure and was facilitated by external deflation. In annualized terms, inflation was 2.2% for tradeables and 3% for non-tradeables. The annualized increase in the wholesale price index was of the order of 13%,

however, driven by the roughly 9% increase in the nominal value of the dollar. A gradual transfer of these cost pressures to consumer prices can be expected.

Unemployment rose from 6.8% in August 1998 to 11.5% in August 1999. It fell by half a percentage point in October, however, opening up the possibility that the year will end with single-digit unemployment. Average unemployment for the first three quarters was 10.1%.

Nominal wages responded, with some lag, to higher unemployment. After having ended 1998 with an annualized increase of 6.9%, they rose 5.6% by September 1999, while the real increase dropped from 3.2% to 2.5%.

The balance of payments deficit went down spectacularly compared with the previous year, falling from US\$ 4 billion to US\$ 1 billion. The current account deficit (1.5% of GDP) represented a drop of 4% from the previous year.

The foreign trade figures reflect both the severity of the adjustment and also the fact that it was based on a drop in expenditure and hence in imports. Thus, the US\$ 400 million trade surplus compares with the deficit of US\$ 2.6 billion in 1998.

The capital account registered a net inflow of US\$ 700 million in 1999 as against US\$ 2 billion the previous year. A significant share of capital outflows are accounted for by changes in the composition of bank portfolios. Bank assets rose by US\$ 3.5 billion, in large measure to cover foreign currency futures sales and through withdrawal of deposits from the Central Bank.

Foreign direct investment totalled US\$ 3.5 billion. Direct investment rose significantly, both in terms of flows from abroad and with respect to investments made by Chileans in the rest of the world. The former amounted to US\$ 9.4 billion, the latter to US\$ 5.4 billion.

Colombia

The recession which the Colombian economy began to experience in the second half of 1998 worsened considerably in 1999. As a result, GDP fell approximately 5% and unemployment reached 20%. Consequent lower tax receipts, combined with the need to support the financial sector and the country's coffee-growing area, hard hit early in the year by an earthquake, brought the fiscal deficit to 4.6% of GDP.

Falling demand and the devaluation of the peso in real terms contributed to the sharp reduction in the current account deficit (from 5.9% to 1.3% of GDP). Thanks to reduced domestic demand and the abundant supply of foodstuffs, inflation fell considerably despite the drop in the exchange rate, so that the rise in the consumer price index (CPI) was less than 10%, as against 16.7% the previous year.

Continued uncertainty about the peace process aggravated the economic situation, but by the end of the year lower interest rates and inflation as well as a more competitive exchange rate made a moderate upturn seem likely.

In the course of the year, economic policy became more expansionary. Interest rates fell very sharply in the first half of the year, but their decline was checked by the measures taken to defend the exchange-rate band. In the last quarter, the establishment of a floating exchange rate and the conclusion of financing agreements for US\$ 6.9 billion with multilateral agencies allowed for a more aggressive policy to stimulate the economy and mitigate the effects of tighter credit.

The currency crises in Brazil and Ecuador early in the year had little impact on Colombia. However, as the domestic recession intensified, the cost of defending the exchange-rate band rose in terms of falling GDP and rising unemployment. Faced with new speculative attacks, the Bank of the Republic decided in June to modify the band for the second time in nine months, resulting in a 9% devaluation but renewed doubts about

the credibility of the currency band approach. Colombia's loss of its "investment-grade" rating in the third quarter intensified the speculative attacks, forcing the Bank to sell US\$ 400 million of its international reserves (5%) in a single week. On 25 September, the Bank of the Republic finally abandoned the currency band system. By that time, the peso had lost 30% of its nominal value, paving the way for the real exchange rate to become competitive again. There was no massive devaluation after this, but rather a gradual revaluation.

Monetary policy was aimed at bringing interest rates down, within the limits of the exchange rate regime. In the first half of the year, the average rate on deposits in the financial system fell from 34% to 18%, where it remained with some fluctuations until November, when it again began to fall. Given the low level of inflation, however, rates remained high in real terms. This was especially true for lending rates, because of the simultaneous increase in the intermediation spread. In early November, the annualized growth rate of the money supply was 11%, while broad money (M3+bonds) grew 5.6%: much less than domestic inflation. This is closely linked with the decline in lending (-2.1%) resulting from low liquidity and increased perception of financial and economic risk.

The Government's capitalization programme and the efforts of the private financial institutions prevented a general crisis, but were not enough to cure the sector's ills. Continued weakness in the financial sector, where losses in the first 10 months amounted to 1.77 billion

COLOMBIA: MAIN ECONOMIC INDICATORS

	1997	1998	1999 ^a
<i>Annual rate of variation</i>			
Gross domestic product	2.7	0.7	-5.0
Consumer prices	17.7	16.7	9.7
Real wages	2.6	-1.3	1.6
Money (M1)	21.5	-5.4	8.1
Real effective exchange rate ^b	-6.4	6.7	10.3
Terms of trade	9.8	-7.9	5.1
<i>Percentages</i>			
Urban unemployment rate	12.4	15.3	19.8
Fiscal balance/GDP	-3.1	-3.4	-4.6
Real deposit rate	4.8	11.7	9.7
Real lending rate	13.4	19.8	17.8
<i>Millions of dollars</i>			
Exports of goods and services	14 220	13 477	14 315
Imports of goods and services	18 400	17 514	13 400
Current account	-5 896	-5 907	-1 155
Capital and financial account	6 122	4 531	405
Overall balance	226	-1 376	-750

Source: See the statistical appendix.

^aPreliminary estimates.

^bA negative rate signifies an appreciation of the currency in real terms.

pesos (1.2% of GDP) and the indicator of portfolio quality moved from 10% in December 1998 to 14%, prevented economic recovery by reducing lending.

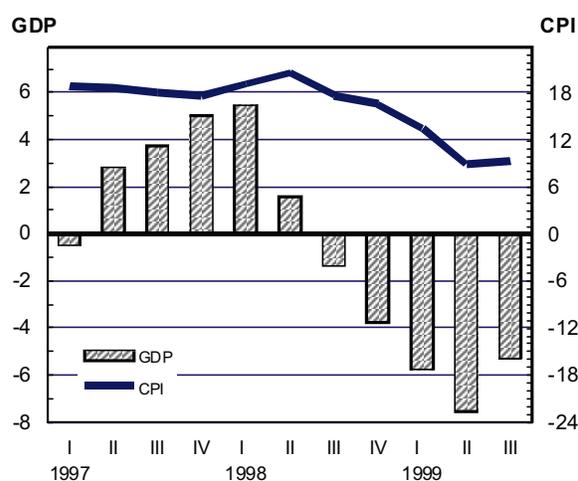
The goal of fiscal policy was to reduce the fiscal deficit from 3.4% to 2.1% of GDP, using revenue generated by the tax reform of December 1998. However, lower tax receipts, together with the financial sector emergency and the January 1999 earthquake, brought the deficit to 4.6% of GDP for the public sector and 5.1% for the central government. The surplus of 0.5% of GDP for the rest of the public sector is due to surpluses in Ecopetrol and the social security system.

For the year as a whole, a 7.8% increase in nominal current revenue is projected for the central government, though the increase is only 2.1% if non-recurrent revenue from the tax on financial transactions is excluded from the calculation. The situation was eased by the exceptional increase in capital revenue (124%), which included the transfer of the profits of the Bank of the Republic. Total revenue is projected to rise by 19.3%, slightly more than total expenditure (19.1%). Investment expenditure fell 10.4%, while outlays for interest and operating expenses rose more than 20%.

In the area of structural reforms, the Government's efforts were focussed on the public finances. The various projects in the legislative pipeline include reforming the transfer system, establishing the decentralized pension fund and implementing measures to keep reasonable limits on spending in both the decentralized system and the central government.

The economic slowdown worsened in 1999, with a drop of 6.6% in economic activity in the first half of the year. In view of the incipient signs of recovery, for the year can be expected to register a decline of 5%. Since public spending rose slightly, the adjustment was concentrated in the private sector. Private investment was particularly affected, falling by more than 50% and dragging domestic demand with it. The only growth sectors were mining and quarrying and social/community/personal services. Manufacturing and construction performed poorly, with declines of the order of 13%. As a result, unemployment in the seven main cities rose five points, reaching the vicinity of 20% in March and remaining there for the rest of the year. Real wages, on the other hand, benefited from the falling CPI, since many collective contracts were based on past inflation.

In contrast to the producer price index (PPI), the CPI did not reflect the effects of the real devaluation,

COLOMBIA: GROSS DOMESTIC PRODUCT AND INFLATION
(Percentage variation)

Source: ECLAC, on the basis of official figures.

since it registered the smallest increase for almost three decades, thanks to depressed domestic demand and an abundant food supply.

Aided by the recovery in oil prices and the devaluation in the real exchange rate, and despite deep recessions in Venezuela and Ecuador, exports of goods showed an upturn, while imports, seriously affected by the drop in private-sector demand, went down by one-third of their previous year's value. The goods and services trade balance is expected to move from the

4% deficit registered in 1998 to a surplus equivalent to 1% of GDP, while the current account deficit will drop from 5.9% to 1.3%.

The fall in the current deficit was accompanied by only a very small net inflow of capital, attributable to the sharp drop in foreign direct investment (from 3% of GDP in 1998 to 0.4% in 1999) and to increased short-term financial outflows. Net international reserves fell by US\$ 560 million, to close the year at US\$ 8.1 billion.



Ecuador



With its financial and currency systems in deep crisis, the Ecuadorian economy contracted by about 7% in 1999. Imports declined drastically, and the previous current account deficit became a surplus equivalent to 6% of GDP. Thanks to weak demand, although inflation rose to over 50% it did not get out of control, despite the rapid depreciation of the currency and vigorous expansion of the money supply. The recovery in oil prices and the fiscal reforms put into effect in May made it possible to bring the non-financial public-sector debt down to 4% of GDP, but the depreciation of the sucre made servicing the heavy foreign debt even more difficult, and late in the year the government defaulted on interest payments to private creditors.

The financial system showed itself to be highly vulnerable as a result of the fact that, in a context of deregulation and with a stabilization programme based on an exchange rate anchor (in place since 1994), it had expanded considerably on the basis of foreign financing, while there were also cases of mismanagement (loans to related companies, unregulated external operations). The climatic phenomenon of El Niño reduced the ability of broad sectors of the economy to service their debts, and this,

along with the difficulty in gaining access to foreign lending as a result of the international financial crisis and the disintermediation caused by the 1% capital circulation tax, forced a large number of banking institutions to close their doors or made necessary public intervention to prevent their collapse.

In the midst of an acute shortage of dollars, early in the year the exchange rate shot through the ceiling of the currency band, which had last been adjusted in September 1998. The authorities tried to defend the

ECUADOR: MAIN ECONOMIC INDICATORS

	1997	1998	1999 ^a
<i>Annual rate of variation</i>			
Gross domestic product	3.9	1.0	-7.0
Consumer prices	30.6	43.4	53.5
Real wages	-3.5	-7.2	-9.6
Money (M1)	29.7	34.8	105.2
Real effective exchange rate ^b	-4.2	-1.5	23.5
Terms of trade	2.1	-11.0	4.6
<i>Percentages</i>			
Urban unemployment rate	9.3	11.5	15.1
Fiscal balance/GDP	-2.6	-6.2	-4.0
Real deposit rate	-2.3	2.6	-1.1
Real lending rate	9.6	10.3	8.5
<i>Millions of dollars</i>			
Exports of goods and services	6 087	5 007	5 080
Imports of goods and services	5 841	6 409	3 425
Current account	-714	-2 169	885
Capital and financial account	745	1 378	-1 485
Overall balance	31	-791	-600

Source: See the statistical appendix.

^aPreliminary estimates.

^bA negative rate signifies an appreciation of the currency in real terms.

sucre by selling international reserves and raising interest rates, but in February the situation became untenable and a dirty float was initiated. In the course of the year there were successive phases of high volatility and heavy pressure on the exchange rate, and over the first nine months of the year the sucre lost 23.5% of its real value. The depreciation continued in the final quarter and put dollar-denominated debtors in a difficult situation, aggravating the financial crisis still further.

In the course of the year, more than half of the assets of the banking system passed over to the Deposits Guarantee Agency, which had been created the previous year to clean up the operations of banking institutions that were unable to honour their commitments and to return their savings to depositors in those institutions. Some institutions were closed down, while there are plans for others to be merged and privatized. The Central Bank granted special rescue loans against bonds issued by the Ministry of Finance and Public Credit in order to stabilize some of the institutions, and it provided the funds to pay off depositors at banks that had been closed. As a result, the nominal money supply increased 119% in the 12-month period from November 1998, despite the

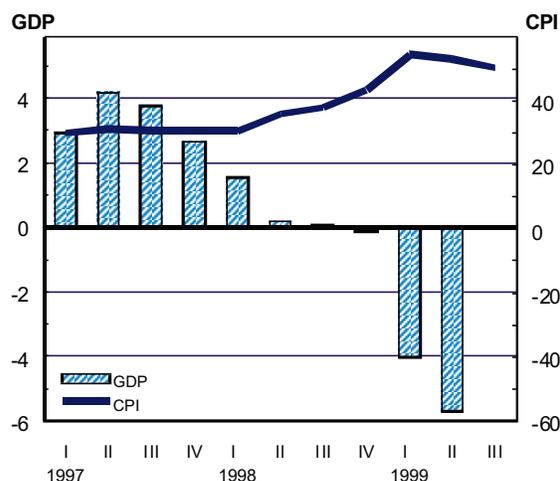
issue of stabilization bonds at a growing pace, while the M1 money supply increased by 105%. In order to try to check this expansion, the compulsory reserve requirements in respect of deposits in sucres were increased from 16% to 19% in December.

To prevent even greater depreciation, protect the financial system and contain inflation, a portion of financial deposits was frozen in March. Some of these funds were released gradually in the course of the year. Because of loss of confidence in the financial system, nominal quasi-money grew only 11%.

Interest rates eased somewhat with the elimination of the currency band, but they still remained high as a result of continuing uncertainty and pressure on the exchange rate. Late in the year, authorities raised interest rates sharply to contain the depreciation of the sucre.

A fiscal package was agreed on in April under which income tax (which had been replaced by the capital circulation tax in 1998) was restored, VAT exemptions were eliminated, and for 1999 only, taxes on corporate assets and expensive automobiles were instituted. Even so, proceeds from VAT, special excise taxes and customs tariffs declined in real terms because of the economic slowdown. The upturn in international oil prices provided a significant degree of relief, and the non-financial public sector deficit (6.2% in 1998) was brought down to 4%. The budget for the year 2000 was approved in November and includes an

ECUADOR: GROSS DOMESTIC PRODUCT AND INFLATION
(Percentage variation)



Source: ECLAC, on the basis of official figures.

increase in the rate of VAT from 10% to 12%, which is considered crucial for reaching an agreement with the IMF in order to be able to renegotiate the external debt.

The financial crisis and the government's stabilization policies aggravated the situation of the productive sector, which was already suffering the consequences of El Niño. The freezing of deposits put a brake on demand and limited the availability of financing for businesses. Between November 1998 and November 1999, the nominal volume of private bank lending fell 8.6%, while the private banks' portfolio of non-performing debts rose from 9.2% at the end of 1998 to 51.8% in November 1999.

The product fell by 4.9% during the first half of the year, and it is estimated that the decline for the year as a whole will be 7%. On the demand side, there were sharp contractions in real terms in the first half of the year in household consumption (-5%), public administration expenditure (-9%) and, most importantly, investment (-19%). Exports fell by 1% and aggregate demand by 10%. As regards supply, real imports went down by 32%.

Predictions for the year as a whole anticipate declines of 7% in manufacturing, 9% in construction and 12% in commerce. Of the main sectors, only agriculture grew during the first half of the year (by 2%), because in spite of some specific problems and a scarcity of formal financing, some areas of agricultural activity succeeded in recovering from the adverse effects of El Niño in the previous year.

The downturn in economic activity prevented inflation from getting out of control (the annual rise was 53.5% in November) despite the rapid depreciation of the sucre and the big increase in the money supply.

Unemployment in the country's main cities stood at 16% in September (as against 10.7% twelve months earlier), while the share of the informal sector, including domestic service, in total employment rose from 36.8% to 41.4%. For its part, the minimum wage fell by almost 10% in real terms between January and November.

Banana and shrimp exports went down considerably. Oil exports, on the other hand, increased 36% in value in the first ten months of the year thanks to the rise in prices, thus regaining first place among exports. Exports of goods fell 1% during this period, but a slight rise is projected for the year as a whole. As imports slumped, a large trade surplus was created, so that the previous year's current account deficit of over 10% of GDP became a surplus of approximately 6%.

Foreign credit was tight, and foreign direct investment declined slightly. Consequently, by November the international monetary reserves had fallen to US\$ 1.22 billion: US\$ 480 million less than at the end of the previous year.

Despite the restructuring of the public sector's private external debt in 1994, public external indebtedness as a whole rose to US\$ 13.7 billion, which, at 1999 prices, represented 95% of GDP. Already in 1996 Ecuador had stopped payment on its bilateral debt (to Paris Club countries), and in September 1999 it suspended payment on some of the external public debt (Brady bonds with collateral). After the holders of these bonds rejected a proposal to resort to their guarantee, the suspension of payments was extended to all public debt in foreign currency owed to private lenders (Brady bonds, Eurobonds, domestic dollar debt).

Paraguay

Paraguay's gross domestic product will not register any growth in 1999, after the slight drop suffered in 1998, so per capita GDP will fall for the fourth consecutive year. The economic crisis affecting the members of Mercosur led to a slump in Paraguayan exports, while negative expectations caused the value of the guaraní against the dollar to fall by 14%, against a background of scarce international reserves. These reserves were built up again through the issue of State bonds on foreign markets, and there was also a significant inflow of foreign direct investment. The government was thus able to increase its consumption and investment. The stagnation of production activities was a contributory factor in the substantial decline in inflation, so that as of the end of November the rise in prices compared with the previous year was approximately 5%: only about one-third of the 1998 figure.

In the first half of the year and during part of the second, monetary policy attempted to counter the pressures of currency depreciation and the inflationary tendencies that had been in evidence since the previous year. Later, fiscal and monetary policy was aimed at fostering recovery, but it did not succeed fully in this, although it is claimed that it will bring results in the year 2000.

The central government deficit is expected to double to at least 2% of GDP. The widening of this gap, which will be covered by foreign funds, is due more than anything to increased capital investment designed to promote recovery. To a lesser extent it may be attributed to the stagnation of tax revenues, which, unlike the non-tax revenues of the binational dams, were highly affected by the weakness of economic activity. The non-financial public sector as a whole will close the year with a deficit equivalent to 1.5% of the product, which is less than the central government deficit because public enterprises reduced current spending more than they

increased capital investment, thus improving their operating results.

In the early part of the year, the monetary authorities attempted to persist in a policy of selling international reserves to defend the guaraní, which was continuing to fall in nominal terms. However, the Central Bank subsequently pulled back from this type of intervention because the reserves were scarce and the guaraní was appreciating against the Brazilian real. At the same time, it sold "monetary regulation bonds" at interest rates higher than the 1998 average. These operations were reduced toward the end of the year, as average yields decreased. Until the second quarter, the international reserves were low –only slightly more than two months of imports. Late in the year, there was a large inflow of foreign exchange thanks to the issue of international bonds, and the reserves rose to the equivalent of four months of imports. The sterilizing effect of the monetary regulation bonds counterbalanced the effect of the rise in reserves, reducing the money supply somewhat. Consequently, lending and deposit rates rose only 1%

PARAGUAY: MAINECONOMIC INDICATORS

	1997	1998	1999 ^a
<i>Annual rate of variation</i>			
Gross domestic product	2.4	-0.6	0.0
Consumer prices	6.2	14.6	4.6
Real wages	-0.6	-2.8	-0.3
Money (M1)	13.9	7.4	-3.5
Real effective exchange rate ^b	-1.7	11.4	-2.7
Terms of trade	6.8	-4.7	-6.6
<i>Percentages</i>			
Urban unemployment rate	6.9	7.2	...
Fiscal balance/GDP	0.5	0.2	-1.5
Real deposit rate	6.8	6.4	14.0
Real lending rate	19.4	17.1	22.0
<i>Millions of dollars</i>			
Exports of goods and services	4 505	4 313	3 115
Imports of goods and services	4 831	4 500	3 270
Current account	-238	-106	-115
Capital and financial account	54	181	250
Overall balance	-184	75	135

Source: See the statistical appendix.

^a Preliminary estimates.

^b A negative rate signifies an appreciation of the currency in real terms.

and 2%, respectively, although if the low rate of inflation is taken into account the rises in real terms were around 5% and 7%.

Lack of confidence in the guaraní was reflected in a pronounced preference for deposits in foreign currency, which grew 23% (expressed in local currency) as well as a reduction in quasi-money, since the decline in savings deposits was not counterbalanced by the upturn in longer-term deposits and savings certificates. Since December 1998, the guaraní has fallen 14% against the dollar in nominal terms. Against the currencies of Paraguay's main trading partners, however, it has appreciated 3%, due to the strength of the guaraní against the Brazilian real.

The performance of the productive sectors was uneven. The agricultural sector led the way in terms of growth, with soya maintaining its strength and being produced at unprecedented levels, compensating for the serious drop (-21%) in the cotton harvest because of bad weather and a reduction in the amount of land planted this year.

Growth in the output of other goods slowed. In the services sector, commerce and finance were most seriously affected by the low level of commercial activity and the political instability associated with a surprise change of government in the second quarter.

The monthly variations in consumer prices were slight or non-existent as a result of the stagnation of production activity, so that the rise through November was only 4.9%. Only in July was there a significant variation (2.6%). This was due to higher prices for imports, which resulted from a sharp drop in the value of the in June (-5%) and July (-7%). Average wages at the year's halfway point registered a nominal increase of slightly more than 2%, which was equivalent to a slight drop in real terms. In construction, commerce and services, the nominal increase in wages was less than 1%. The largest increases were in basic services (4%), transport (3%) and industry (2%). The minimum wage remained frozen at the level set in March 1998 (approximately US\$ 180), representing a loss in purchasing power of around 4%.

The current account deficit measured in current dollars stayed in the same range as the previous year and was financed without difficulty by capital flows from two main sources: credit received in return for international bonds issued by the National Treasury, and inflows of foreign direct investment. This left an overall balance-of-payments surplus of US\$ 135 million. The trade deficit also remained relatively unchanged as a result of comparable declines of foreign purchases and sales of goods. Officially registered imports fell by approximately one-third from their 1998 level because of weak demand for consumer goods not only for re-export but also for domestic consumption, which was down because of the sluggish economic activity. Registered exports declined by 30%, putting them at their lowest level in five years, due largely to a 20% drop in the international prices of soya beans, which account for half of Paraguay's exports—a drop only partially offset by a 10% increase in volume. A smaller harvest and lower prices on international markets also brought the value of cotton exports down to two-thirds of its previous level. The decline in registered exports was concentrated in Mercosur, where they fell by half because of the devaluation of the Brazilian currency (Brazil being Paraguay's largest trading partner) and because of increased production of soya beans in both Brazil and Argentina.

The public external debt at the end of the third quarter was US\$ 2.1 billion, some US\$ 600 million

more than 12 months earlier. The increase is

attributable largely to the sale of roughly this amount of Treasury bonds on international markets.

Peru

The 3% growth of the Peruvian economy in 1999 was concentrated in the primary sector. The other sectors of activity were affected by the decline in domestic private-sector demand, which caused tax revenue to go down and raised the fiscal deficit to 2.6% of GDP. Inflation, at 4.8%, was the lowest since 1970, despite a nominal 12% devaluation and an increase in fuel prices. The current account deficit fell significantly, to 3.7% of GDP. Outflows of short-term bank capital made it necessary to utilize some of the large stock of international reserves and caused some disturbances in the financial sector.

Economic policy was close to the lines of the agreement with the International Monetary Fund. Fiscal revenue and privatization targets were not met, however, and for the first time in the 1990s there was a primary deficit (0.9% of GDP). Tax revenue was eroded by the mediocre performance of the sectors other than the primary sector and lower private-sector demand. Current income fell to an estimated 12.8% of GDP (compared to 14.3% in 1998). In order to maintain domestic demand, the authorities refrained from cutting spending, which indeed increased 2.9% in real terms to 15.6% of GDP (as against 15.2% in 1998).

To avoid further widening of the fiscal deficit (which may amount to as much as 2.6% of GDP for the central government, compared with a target of 1.2%), the authorities raised the excise tax on fuels and tobacco in the second half of the year. To cover the deficit, the public sector's current deposits were drawn on and foreign indebtedness was increased. Work began on the implementation of a Fiscal Prudence and Transparency Law that would limit the public sector deficit to a maximum of 1% of GDP and formally regulate the administration of a stabilization fund to be established mainly with the proceeds from privatization operations.

With the withdrawal of foreign short-term capital and the rise in the exchange rate after the international crisis intensified in September 1998, the financial system was plunged into a liquidity crisis. The national currency depreciated 20% in the first quarter of 1999 in annualized terms after suffering a number of speculative attacks in reaction to the Brazilian devaluation and the Ecuadorian moratorium. The situation returned to normal in April, and by the end of November the exchange rate had stabilized at 3.47 soles to the dollar, representing a real depreciation of 8.4%.

These developments caused a large rise in the interbank rate in the first quarter (55%) and a reduction in the international reserves. The lending rate in local currency, which had reached a peak of 37.1% in April-May, fell to 32.1% in November, while the deposit rate fell to 10.3% after having reached 13.6% in April.

Liquidity ratios rose slightly with the increase in currency outside banks (+19%) and higher deposits in local currency (+13%). The vigorous expansion of loans based on foreign credit lines had led to 75% of the loan portfolio being in foreign currency, but this situation changed in the last quarter of 1998. This, along

PERU: MAIN ECONOMIC INDICATORS

	1997	1998	1999 ^a
<i>Annual rate of variation</i>			
Gross domestic product	8.6	0.1	3.0
Consumer prices	6.5	6.0	4.8
Real wages	-0.7	-1.9	-2.1
Money (M1)	19.3	0.5	10.8
Real effective exchange rate ^b	0.6	1.4	8.4
Terms of trade	6.9	-13.1	-9.1
<i>Percentages</i>			
Urban unemployment rate	9.2	8.4	9.2
Fiscal balance/GDP	-0.8	-0.9	-2.6
Real deposit rate	1.6	3.4	8.4
Real lending rate	20.5	23.6	31.2
<i>Millions of dollars</i>			
Exports of goods and services	8 370	7 487	7 750
Imports of goods and services	10 858	10 492	8 855
Current account	-3 279	-3 791	-2 095
Capital and financial account	5 841	2 420	1 565
Overall balance	2 562	-1 371	-530

Source: See the statistical appendix.

^a Preliminary estimates.

^b A negative rate signifies an appreciation of the currency in real terms.

with the recession in the domestic market, led to a decline in bank lending (-2.6% in dollars and -0.6% in local currency in the first three quarters of 1999). The quality of the loan portfolio also fell, and the arrears rate rose to 11% in August. A number of banks were adversely affected as the crisis forced mergers, takeovers and, in two cases, closures. The authorities designed a rescue package that moved some of the portfolio of bad debts to public institutions at a quasi-fiscal cost estimated at 1% of GDP, thus bringing the arrears rate down to 8.5% by the end of the year.

The economic situation and some administrative and regulatory problems slowed down plans for privatization operations and concessions amounting to some US\$ 800 million, so that progress in this respect was only a little over 50% of the planned level.

After the stagnation registered in 1998, the product increased by approximately 3%, with growth concentrated in primary products, physical exports of which rose more than 17%. On the other hand, private-sector domestic demand went down, especially in the case of gross investment, which dropped 24% in the first three quarters. The anticyclical effect of greater public spending was not enough to prevent a 4% drop in domestic demand and stagnation in the other sectors of

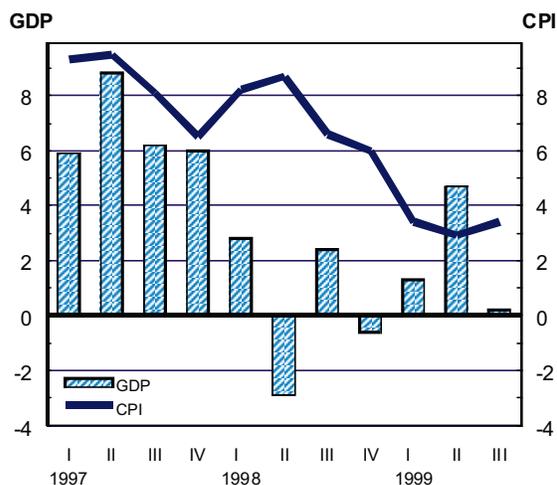
the economy, though there was a prospect of recovery in the last quarter. Private saving rose to 2% of GDP, but public saving fell. External saving went down by almost 3% of GDP.

The agricultural and mining sectors grew more than 10%. However, domestic and foreign commodities prices remained low. The recession in the construction industry worsened as a result of constraints on bank lending, and it is expected that the sector will shrink by 12%. Manufacturing is expected to grow slightly more than 4% (the 1998 figure was -3%) thanks to processing of primary products, while the services sector will remain virtually unchanged with a growth rate of 0.9% after the decline of 0.3% the previous year.

Declining agricultural prices and weak demand counterbalanced the effects of devaluation and the consequently higher prices of imported goods (especially fuels), so that inflation in 1999 was only 4%: the lowest figure in the last 30 years.

Open unemployment increased during the first six months, standing at 9.2% in the metropolitan area, against a background of widespread underemployment. In October, the minimum wage was raised 3% over the January level, and public sector wages were raised by 16% in April.

PERU: GROSS DOMESTIC PRODUCT AND INFLATION
(Percentage variation)



Source: ECLAC, on the basis of official figures.

The positive evolution of trade in goods brought the current account deficit down to 3.7% of GDP. The value of sales of goods rose 5.6% thanks to a 17% increase in traditional exports. The volume of fishery exports recovered from the slump of the previous year, but international prices were low. Mineral prices were also depressed (especially gold and copper). Non-traditional exports fell by 6%, with metal products and machinery and iron and steel suffering most (-20%). Imports declined by 18%, the items most strongly affected by weak domestic demand and by the currency devaluation being consumer goods (-22.5%), inputs (-14%) and capital goods (-15%). The

merchandise trade deficit thus registered an improvement of US\$ 1.9 billion, despite the 6.2% decline in the terms of trade.

Net capital inflows were 35% less than in the previous year, reflecting a US\$ 1.807 billion outflow of short-term capital and a number of postponements in the privatization programme. Total indebtedness fell to US\$ 28.7 billion as a result of net amortization of banking-sector debt. Service on the external public debt was US\$ 1.8 billion (US\$ 1 billion in interest and US\$ 800 million in principal). The international reserves went down by more than US\$ 500 million, but they still remained high at US\$ 8.58 billion, or one year of imports.



Uruguay



In 1999 the Uruguayan economy was hard hit by the deterioration in the international environment, especially in the form of weak prices for its main exports and reduced demand from its Mercosur trading partners. Domestic demand also fell under the influence of tighter domestic credit and rising unemployment. Estimates for the year foresee a decline of 2.5% in the gross domestic product, while inflation should go down to less than 4% annually: the lowest figure in half a century. The recession caused a further deterioration in the fiscal situation, while the considerable decline in exports increased the balance-of-payments current account deficit.

The elements of the international scene that are most important to the Uruguayan economy worsened significantly in 1999. After a very 1998, the terms of trade went down because of lower international prices for raw materials, together with rising oil prices. Domestic demand also fell, especially among Uruguay's Mercosur trading partners, who account for half of Uruguay's export sales, because of the effect that the Brazilian devaluation had on bilateral competitiveness.

In view of all these factors, plus the fact that general elections were to be held in the course of the year, economic policy makers opted for the same general course as in the past, attempting to reduce inflation in two ways by managing fiscal outlays in such a way as not to create pressure on the money supply and by maintaining the annual devaluation rate around 7.5%. In the face of the new external conditions, GDP was expected to fall roughly 2.5%, with a consolidated public-sector deficit of 2.5% of GDP: a gap that would

URUGUAY: MAIN ECONOMIC INDICATORS

	1997	1998	1999 ^a
<i>Annual rate of variation</i>			
Gross domestic product	5.0	4.6	-2.5
Consumer prices	15.2	8.6	3.4
Real wages	0.2	1.8	1.6
Money (M1)	16.9	14.4	6.9
Real effective exchange rate ^b	-2.0	-0.8	-6.7
Terms of trade	-0.4	7.0	-4.1
<i>Percentages</i>			
Urban unemployment rate	11.5	10.1	11.2
Fiscal balance/GDP	-1.3	-0.5	-2.5
Real deposit rate	-0.3	3.8	7.1
Real lending rate	42.9	42.4	45.3
<i>Millions of dollars</i>			
Exports of goods and services	4 217	4 225	3 765
Imports of goods and services	4 387	4 507	4 155
Current account	-289	-400	-565
Capital and financial account	688	760	485
Overall balance	399	360	-80

Source: See the statistical appendix.

^a Preliminary estimates.

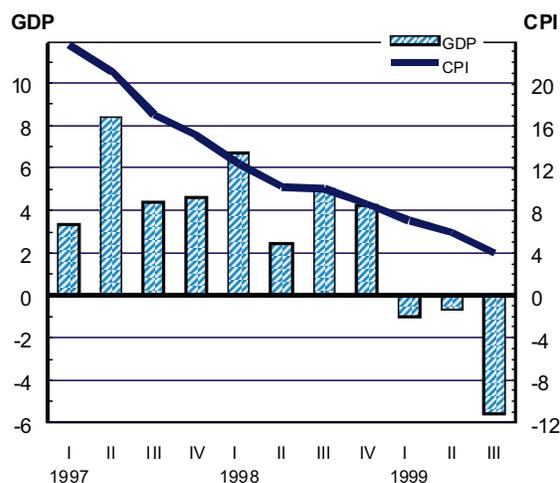
^b A negative rate signifies an appreciation of the currency in real terms.

The deterioration in the international situation had a heavy impact on exports. Falling revenue and tight domestic credit also reduced private investment and consumption. Sectoral performance was uneven, with agriculture, construction and communication services continuing to grow while other sectors fell markedly. Cattle-raising activity continued to grow due to more births, although levels of slaughtering and exports fell, and dairy and poultry production also rose. However, drought affected production in the second half of the year. Since domestic demand was weak, a large part of farm production went to increasing stocks. Construction activity continued to expand, albeit more slowly due to the slowdown in public investment and the weakening of private demand. Finally, communications continued to advance vigorously, with cellular telephony playing a leading role.

Other sectors, however, suffered significant setbacks. The manufacturing sector declined by 8% in the first three quarters, with lower levels of activity throughout the sector; mining of non-metallic minerals fell by one-fifth, textiles, clothing and footwear by a quarter, and machinery and equipment by almost one-third. Manufacture of foodstuffs, beverages and tobacco and activity in the paper and printing sector suffered least (-2% and -4% respectively). Commercial

be covered by foreign loans and by using some of the international reserves accumulated the previous year.

In general, the principal macroeconomic variables followed the expected course. Thus, the consolidated public-sector deficit for the year is within the planned range, though private analysts estimate that it could slightly exceed the target originally set. The decline in economic activity affected fiscal revenues, which are highly dependent on the economic cycle. Real central government revenue fell 6% during the first half of the year, with a sharp drop in revenue from taxes on foreign trade (-15% in nominal terms) and lower revenue (in real terms) from those domestic taxes which are strongly dependent on the level of economic activity. Central government spending, in contrast, continued to grow (6% in real terms) even though there was a reduction in real outlays on wages, since interest payments on the public debt rose almost one third and social security expenditure, as well as investment and operating outlays, increased. The surplus produced by State-owned enterprises declined, as did Central Bank para-fiscal expenditure.

URUGUAY: GROSS DOMESTIC PRODUCT AND INFLATION
(Percentage variation)

Source: ECLAC, on the basis of official figures.

intermediation went down in line with industrial production and imports.

In this recessionary environment, unemployment was around 11% of the work force, approximately one point above the previous year's average. The increase in unemployment was concentrated in Montevideo, where the employment rate declined. The purchasing power of wages increased 1.6%, primarily because of the real salary increase for public employees (3%), though private-sector wages also rose (0.7%).

The drop in domestic demand and the lower cost of some imported goods continued to limit the rise of consumer prices, which increased less than 4% during the year –the lowest figure since 1950. For the first time in several years, the value of the dollar rose more than did domestic prices. The financial programme agreed on with the IMF anticipated a devaluation in the floor of the Uruguayan peso's currency band in line with the expected level of inflation, and although prices rose less than predicted, the monetary authorities maintained the annual devaluation rate of 7.5%, which represented a depreciation in real terms. This was more than counterbalanced, however, by the sharp devaluation in the Brazilian real, so that the Uruguayan

peso again appreciated against the currencies of its main trading partners.

Trade suffered heavily. The value of exports of goods fell 27% in the first half of the year, since there was a decline of more than 15% in physical volume as well as a price drop of roughly 10%. The 40% decline in sales to Mercosur explains the bulk of this. There was also a drop of 11% in income from tourism. Although the lower overall demand reduced imports of goods by 14%, this was considerably less than the decline in exports, so the balance-of-payments current account deficit grew to close to 3% of GDP. As anticipated, the gap was covered by drawing on the international reserves and increasing foreign indebtedness. The fact that the country's debt has an "investment-grade" rating made it possible to issue international obligations at moderate interest rates. In April, the government put a US\$ 250 million ten-year global bond issue on the market, paying 212.5 base points more than United States bonds with the same maturity term. In October, there was a swap of US\$ 95 million of Brady bonds for US\$ 85 million of bonds maturing in 2021, with an intermediation spread of 195 base points. This operation freed up US\$ 25 million in United States zero-coupon bonds that had served as collateral.



Venezuela



The recession that had begun in 1998 intensified in the first half of 1999, and although it eased somewhat later, GDP went down by 7% for the year as a whole, further aggravating the unemployment situation. This decline in the product was due to cuts in oil production agreed on in OPEC and the weakness of overall demand on account of the contraction in disposable income, lower levels of public spending because of lack of financing, and a climate of political uncertainty connected with the change of government and the drafting of a new Constitution. The rise in oil prices as from the end of the first quarter (along with the decline in imports) helped to generate a large surplus on the balance-of-payments current account, to maintain a high level of international

VENEZUELA: MAIN ECONOMIC INDICATORS

	1997	1998	1999 ^a
<i>Annual rate of variation</i>			
Gross domestic product	6.6	-0.2	-7.0
Consumer prices	37.6	29.9	20.2
Money (M1)	58.4	6.6	13.9
Real effective exchange rate ^b	-22.3	-17.7	-6.5
Terms of trade	-3.1	-25.9	27.2
<i>Percentages</i>			
Unemployment rate	11.4	11.3	15.4
Fiscal balance/GDP	2.6	-6.6	-4.0
Real deposit rate	-24.4	0.2	-2.6
Real lending rate	-19.4	6.8	5.7
<i>Millions of dollars</i>			
Exports of goods and services	25 120	18 941	22 450
Imports of goods and services	18 282	18 927	16 500
Current account	4 684	-1 698	4 500
Capital and financial account	-1 434	-1 794	-3 310
Overall balance	3 250	-3 492	1 190

Source: See the statistical appendix.

^a Preliminary estimates.

^b A negative rate signifies an appreciation of the currency in real terms.

Fiscal policy was once more shaped by changes in oil prices. With prices extremely low at the beginning of the year, the new government took measures to limit spending, and in order to boost revenues it put a tax on financial transactions, increased the tax on luxury goods and wholesale transactions to make it a true value-added tax, and reformed income tax was.

However, the recession in which the Venezuelan economy was mired affected tax collection and this, combined with difficulties in obtaining foreign financing and the postponement of privatization operations that had been planned in the electricity and aluminium sectors, caused delays in budget execution. As from April, however, the sustained improvement in oil prices, which more than trebled in the course of the year, made possible a substantial increase in spending.

For the year as a whole, the apparent public-sector deficit was 4% of GDP, part of which was financed by having the national oil company PDVSA issue debt paper. The central government also had a deficit, but its size is unknown because information is lacking on the allocation of a portion of regular oil revenues to the new Macroeconomic Stabilization Fund. This deficit was financed mostly through non-recurrent transfers of

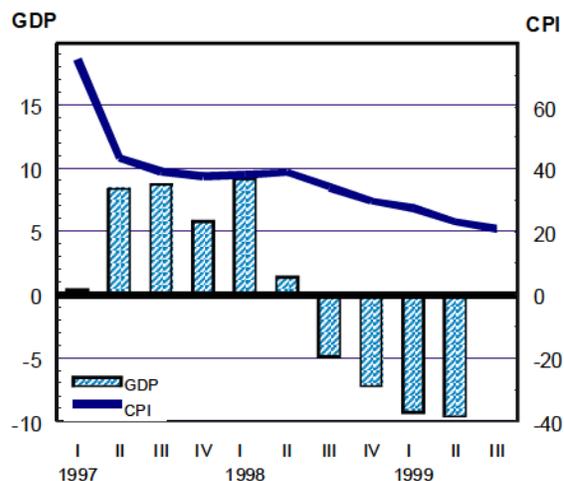
reserves, and to push up the real price of the bolívar. This latter development, combined with low demand, made it possible to continue bringing down inflation, which was around 20%.

PDVSA profits to the central government and the issue of National Public Debt Certificates and Treasury Bills on the domestic market to a much larger extent than in the previous year.

Monetary policy continued to be subordinated to the aim of maintaining the exchange rate within a flotation band of 7.5% around a central parity devalued monthly by 1.28%. The spectacular recovery in oil prices made it possible to keep the exchange rate in the lower part of the band, moving up from 564 bolívars to the dollar at the end of 1998 to 635 by the end of November 1999, which represented a real appreciation in the value of the currency.

Except in the first quarter, the increase of international reserves expressed in continued to give the monetary aggregates an expansionary character. The amount of Monetary Stabilization Securities (TEMs) issued was less than the outlays in respect of the amortization of securities reaching maturity, so the Central Bank had some leeway for issuing other types of public debt paper to finance the budget deficit. Thus, the contraction of the money supply was checked by the end of the first quarter, though its later growth, as well

VENEZUELA: GROSS DOMESTIC PRODUCT AND INFLATION
(Percentage variation)



Source: ECLAC, on the basis of official figures.

as the increase in money in circulation and in liquidity, was less than the change in the nominal GDP.

In the prevailing recessionary climate, interest rates went down, while the spread between lending and deposit rates widened against the backdrop of the banking sector's deteriorating results. The annual average deposit rate went down from 35% in December 1998 to 17% in November 1999, while the lending rate moved from 44% to 28%. As a result, the yield on money became negative as from June.

The decline in economic activity was due to the cuts in oil production and in investment following the decisions taken by OPEC in March; to the uncertainty provoked by the process of drafting a new Constitution, which affected private-sector investment decisions; to the drop in public expenditure; to problems in the non-oil export sector, and to the fact that interest rates were still high, especially in the first part of the year. The decline in activity was more pronounced in the first six months (over 9%), but it then eased considerably, and by year's end there were signs of improvement as oil prices rose and public spending increased.

The recession further aggravated unemployment, which had stood at around 11% since 1997. In the third quarter of 1999 it was already 15.4%, and there were fears that it would continue worsening despite the possibility that government investment in infrastructure and housing construction could provide some relief in the final months of the year. Government employees were given a 20% wage increase in May, in line with anticipated inflation, and this served as a benchmark for wage adjustments in the private sector.

Weak demand and sluggish economic activity moderated the upward movement of prices, as did the limited depreciation of the and seasonal factors that held back price rises of agricultural products in the first

half of the year. The monthly inflation rate fell to under 1% in September for the first time since March 1988 and also for the first time since price controls were abolished in 1989. As of November, year-on-year inflation was only a little over 20%, which was in line with the government's goals. This is the lowest figure for the decade, though still high if the deflationary factors that were present are taken into account.

Foreign trade slackened, with only oil exports increasing in value, due to the rise in oil prices, which more than compensated for the reduced shipments. In December, the average price of the mix of fuels exported by Venezuela during the year was more than 50% above the previous year's average. On the other hand, non-oil exports fell by one-third, affected by the evolution of the exchange rate, especially against the currency of Colombia (Venezuela's main market), as well as by the recession in Colombia. Imports also fell (-14%), due to weak domestic demand in spite of the appreciation of the bolívar in real terms. As a consequence, the current account balance became positive again, after the previous year's deficit, and totalled US\$ 4.5 billion, or roughly 5% of GDP.

This served to offset the net outflow of capital registered in the balance-of-payments financial account. In addition to the large outflow of private capital, there was also an outflow of public capital, since in spite of the inflow resulting from PDVSA borrowing and the collateral freed up in the swap of Brady bonds from the previous year, amortization payments on the debt were more than the disbursements received. The inflow of direct investment was close to US\$ 2 billion. The balance of payments thus showed a surplus, so that the international reserves, which began to recover as from the second quarter, passed the US\$ 15 billion mark (11 months of imports), which is somewhat higher than the figure at the end of 1998.