2004-2005

Economic survey

of Latin America and the Caribbean

United Nations

ECLAC

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Notes

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

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Foreword

This year's edition of the *Economic Survey of Latin America and the Caribbean* is the fifty-seventh in this 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. The full statistical appendix is published in electronic format for ease of data processing.

Part one deals with the performance of the region's economy as a whole and begins with an introductory section that analyses recent changes in some aspects of the region's trade linkages and financial position. This section then goes on to discuss the macroeconomic policies being pursued by many of the countries, together with their implications for the region's growth. The following chapters are devoted to the international situation and the external sector, macroeconomic (fiscal, exchange-rate and monetary) policy, and the region's performance (level of economic activity, inflation, employment and wages). It includes sidebar boxes on such issues as the restructuring of Argentina's external debt and the progress being made under the Heavily Indebted Poor Countries (HIPC) Initiative. These analyses highlight important factors in the current economic environment and, more specifically, in the effort to reduce the region's vulnerability.

The main link between economic development and social development is the labour market. This market has performed poorly in recent years, and a special chapter on the topic has therefore been included in this edition of the *Economic Survey*. In this chapter, after a brief review of recent trends in the region's labour markets, the discussion moves on to labour and employment policy options for improving job creation and employment conditions.

Part two provides overviews of macroeconomic policies and trends in the Latin American and Caribbean countries in 2004 and the first half of 2005. These country reports include tables on the main economic indicators.

The print version of the statistical appendix contains 25 regional tables, while the statistical appendix included in the attached CD-ROM includes over 400 tables which provide ready access to information for recent years and facilitate the creation of electronic spreadsheets. The CD-ROM also contains the electronic version of the text and figures presented in the *Economic Survey*.

Executive summary

Introduction

Within a context of economic dynamism which included all but a very few of the Latin American and Caribbean countries, the region posted an economic growth rate of nearly 6% in 2004 and is expected to grow by around 4.3% in 2005 and by close to 4% in 2006. If these projections are borne out, the region will have four consecutive years (2003-2006) of economic growth to its credit that will have resulted in an increase in per capita GDP of about 10%.

The region has been reaping the benefits of a highly favourable external environment, marked by worldwide GDP growth, an expansion of international trade, higher commodity prices and low interest rates. At the same time, an upswing in demand is being driven by exports of goods and services. In conjunction with a high level of external competitiveness and the current account and primary fiscal surpluses being achieved by many countries of the region, the continuation of this growth process is beginning to open up opportunities for investment. In addition, the slow but steady recovery of total wages, thanks both to higher employment and rising pay levels, has started to spur private consumption. The effect of these trends is heightened by the region's sizeable current account surplus, which ought to allow it to accommodate stronger domestic demand without, at least in the short run, being troubled by tensions in the external sector.

This international macroeconomic situation, which is having such a positive influence on all the world regions, is not, however, free of sharp imbalances, and this has sparked a wide-ranging debate. The question at issue is whether the region can sustain its present growth rate or whether its characteristic external vulnerability will render it unable to withstand a future deterioration in terms and conditions for emerging economies on international financial markets or on international goods markets, even if this deterioration, when it comes, is neither severe nor sudden.

A number of characteristics set the current boom apart from past episodes and could strongly influence the future of the Latin American and Caribbean economies:

- The large Asian economies' growing participation in international trade and the impact this is having on the demand for commodities and the supply of manufactures may bring about long-term changes in the terms of trade.
- The region's economic history over the past 50 years includes a strong increase in export growth, measured at constant prices. The expansion of many South American countries' exports is, interestingly enough, not confined to commodities, but also increasingly includes exports of industrial manufactures or non-traditional products.
- Export growth was also buttressed by a number of South American countries' decision to switch from fixed exchange-rate regimes to flexible market-based schemes, which has given way to a sustained depreciation in real terms.
- In another noteworthy break with the past, the region's economies have been able to grow without relying on external financial resources. In fact, the region's posting of a surplus on its current account

at a time when it is experiencing economic growth is an unprecedented event. This has occurred for the past two years and may happen again in 2005.

- Although most of the countries now have flexible, market-based exchange-rate regimes, in a desire to shore up the exchange rate or rebuild their foreign assets, the countries' central banks have been intervening in currency markets in order to buy foreign exchange and boost their international reserves, by an average annual rate equivalent to 1.5% of GDP in the last two and a half years.
- The net external debt (in reserve assets), measured as a percentage of exports of goods and services, has fallen sharply. The share of the total external debt that is made up of short-term liabilities has also shrunk considerably.
- In the great majority of the countries, the public sector is taking advantage of favourable macroeconomic conditions to bolster its fiscal accounts by raising revenues and cutting expenditures relative to GDP. This has helped to boost the primary surplus within a context of extraordinarily low international interest rates.

In view of the above factors, and while it is true that the Latin American and Caribbean region should achieve higher growth rates so that it can resolve the problems troubling its labour markets more quickly, and even though challenges remain to be met in overcoming external problems and pitfalls, as well as internal weaknesses and risks, there are some grounds for optimism because the region is now better equipped to take up those challenges.

External sector

In 2004, worldwide economic activity rose by 4.0%, while world trade expanded by 10.6% in real terms. These figures are among the highest to be registered in the entire decade. Most projections point to a somewhat slower pace of world economic activity in 2005, however, with estimates placing real GDP growth at 3.3% and the expansion of international trade at around 8%.

The current account of the region's balance of payments yielded a surplus of some US$ 18 billion (0.9% of regional GDP) for the second year in a row. Among the other main components of the balance of payments, the capital and financial accounts (including errors and omissions) showed a deficit of around US$ 5.65 billion. The overall balance therefore closed with a surplus of US$ 12.35 billion, plus compensatory financing amounting to US$ 8.8 billion. The counterpart to this result was a US$ 21.1 billion increase (1.1% of GDP) in holdings of reserve assets.

The positive balance on the current account reflected surpluses in merchandise trade and current transfers amounting to 3.0% and 2.1%, respectively, of GDP, with total net revenues of US$ 99.4 billion. The services trade and income accounts, on the other hand, registered US$ 81.3 billion in net payments, of which US$ 66.8 billion (3.4% of GDP) corresponded to interest payments, profit remittances and dividends. Export growth (22.9%) far outstripped its 2003 rate (8.8%), while a steep rise in imports (21.7%) completed the recovery that had begun the year before, following the contraction seen in 2002. Current transfers, composed primarily of remittances from emigrants, remained strong, climbing by US$ 6.4 billion (18.3%). The deficit on the services account deepened by 10.2% as transport costs rose, and the shortfall on the income account, which is linked to the level of borrowing and foreign capital operations, widened by 15.6%.

Foreign direct investment (FDI) rebounded, with net inflows totalling nearly US$ 43.9 billion, which was a 38.4% improvement over the low figure recorded for 2003. Net FDI inflows were more than offset by outflows of financial capital (the sum of the balances on the capital and financial accounts plus errors and omissions, excluding FDI), however, which amounted to US$ 49.6 billion. A portion of these outward flows corresponds to paydowns of debts owed to non-residents and to asset formation abroad (i.e., capital flight).

Against the backdrop of low international interest rates, the region took advantage of its achievements in terms of growth and the improvement of its public finances in order to strengthen its external debt position, reducing its level of indebtedness from 42.5% to 37.5% of GDP. In some countries, the appreciation of the local currency helped to improve the debt ratio, since much of their external debt is denominated in dollars. The countries also seized the opportunity offered by low interest rates and narrower spreads to lengthen their maturities and issue local-currency debt instruments.

The trends observed in the early months of the year appear to indicate that the region will post another surplus on its balance-of-payments current account in 2005, this time of around 1% of GDP. Imports are rising faster than in 2004, but export performance is also strong, although slightly less so than last year. This is attributable to the slower pace of world economic activity and to the situation in some commodity markets, which are not quite as buoyant as they were in 2004.

Economic policy

Fiscal policy

The favourable macroeconomic situation existing in 2004 enabled the countries of the region to make significant improvements in their fiscal accounts. At the end of 2004, the countries' central governments posted a weighted average primary surplus of 2.2% of GDP, as compared to 1.6% in 2003. Meanwhile, the overall balance, which includes interest payments on the public debt, shows a decrease in the deficit from -1.8% to -0.9% of GDP. The primary surplus is expected to remain at more or less the same level in 2005, but the overall deficit will probably increase owing to higher interest payments on the public debt.

The improvement in the fiscal balance in 2004 is attributable to the fact that, while revenues kept pace with the level of economic activity and rose in terms of GDP as compared to 2003, expenditure remained constant relative to GDP (weighted averages). Since increases in economic activity boost fiscal revenues (not only because the tax base expands but also because evasion decreases), the region's higher economic growth rate had a strong impact on tax receipts.

A number of reforms and policy decisions were contributing factors in the improvement seen in the aggregate fiscal balance. The performance of this variable was affected by the application of macro-fiscal rules, government commitments to maintain a fiscal surplus over the medium term, and decisions regarding revenues and expenditures designed to capitalize upon the favourable economic situation.

Exchange-rate policy

Between December 2003 and December 2004, the currencies of the Latin American and Caribbean countries remained virtually constant in real effective terms relative to the rest of the world, appreciating by just 0.2%. South America registered a mean appreciation of 0.8% in its real effective extraregional exchange rate (i.e., the real effective rate, excluding trade with other countries in the region). The Central American nations, the Caribbean countries and Mexico, whose main trading partner is the United States, recorded a very slight depreciation (0.3%) in their real effective exchange rate vis-à-vis the currencies of countries outside the region. The countries' GDP-weighted real effective extraregional exchange rate (in which Brazil, Mexico and Argentina account for 75% of the weighting) appreciated by 2.3%.

The region's performance in this respect was influenced by its strong balance-of-payments position, which reflects the improvement in the terms of trade and the more robust external demand for commodities generated by the powerful growth of China's economy. With the low level of inflation making it possible to adopt more expansionary monetary policies, a number of the region's central banks increased their international reserves in an effort to dampen the nominal appreciation of their currencies.

In 2004 and early 2005, the real effective extraregional exchange rate of Latin America and the Caribbean has remained above the levels seen in the 1990s. In the first five months of 2005, the real effective extraregional exchange rate fell (i.e., appreciated) by an average of 4.2% relative to its December 2004 level. A widespread appreciation in real effective extraregional exchange rates was observed, both in South America and in Central America, the Caribbean and Mexico.

Monetary policy

The region's monetary policy-makers have had to cope with different sorts of challenges than in the past. The abundance of external resources stemming from higher exports and capital inflows have fuelled the appreciation of the countries' currencies. In order to keep the appreciation under control, the countries' central banks intervened in the currency market, buying up foreign exchange in order to rein in their exchange rates. In turn, in an effort to ease the inflationary pressures generated by this strategy, the monetary authorities have had to sterilize the excess liquidity by engaging in open-market operations. The countries' central banks have also tended to raise interest rates in response to the increases made by the United States Federal Reserve, but at a slower pace. Consequently, interest rates have remained fairly low in historical terms.

Monetary policy's core objective continues to be to keep inflation under control. The current set of conditions is such, however, that some central banks have had to pursue a number of different objectives and to choose two or even three different policy options in an effort to avert an excessive appreciation of their currencies, ensure that they meet their inflation targets and prevent their monetary sterilization operations from driving up the quasi-fiscal deficit. A fourth objective might even need to be added here, as the central banks strive to keep the spread between domestic and international interest rates at a steady level.

In the past few months, however, most of the countries' real lending rates have risen, as is to be expected as they move past the turning point in the business cycle that was initiated by the United States Federal Reserve in June 2004, with the central banks of the region following suit.

Domestic performance

Economic activity and inflation

In 2004 the economies of Latin America and the Caribbean posted a growth rate of 5.9% and per capita GDP growth of 4.4%, which was an improvement over the situation in 1998-2003. This growth trend is expected to continue in 2005, although at a somewhat slower pace (around 4.3%).

Economic growth in 2004 was a combined effect of favourable external conditions, which were reflected in the export sector's strong performance, and the expansion of domestic demand. The effect of the international economy's dynamism was augmented by trends in the real exchange rates of most countries in the region, which made their exchange rates more competitive and allowed a majority of the countries to boost their exports.

The continued effects of external stimuli spurred on other activities, and domestic demand consequently expanded more than had initially been projected. Previously, demand had been depressed in most of the countries of the region, and a portion of the increase in some of its components therefore corresponds to its recovery of lost ground. In 2004, continued low interest rates, the considerable increase in national income generated by the 5.3% upturn in terms of trade and the gradual expansion of total wages paved the way for investment and consumption decisions. As a result, domestic demand rose by 6.3%, thanks to a 4.8% increase in total consumption (private consumption was up by 5.6% and public consumption by 1.2%) and a strong upswing in investment. With an increase of 12.2%, investment was the most dynamic component of domestic demand. The 12.7% upturn in gross fixed investment, following various years of declines in this aggregate, was a significant contributing factor in this result.

GDP growth for the region in 2005 is projected at around 4.3%. Although this figure is lower than the 2004 rate, it is still above the average for recent years. The international economic situation remains positive, although world economic growth is expected to slow somewhat. The rebound in domestic demand is being bolstered by interest rates, which remain at historical lows, and the currency appreciation observed in various countries in early 2005, which will help to reduce the cost of imports. Consequently, although the export sector is expected to perform well in 2005, domestic demand is likely to be an important engine of economic growth during the year.

Inflation in Latin America and the Caribbean continued to follow the downward trend that it has exhibited since 2002, with the cumulative rate to December amounting to 7.3%, as compared to 8.5% in December 2003. Some countries' inflation rates for 2004 were higher than in 2003, however. In most cases, this was due to higher prices for commodities and for some industrial manufactures and higher transport and insurance costs.

The main trends seen in the second half of 2004 carried over into the first five months of 2005. Generally speaking, the upward movement of international food prices and agricultural raw material prices is slowing, while the impact of higher import prices was cushioned by the appreciation in the countries' exchange rates against the United States dollar.

Employment and wages

The regionwide unemployment rate declined from 10.7% to 10.0% in 2004. This reduced the number of unemployed persons in urban areas by 800,000 (from 19.4 million to 18.6 million). The decline reflected an increase in employment levels in almost all the countries, with the regional rate rising from 52.2% to 52.8% of the working-age population. Thanks to the reactivation of production, most of the newly created jobs were for wage-based forms of employment, and in many countries formal-sector employment expanded.

Given the sharp deterioration in the employment situation in earlier years, however, regional unemployment levels are still high, since in most of the countries, the job creation stimulated by economic growth was counteracted by an increase in the labour supply. The continuation of a tight employment situation, as reflected in high unemployment, also meant that average real wages in the formal sector did not benefit from the upswing in growth and productivity gains. In fact, the weighted average wage level edged up by a mere 0.9% and median wages were flat.

The year-on-year change in the unemployment rate points to a significant improvement in early 2005, with the rate falling from 10.6% for the first half of 2004 to 9.4% one year later. As the region's pace of economic growth eased, however, its employment rate's year-on-year increase also slowed to 0.4 percentage points, whereas in the first half of 2004 it had been 0.6 points. Another factor contributing to the decline in unemployment was the 0.4 percentage-point reduction in the average weighted labour force participation rate. Despite the improvement in employment and unemployment indicators, however, no upturn was seen in real wages in early 2005.

Employment problems and policies

The sweeping economic and technological changes of the past few decades have had a strong impact on labour markets around the world. Factors such as technological changes that permit production processes to be made more flexible, the increasing mobility of capital and technology, and the business strategies used to cope with all these changes have tended to diversify and polarize the occupational structure. In addition, during recent decades the region's labour markets have been affected by the slack pace of economic activity, which is the main determinant of the demand for labour, and by the volatility of economic growth.

Recent structural changes notwithstanding, the sluggish rate of job creation seen in past decades is chiefly due to the low economic growth rates of those years. The region therefore cannot be said to be experiencing "jobless growth". On the other hand, and contrary to the expectations sparked by economic reforms, the region's economic growth has not led to a more intensive use of labour either.

The adoption of policies to facilitate high, sustained economic growth along with a productive development process that will transform the foundations of that growth in order to foster increasing productivity gains through the ongoing incorporation of innovations will be a key factor in creating productive jobs. Within the context of the increasingly marked heterogeneity of production and employment structures, however, economic growth alone will not be though to solve the region's labour problems. Employment and labour-market policies will have to underpin these efforts by successfully meeting the following four challenges:

- Boosting labour productivity.
- Creating productive employment.
- Developing protection mechanisms in keeping with the new economic environment.
- Fostering the entry into the workforce of groups that have specific problems in gaining access to productive employment.

First part

The region

Chapter I

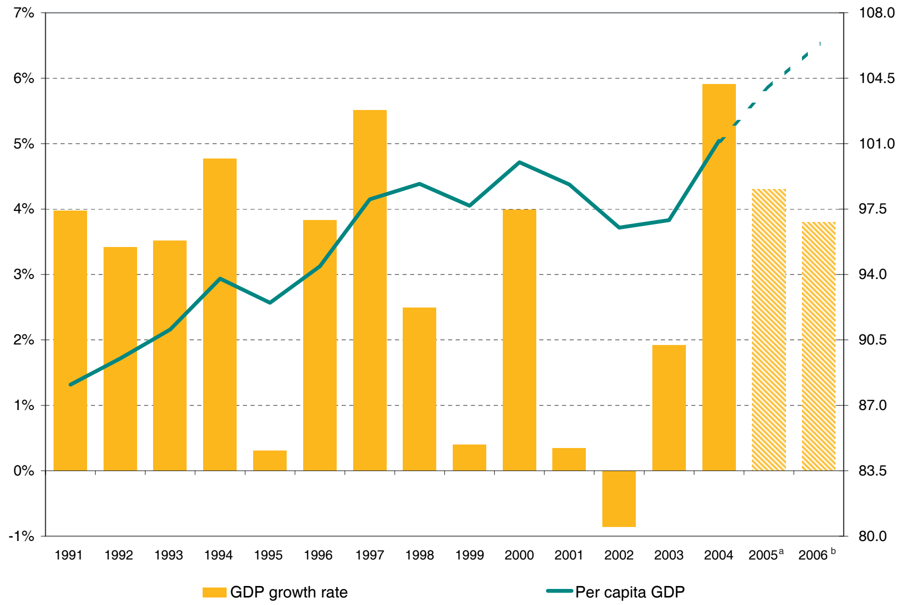
Introduction

The Latin American and Caribbean region posted an economic growth rate of nearly 6% in 2004, will grow by somewhat more than 4% in 2005 and is expected to attain a growth rate of close to 4% in 2006. If these projections are borne out, the region will have four consecutive years of economic growth to its credit that will have resulted in an increase in per capita GDP of around 10% in 2003-2006 (see figure I.1). As in 2004, these rates are expected to reflect an across-the-board expansion in 2005 that will take in almost every country in the region (see table I.1). According to these projections, South America will grow by 4.7%, Mexico and Central America by 3.6% and the Caribbean by 4.0%.

Figure I.1

LATIN AMERICA AND THE CARIBBEAN: GDP AND PER CAPITA GDP

(Dollars at 2000 prices, index: 2000=100)



Source: Economic Commission for Latin America and the Caribbean (ECLAC).
[a] Estimate.
[b] Projection.

Table I.1

LATIN AMERICA AND THE CARIBBEAN: ANNUAL GROWTH RATES

(Percentages)

Country	2003	2004 [a]	2005 [b]
Argentina	8.8	9.0	7.3
Bolivia	2.8	3.6	3.5
Brazil	0.5	4.9	3.0
Chile	3.7	6.1	6.0
Colombia	4.1	4.1	4.0
Costa Rica	6.5	4.2	3.0
Cuba	2.9	3.0	5.0
Ecuador	2.7	6.9	3.0
El Salvador	1.8	1.5	2.5
Guatemala	2.1	2.7	3.0
Haiti	0.5	-3.8	2.0
Honduras	3.5	5.0	4.5
Mexico	1.4	4.4	3.6
Nicaragua	2.3	5.1	4.0
Panama	4.3	6.2	4.5
Paraguay	3.8	4.0	3.0
Peru	4.0	4.8	5.5
Dominican Republic	-1.9	2.0	3.5
Uruguay	2.2	12.3	6.0
Venezuela (Bolivarian Republic of)	-7.7	17.9	7.0
Latin America	1.9	5.9	4.3
The Caribbean	6.5	3.9	4.0
Latin America and the Caribbean	1.9	5.9	4.3

Source: Economic Commission for Latin America and the Caribbean (ECLAC).
[a] Preliminary data.
[b] Estimates.

The region is clearly reaping the benefits of the highly favourable external environment being generated by world GDP growth, the expansion of international trade, higher commodity prices and low interest rates. A review of the global economic situation indicates, moreover, that every region in the world has profited from this propitious combination of economic conditions.[1]

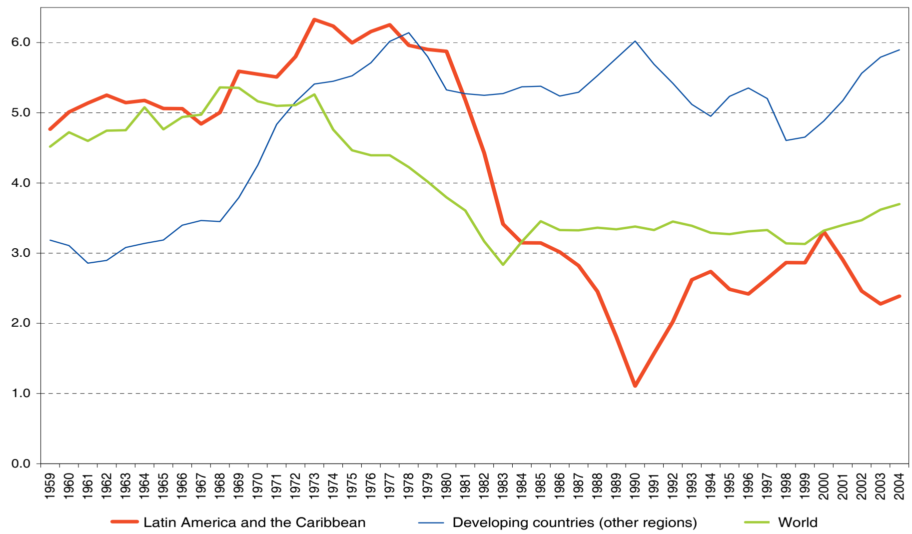
While it is true that all the world regions are growing, the Latin American and Caribbean region has not always kept pace with worldwide economic growth, as it is doing now (see figure I.2a).

Moreover, as is illustrated in figure I.2b, the region's growth has not only been sluggish, but also very volatile. The real volatility that has afflicted the region has negative

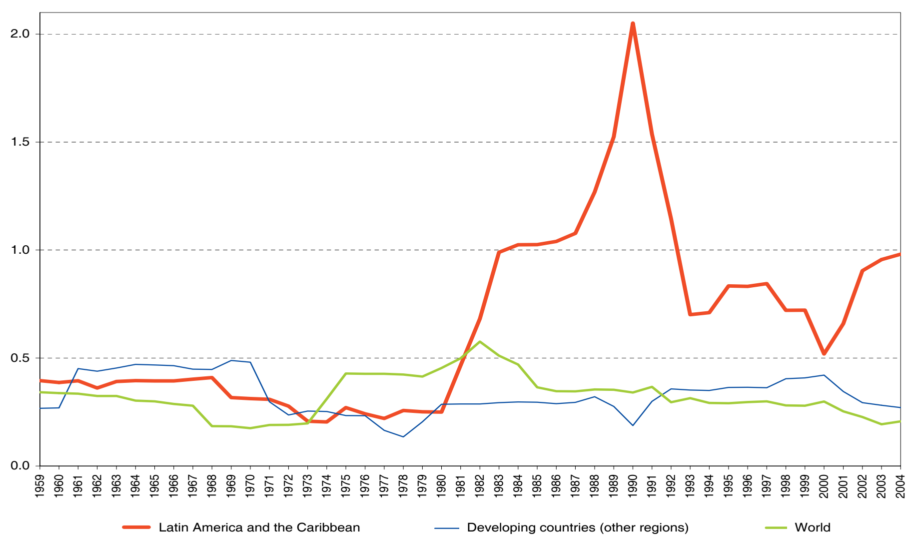
Figure I.2

ECONOMIC GROWTH AND VOLATILITY, 1960-2004

(a) Economic growth, 1960-2004 (annual rates, rolling 10-year periods)



(b) Volatility of growth, 1960-2004 (coefficients of variation, rolling 10-year periods)



Source: Economic Commission for Latin America and the Caribbean (ECLAC).

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[1] See, inter alia, United Nations, "World economic situation and prospects as of mid-2005", June 2005.

implications for resource allocation and, in particular, interferes with savings and investment decisions, thereby dampening the economies' long-term growth rates. This volatility stems both from external conditions, such as the volatility of capital flows or the terms of trade, and from internal factors, many of which are associated with problems in the timing of public policies that have an impact on such variables as fiscal accounts, real exchange rates, the balance of payments and levels of indebtedness. These internal and external factors tend to interact with one another until they eventually lead to the crises that periodically break out in the region.

An analysis of the economic situation therefore raises the question as to whether the region is experiencing a durable growth process or whether it is simply capitalizing upon a set of fortunate circumstances.[2]

The international macroeconomic situation that is having such a positive influence on all the world regions is not, however, free of sharp imbalances. The existence of these disequilibria has sparked a wide-ranging debate. An issue of particular concern is the persistence of the United States economy's "twin deficits" in its public-sector accounts and in the balance-of-payments current account. By the same token, the headlong growth of China's economy and doubts as to its sustainability also raise questions about the future course that the world economy may take. Obviously, if these imbalances were to trigger a hard landing, the repercussions for the world economy would be extremely adverse, and the impact on Latin America and the Caribbean, as for any other region of the world, would be very serious. Could the region sustain its present growth rate if the adjustment, which is bound to occur eventually, takes the form of a soft landing? Or will the Latin American and Caribbean economies' characteristic external vulnerability render them unable to withstand a deterioration in the terms and conditions available to emerging economies on international financial or goods markets, even if the landing does turn out to be a soft one?

Although, for the time being, it is impossible to answer these questions accurately or fully, it is worth taking the time to analyse some of the changes taking place in the international economy and in the countries of the region that may have a considerable influence on the Latin American and Caribbean economies' future path.

First of all, with regard to the changes occurring in the international economy, the large Asian economies' growing participation in world trade has tended to alter the structure of global demand, skewing it more towards raw materials and certain manufactures, while at the same time prompting a considerable expansion of the supply of a broad range of manufactured products. As a result, the region's terms of trade have recovered from the slump seen in the 1980s and exhibit a generally positive, albeit volatile, trend since the 1960s. Thus, the trend in the region's terms of trade over the past 40 years, as depicted in figure I.3a, can be clearly distinguished from the downswings characteristic of the trend in commodity prices observed throughout the twentieth century.[3] This new structure of the world supply and demand of goods could give rise to long-term changes in the price trends for commodities and basic manufactures which the region would be in a position to make the most of.[4]

Although this series can be reconstructed to exclude petroleum since 1970, figure I.3b reveals a similar trend in the terms of trade for products other than oil during that period. It is particularly noteworthy that both series yield an upward trend from the early 1990s on, which is largely attributable to the weakening prices of the manufactures imported by the region.

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2 See, inter alia, Economic Commission for Latin America and the Caribbean (ECLAC), *Preliminary Overview of the Economies of Latin America and the Caribbean, 2004* (LC/G.2265-P), Santiago, Chile, December 2004. United Nations publication, Sales No. E.04.II.G.147, and Nouriel Roubini, "Latin America: secular change leading to a new paradigm for growth or cyclical/external luck?" [on line] <http://www.roubiniglobal.com/archives/2005/05/latin_america_s.html>, 2005.

3 José Antonio Ocampo and María Ángela Parra, "The terms of trade for commodities in the twentieth century", *CEPAL Review*, No. 79 (LC/G.2200-P), Santiago, Chile, Economic Commission for Latin America and the Caribbean (ECLAC), April 2003.

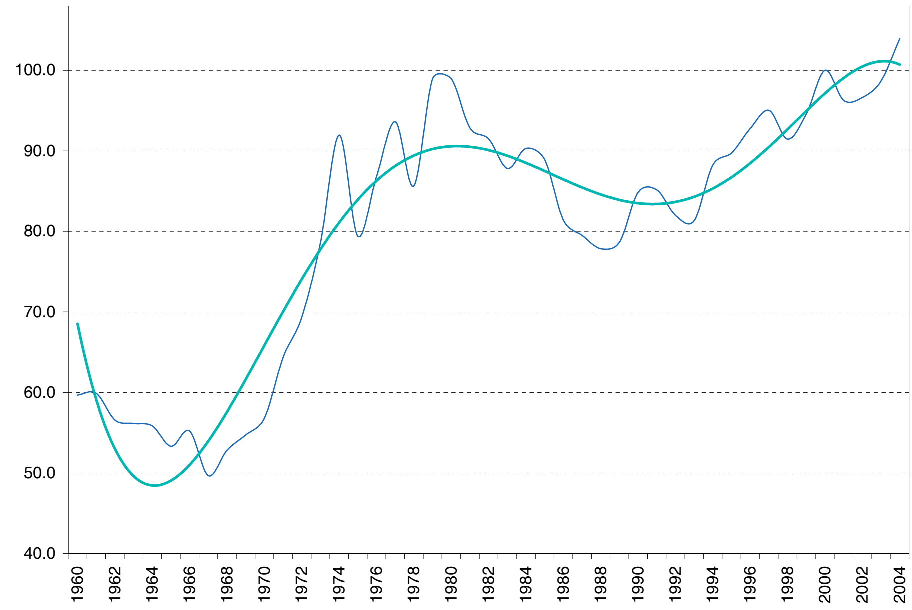
4 Concerning the effects that the Chinese economy is having on the terms of trade, see Raphael Kaplinsky, "Revisiting the revisited terms of trade: will China make a difference?", Institute of Development Studies, University of Sussex, March 2005.

Figure I.3

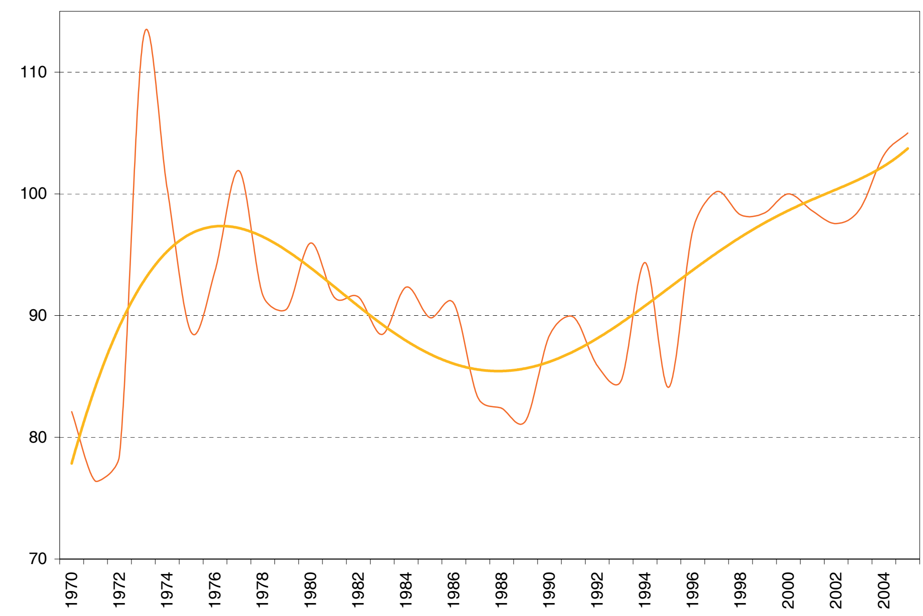
TERMS OF TRADE FOR GOODS

(Index: 2000=100)

(a) Terms of trade for goods (total)



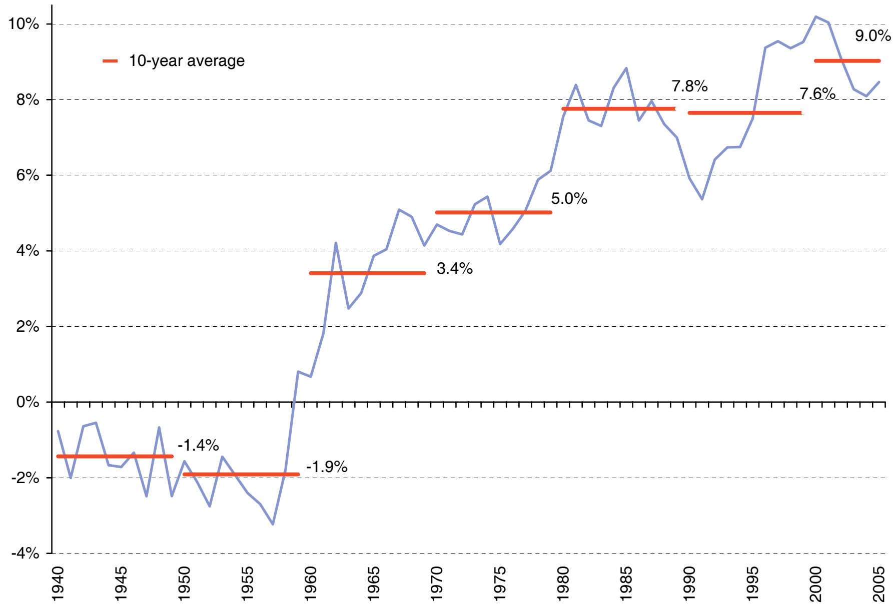
(b) Terms of trade for goods other than petroleum



Source: Economic Commission for Latin America and the Caribbean (ECLAC).

Secondly, the region's economic history over the past 50 years includes a strong acceleration in export growth, measured at constant prices (see figure I.4). Thus far in this decade, the average 10-year growth rate for exports amounts to 8.4%, as compared with 7.3% in the 1990s, 4.7% in the 1980s and 1.5% in the 1970s.

Figure I.4
10-YEAR GROWTH RATES IN EXPORT VOLUMES



Source: Economic Commission for Latin America and the Caribbean (ECLAC).

Between 1991 and 2000, the physical volume of the region's exports expanded at a rate of 9.3% per year, which is above the world average and is surpassed only by China and India. The difficulties experienced by the international economy in 2001-2002 interrupted this process, but exports began to make a recovery in 2003, and 2005 will be the second year in a row that the physical volume of exports has grown significantly (10% in 2004 and 12% in 2005).[5]

The recent upswing in exports is therefore part of a trend that has been in evidence for at least the past 15 years. The expansion of many South American countries' exports is, interestingly enough, not confined to commodities, as the growth rates for exports of industrial manufactures or non-traditional products have also picked up in the past few years and especially in the last 12 months (see table I.2). What is more, the increase in these countries' exports of manufactures is not limited to intraregional trade but is instead taking in other markets, including those of the North America Free Trade Agreement (NAFTA) and Asia.

It is thus reasonable to conclude that the region's improved position in external markets has enabled it to begin to take advantage of export-related externalities associated with the lessons it has learned from experience; these lessons represent an intangible asset that not only accounts for the region's success in maintaining high export growth rates, but also provides grounds for optimism regarding its future opportunities.

Export growth has also been buttressed by a number of South American countries' decision to switch from fixed exchange-rate regimes to flexible market-based schemes, which has given way to a sustained depreciation in real terms.

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[5] On export growth and its impact on the Latin American and Caribbean economies in recent years, see Economic Commission for Latin America and the Caribbean (ECLAC), *Productive development in open economies* (LC/G.2234(SES.30/3)), Santiago, Chile, June, 2004.

Table I.2
SOUTH AMERICA: EXPORT GROWTH, 2005
(*Cumulative 12-month growth rates at the end of each month*)

	January	February	March	April	May
Total exports					
Argentina	17.5	17.2	16.5	16.0	14.8
Brazil	32.5	33.9	31.0	32.8	32.6
Chile	50.2	47.4	42.2	39.8	34.7
Colombia	25.7	30.0	32.1	...	...
Ecuador	26.5	28.6	31.8	29.8	26.2
Peru	42.1	41.6	39.5	39.6	39.9
Uruguay	30.7	31.1	29.1	28.7	...
Exports of manufactures or non-traditional goods					
Argentina [a]	27.0	27.8	28.2	31.3	31.9
Brazil [a]	35.5	38.0	36.1	36.5	36.0
Chile [a]	26.2	24.6	24.1	24.4	24.8
Colombia [a]	33.7	35.1	34.1	...	...
Ecuador [a]	7.3	9.6	9.9	14.7	13.0
Peru [b]	33.6	32.8	31.3	32.1	30.0
Uruguay [b]	27.7	28.6	26.5	25.8	...

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.
[a] Industrial manufactures.
[b] Non-traditional goods.

The devaluations' more limited pass-through to domestic prices may have been due to cyclical factors, such as the fact that these devaluations occurred at a time when countries were coming out of a recession, which means that idle resources were available and installed capacity was not being fully used. This pattern may also be partly attributable to structural changes that have influenced competitive conditions in the region's markets at a time when the upsurge of large Asian economies in the global economy is leading to the large-scale incorporation of factors of production (especially labour) that generate deflationary pressures.[6]

Although there are marked differences between South America, on the one hand, and Central America and Mexico, on the other, the region as a whole has high real exchange rates (see figure I.5). This heightened external competitiveness has contributed to a shift in export trends that, as will be discussed later on, are one of the engines of the current economic growth process.

The upturn in exports enabled the South American countries to build up trade surpluses, even though their higher economic growth rates had begun to drive up imports. These surpluses marked a turnaround from the deficits previously registered in services trade and on the income account and allowed the countries of this subregion to post a surplus on their current accounts.

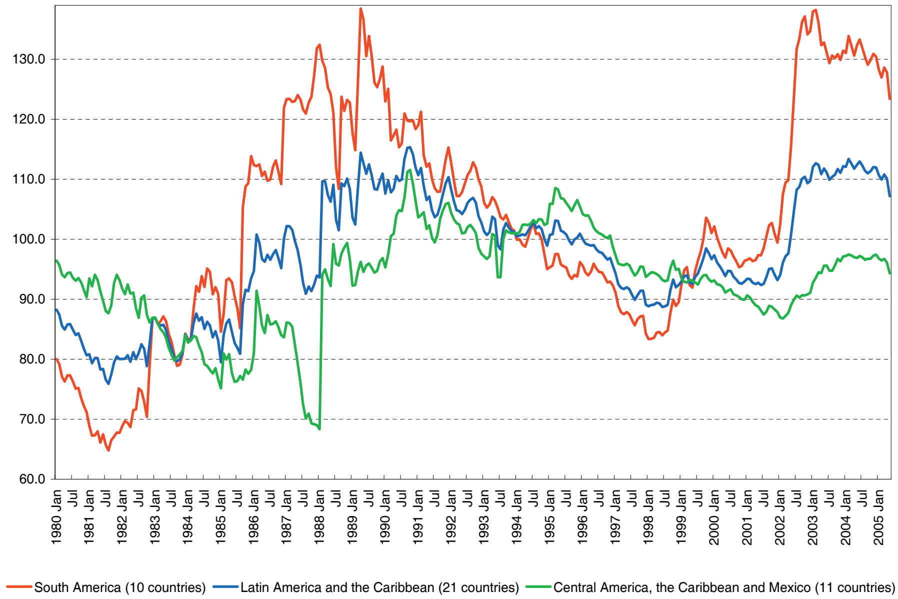
The situation in Mexico and Central America has been quite different. In both cases, the slackening of export growth as a result of competition from China in the United States market —combined, in the case of the Central American countries, with the impact of oil prices on the value of imports— was one of the factors behind the deficit registered on the merchandise trade account. Neither the surplus on the services trade account posted by some countries (including Costa Rica, the Dominican Republic and Panama) nor the remittances sent by emigrants (which were very high in Mexico and in almost all the Central American countries) were enough to offset the trade deficit, and they all consequently recorded negative balances on the current account.

6 For an analysis of possible reasons why the pass-through effect has weakened in developing economies, see Jeffrey Frankel, David C. Parsley and Shang-Jin Wei, "Slow passthrough around the world: a new import for developing countries?", *NBER Working Paper*, No. 11199, National Bureau of Economic Research, Inc (NBER), 2005.

Figure I.5

REAL EXCHANGE RATES WITH RESPECT TO THE REST OF THE WORLD

(Index: 1990-1999=100)



Source: Economic Commission for Latin America and the Caribbean (ECLAC).

A similar situation arose in the Caribbean countries, where, with the exception of Trinidad and Tobago,[7] the balance on current account was negative. Both the merchandise trade balance (owing to the effect of high oil prices) and the balance on the income account showed deficits, as is usually the case for these countries. The balances for services trade and transfer payments, on the other hand, yielded surpluses. The former reflects these countries' tourism and related services activities, which are a structural trait of their economies, while the latter is due to the fact that this subregion is a net recipient of current transfers, thanks to the remittances sent back by emigrants.

Another noteworthy development is that, backed by hefty trade surpluses and inflows in the form of transfers from emigrants, the region's economies have, in a departure from past trends, been able to grow without relying on external financial resources. In fact, the region's posting of a surplus on its current account at a time when it is experiencing economic growth is an unprecedented event. This has occurred for the past two years and may happen again in 2005. Unlike in the past, the region has achieved this surplus position on its current account at the same time that the country-risk ratings of a number of its economies are at a 15-year low —a signal that the region is an attractive destination for foreign capital.

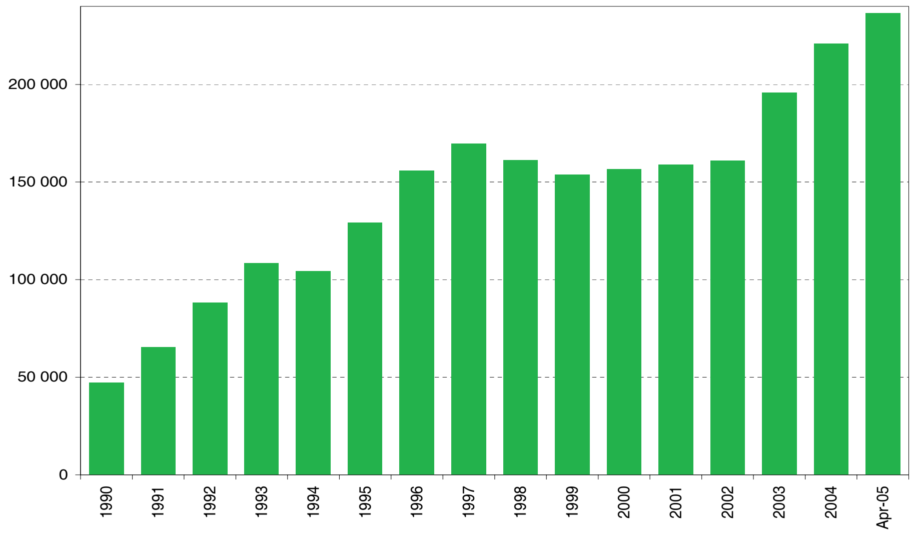
Whether as a result of current account surpluses (in the case of South America and Trinidad and Tobago) or capital inflows (into Mexico, Central America and the Caribbean) almost all the countries of the region are building up balance-of-payments surpluses. Although most of the countries now have flexible foreign-exchange markets, in a desire to shore up the exchange rate or to alter the composition of their foreign assets, the countries' central banks have been intervening in currency markets, buying up foreign exchange and increasing their international reserves (see figure I.6) at an average annual rate equivalent to 1.5% of GDP in the last two and one half years. This fits in with a global trend towards the accumulation of reserves, which is particularly strong in some Asian countries, which are thus providing the necessary savings to finance the current account deficit of the United States.[8]

[7] Trinidad and Tobago's trade surplus reflected a 23% increase in its exports, chiefly of petroleum, that was associated with the rise in hydrocarbons prices.

[8] In 2004, the Latin American and Caribbean countries' reserves amount to around US$ 20 billion, whereas the international reserves of Asia totalled over US$ 560 billion, with Japan accounting for somewhat more than US$ 170 billion of that sum and China holding over US$ 360 billion.

Figure I.6

LATIN AMERICA AND THE CARIBBEAN: INTERNATIONAL RESERVES

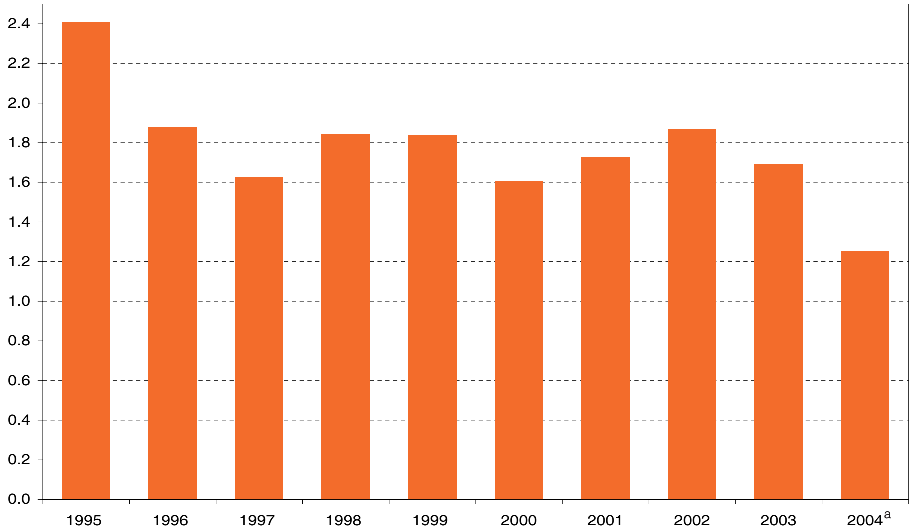


Source: Economic Commission for Latin America and the Caribbean (ECLAC) and International Monetary Fund (IMF).

As a consequence of converging movements, the settlement of public- and private-sector debts, the build-up of reserve assets and increasing exports, the region is witnessing a steep decline in its net external debt (reserve assets) relative to its exports of goods and services (see figure I.7).

Figure I.7

LATIN AMERICA: DEBT NET OF INTERNATIONAL RESERVES/EXPORTS OF GOODS AND SERVICES



Source: Economic Commission for Latin America and the Caribbean (ECLAC) and International Monetary Fund (IMF).

[a] The effect of Argentina's debt restructuring, which was carried out in March 2005, has been included in the calculations.

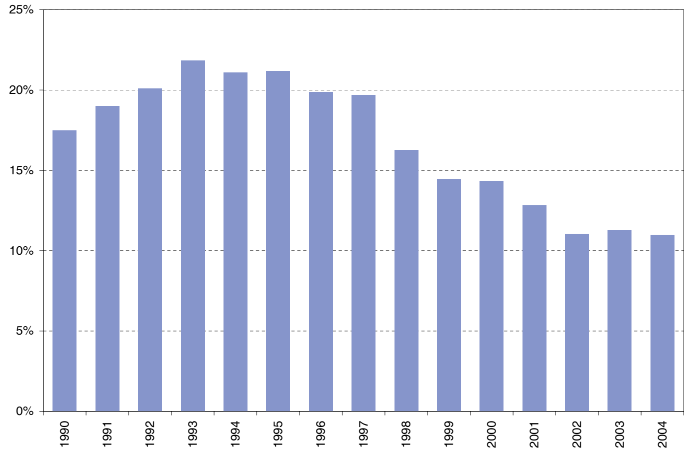
Some countries in the region still have fairly high debt-to-exports ratios, but the ratio for the region as a whole is roughly half of what it was before the Asian crisis, and all the Latin American countries are exhibiting a downward trend.[9] As noted in the chapter dealing with the external sector, the situation in the Caribbean is quite different, as the debts of several countries in this subregion have reached disturbingly high levels.

The share of the total external debt that is made up of short-term liabilities has also shrunk considerably.[10] As may be seen from figure I.8, the proportion of short-term debt included in the total debt is now about half of what it was in the mid-1990s, and such liabilities represent slightly more than 40% of international reserves, after having topped 100% in the first half of the 1990s. At the same time, the share of local-currency debt paper has been expanding.

Figure I.8

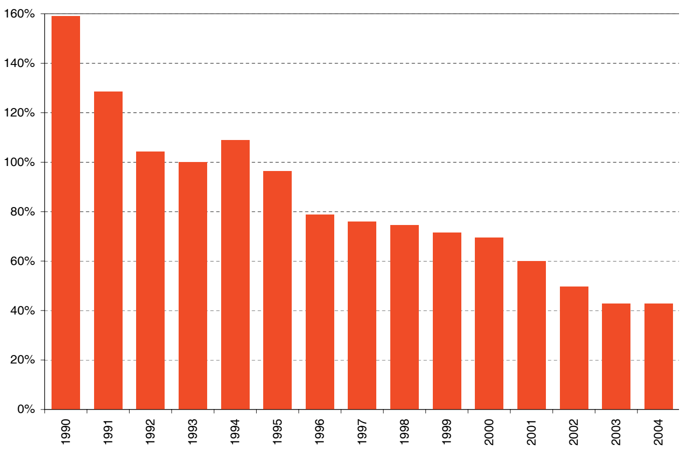
LATIN AMERICA: SHORT-TERM DEBT

(a) As a percentage of total debt



Source: Economic Commission for Latin America and the Caribbean (ECLAC) and the World Bank.

(b) As a percentage of international reserves



Source: Economic Commission for Latin America and the Caribbean (ECLAC) and International Monetary Fund (IMF).

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9 For an analysis of the ratio between the present value of the debt and exports as an indicator of debt sustainability, see Aart Kraay and Vikram Nehru, "When is external debt sustainable?", *Policy Research Working Paper*, World Bank, 2004. The authors argue that the probability of incurring debt-related problems is less than 25% below a threshold equivalent to a debt-to-export ratio of between 2 and 3, depending on the GDP growth rate in question.

10 This does not necessarily mean that maturities are less tightly bunched together, but it does permit a more accurate projection of resource requirements.

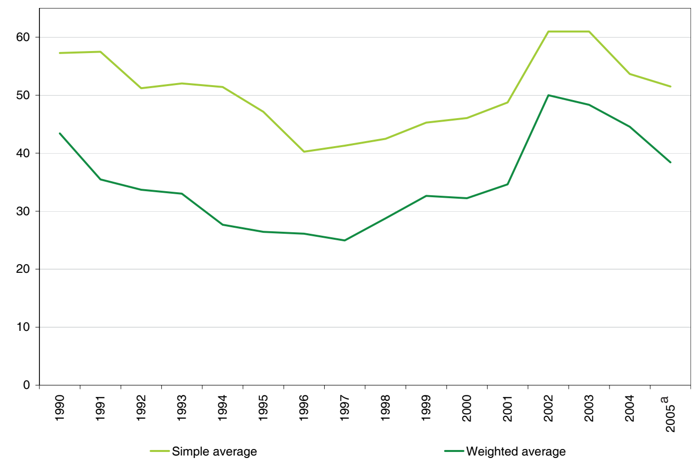
In the case of the public debt, the upward trend in the countries' primary surpluses at a time when international interest rates are near record lows is also helping to reduce the region's vulnerability. Although debt levels remain high in terms of GDP, movements in public-sector accounts over the past two years have reversed the upward trend seen in this indicator since 1997 (see figure I.9).

In fact, the trend in public accounts is another factor that sets the present situation apart from other periods of growth. In the great majority of the countries, the public sector is taking advantage of favourable macroeconomic conditions to bolster its fiscal accounts by boosting revenues and holding primary expenditure steady relative to GDP for the last three years (see figure I.10).

Figure I.9

LATIN AMERICA: GROSS PUBLIC DEBT OF THE CENTRAL GOVERNMENT

(As a percentage of GDP)



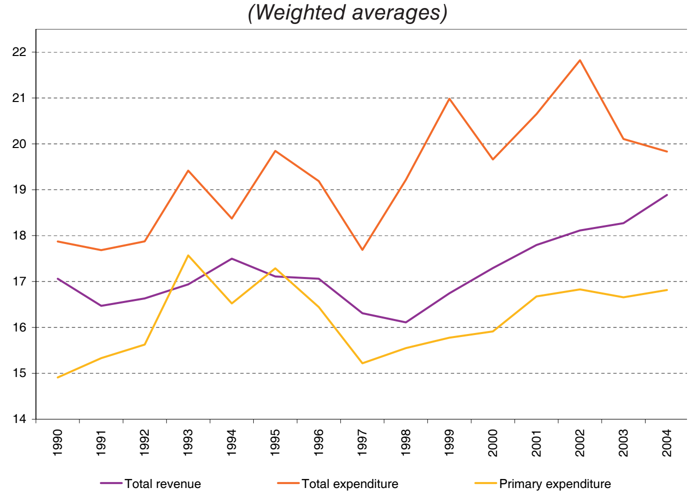
Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.

[a] Estimates.

Figure I.10

LATIN AMERICA: CENTRAL GOVERNMENT REVENUES AND EXPENDITURES AS A PERCENTAGE OF GDP

(Weighted averages)



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

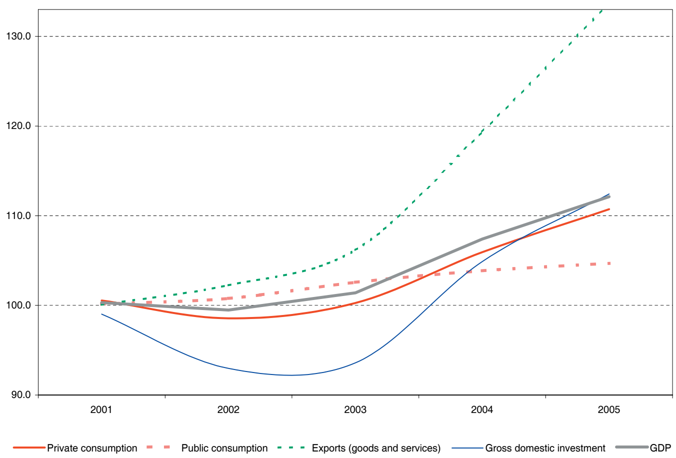
As noted earlier, the upswing in demand is being driven by exports of goods, which jumped by around 10% in 2004 and will probably grow by around 12% in 2005. The continuation of this growth process, in conjunction with a high level of external competitiveness and the current account and primary fiscal surpluses being posted by many countries of the region, is beginning to open up opportunities for investment. In fact, investment rose faster than GDP in 2004 and is likely to do so again in 2005. In addition, the slow but steady recovery of total wages, thanks both to higher employment and rising pay levels, has begun to spur private consumption (see figure I.11). As mentioned earlier, the region is also running a sizeable current account surplus, which ought to allow it to accommodate an upturn in domestic demand without, at least in the short run, being troubled by tensions in the external sector.

Another notable development in relation to the region's macroeconomic aggregates is that the surplus on its balance-of-payments current account has been accompanied by increases in national saving. This is because the growth rate of private consumption, combined with the primary surplus on the countries' public accounts and the effect that the improvement in the terms of trade and the flow of remittances from emigrants are having on revenues, has pushed up national saving to the equivalent of 21.4% of GDP (in dollars at 2000 prices), which is 3.4 percentage points of GDP higher than the average for the 1990s (see figure I.12).

Figure I.11

COMPONENTS OF DEMAND

(Index 2000=100)

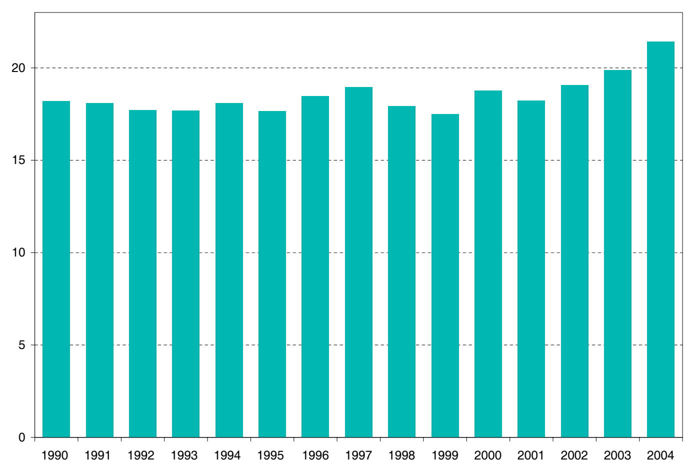


Source: Economic Commission for Latin America and the Caribbean (ECLAC).

Figure I.12

NATIONAL SAVING

(As a percentage of GDP, in dollars at 2000 prices)



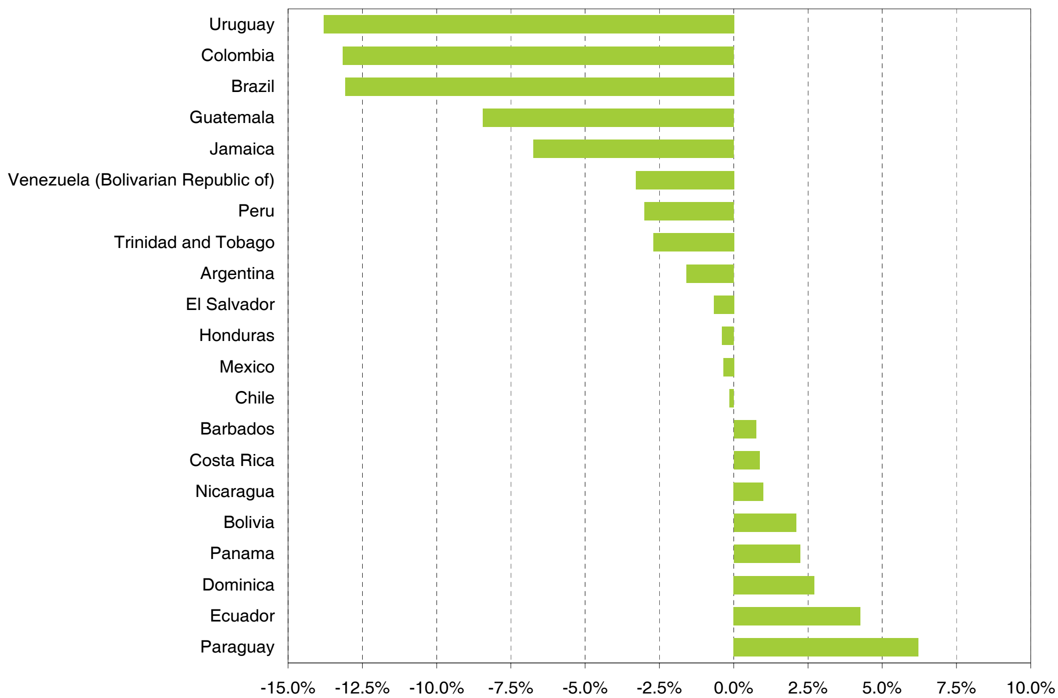
Source: Economic Commission for Latin America and the Caribbean (ECLAC).

These encouraging indicators notwithstanding, a number of problems or hazards remain, such as the possibility of a traumatic adjustment of some of the imbalances existing in the international economy, which could in turn cause world GDP to plummet while fuelling an increase in global uncertainty. Serious political conflicts in various regions may also create greater uncertainty. The prevailing strategy in the region —and in other parts of the world— for hedging against such possible financial shocks has been to build up reserve assets. This strategy is a costly one, however, in terms of the absorption of resources that could be put to other uses, as well as being less efficient than other options that international financial institutions could design to cope with the situation.

On the external front, the possibility of an increase in protectionism is another potential hazard, especially if progress is not made in reducing global macroeconomic imbalances.

Internal risk factors include the fact that the strategy of maintaining high real exchange rates is generating some tension between exchange-rate and monetary policy that could eventually fuel inflationary pressures. These pressures would stem from the excess money creation associated with the central banks' intervention in currency markets or an increase in the quasi-fiscal deficit resulting from their efforts to mop up excess liquidity. These problems place a limit on that strategy, as is demonstrated by the trend in some of the region's real exchange rates over the past year (see figure I.13).

Figure I.13
EXTRAREGIONAL REAL EFFECTIVE EXCHANGE RATES
(Average year-on-year variation, January-May 2005/January-May 2004)



Source: Economic Commission for Latin America and the Caribbean (ECLAC).

The surge in exports has been offset by the even higher import growth rates triggered by GDP growth, especially in South America.[11] This is not a problem in the short run, but it certainly bears watching. The high income-elasticity of imports in the past two years may be, in part, a short-run phenomenon associated with the resumption of growth in these economies following a protracted stagnation, but it may also stem, at least in part, from longer-lasting circumstances having to do with the disappearance of a portion of the region's industrial fabric during the 1990s or changes in consumption patterns in response to the availability of imported goods now the Latin American and Caribbean economies are more open.

[11] According to estimates, goods imports will grow by around 13% in 2005, but in South America this rate will exceed 22%.

If these trends continue in the medium term, it seems wise to combine a more aggressive export-promotion strategy that will speed up export growth with policies designed to increase saving in order to avert balance-of-payments problems or a debt overhang. These factors make it all the more important to move forward with the implementation of counter-cyclical fiscal policies. Although, as noted in the chapter on fiscal policy, some headway has been made in this direction, greater progress is needed.[12]

Latin America and the Caribbean continue to suffer from conflicts and the accompanying political instability and social tensions that interfere with good governance. The region's young democracies have overcome a number of problematic situations, but in the past few years social, ethnic and political antagonisms —some more recent, some of long standing— appear to have intensified. Resolving these disputes sooner rather than later is one of the greatest challenges to be faced by the region.

Finally, although, from a historical perspective, maintaining an average positive growth rate of 4.7% for three years in a row (if these projections are borne out by the facts) is a laudable achievement, this pace of growth is not enough to correct the imbalances that have been troubling the region's labour markets for over a decade now. Clearly, given the economically active population's growth rate of nearly 2.5% per year and the continuing need to boost productivity, the above rate of GDP growth does not leave much room for reducing unemployment.

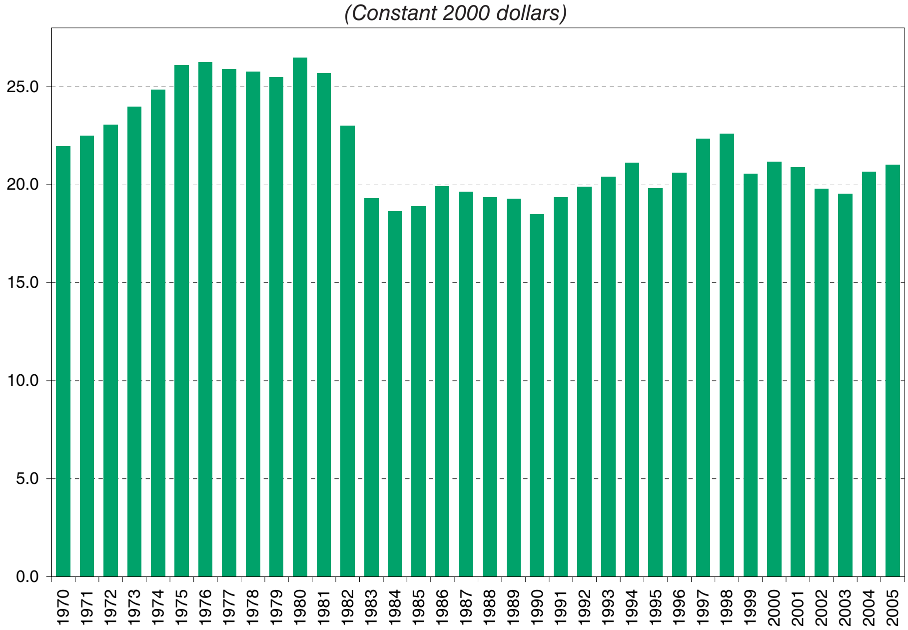
This points up the need to generate high growth rates in order to help do away with the imbalances in the labour market,[13] as quickly as possible as a means of working towards the Millennium Development Goal of eradicating poverty. This will call for higher rates of investment as well as steps to ensure that the beneficial effects of stronger export growth will carry over into the rest of the production apparatus.

Investment rates of around 20% of GDP, such as those shown in figure I.14, cannot possibly sustain a higher growth rate, even though the region's significant natural-resource-based comparative advantages mean that it does not require as high a capital-to-GDP ratio as other economies. The Latin American and Caribbean countries should seize this opportunity to add greater value (especially in the form of knowledge) to their exports. Otherwise, they will fail to lay the foundations for longer lasting growth.

Figure I.14

LATIN AMERICA AND THE CARIBBEAN: INVESTMENT AS A PERCENTAGE OF GDP

(Constant 2000 dollars)



Source: Economic Commission for Latin America and the Caribbean (ECLAC).

12 This could also help to reduce the region's still high public debt-to-GDP ratios.

13 This topic is the focus of the special chapter included in this issue of the *Survey*.

In sum, there is unquestionably a great deal that remains to be done. The following chapters will explore some of the problems that persist in the region in greater depth and discuss what kinds of changes will need to be made in economic policy in order to consolidate the current growth process. As has also been pointed out, the present situation is not without its pitfalls, some of which are beyond the Latin American and Caribbean governments' control. Nevertheless, as the above review has sought to demonstrate, there is indeed room for greater optimism than in the recent past.

Projections for Latin America and the Caribbean: 2005-2006

The GDP of the Latin American and Caribbean countries will increase by almost 4.3% in 2005 and by 3.8% in 2006. At a more disaggregated level, the growth rate for the Southern Cone in 2005, not including Brazil, is expected to be close to 7%, with rates of 7.3% for Argentina and 6% for Uruguay, thanks to the continued strength of the export sector and domestic demand in both of these countries. Chile's 6% growth rate, which is one of the highest in Latin America, attests to the robustness of its economy. The Andean Community should post growth of around 5.5% as a result of the culmination of the recovery in the Bolivarian Republic of Venezuela, lower growth expectations in Bolivia following its political crisis and an increase of one percentage point in the projected figure for Peru owing to the positive performance of its external sector, the high level of public spending, and increased private consumption and investment (see table I.3).

Table I.3

LATIN AMERICA AND THE CARIBBEAN: GDP GROWTH, 2004-2006

(Annual growth rates in percentages)

	2004	2005 [a]	2006 [b]
Latin America and the Caribbean	5.9	4.3	3.8
South America	6.9	4.6	4.0
Brazil	4.9	3.0	3.5
Southern Cone	8.4	6.9	4.7
Andean Community	9.5	5.4	4.2
Mexico and Central America	4.3	3.6	3.5
Central America	3.6	3.3	3.2
Mexico	4.4	3.6	3.5

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.
[a] Estimates.
[b] Projections.

For Mexico and Central America, growth is projected at 3.6%, which is a lower rate of expansion than for the region as a whole but higher increase than it has been in the recent past (see figure I.15). In Mexico, although indicators for the first quarter show a decline in goods production owing to the slight slowdown in the United States during that period, domestic demand continues to be strong and is expected to remain so during the course of 2005. According to projections, the upward trend seen in Central America's economic activity in the past few years may subside somewhat, resulting in a growth rate of 3.3%. External demand and private investment will be the driving forces behind economic growth in this biennium.

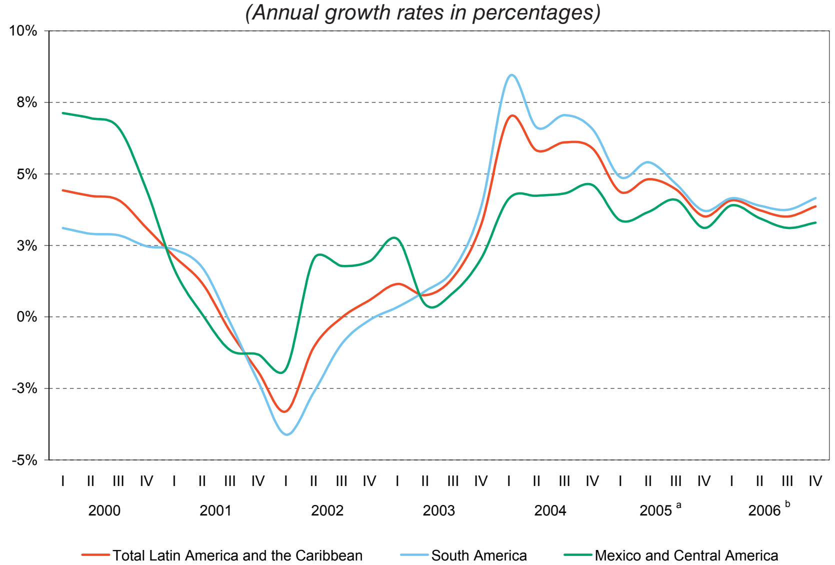
In the Caribbean, despite the negative effects of natural disasters on the economy, a growth rate of 4% is projected for 2005, which is slightly above the rate recorded in 2004. Trinidad and Tobago stands out with a projected growth rate of 6.3%, mainly thanks to the performance of the energy and tourism sectors.

At the beginning of the year, inflationary spikes were observed in some countries as a result of upswings in food and energy prices and regulated utility tariffs, but they were soon brought under control. This was achieved thanks to monetary policy and the relative stability of exchange rates. The inflation rate for Latin America and the Caribbean is therefore estimated at around 6.5%, which is lower than in 2004 (see figure I.16).

Figure I.15

GROWTH OUTLOOK, 2000-2006

(Annual growth rates in percentages)



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

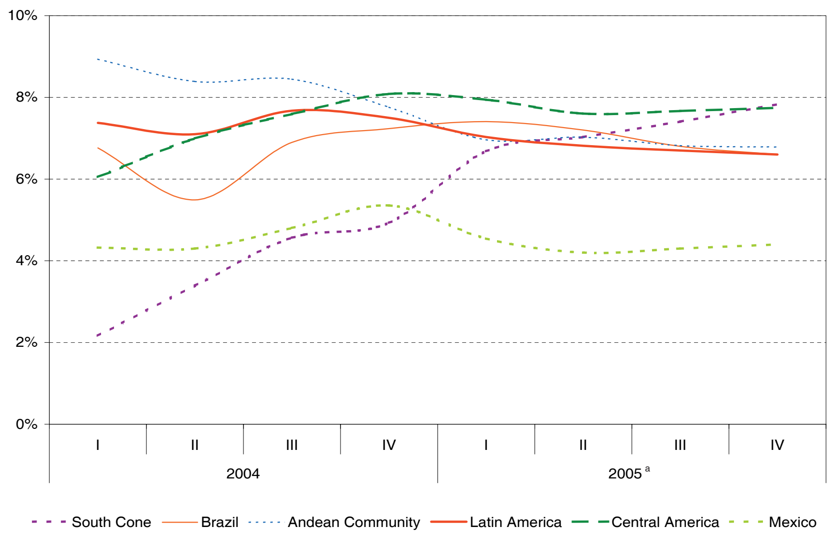
[a] Estimates.

[b] Projections.

Figure I.16

LATIN AMERICA: INFLATION, 2004-2005

(Annual growth rates in percentages)



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

[a] Estimates.

Projections for 2006 remain relatively optimistic, with an estimated growth rate of 3.8%. This forecast of lower growth than in 2005 is attributable to expectations of a slowdown in the world economy and the normalization of the situation in several of the region's economies as they complete their recovery. Growth rates, which are expected to be relatively uniform across Latin America, should range between 3% and 5.5% (see table I.4). As in previous years, the Southern Cone and the Andean Community are expected to post the highest rates of growth.

Table I.4

LATIN AMERICA AND THE CARIBBEAN: GDP GROWTH BY COUNTRY, 2004-2006

(Annual growth rates in percentages)

Country	2004	2005 [a]	2006 [b]
Argentina	9.0	7.3	4.5
Bolivia	3.6	3.5	3.0
Brazil	4.9	3.0	3.5
Chile	6.1	6.0	5.5
Colombia	4.1	4.0	4.0
Costa Rica	4.2	3.0	3.0
Cuba	3.0	5.0	…
Ecuador	6.9	3.0	3.0
El Salvador	1.5	2.5	2.5
Guatemala	2.7	3.0	3.0
Haiti	-3.8	2.0	…
Honduras	5.0	4.5	4.0
Mexico	4.4	3.6	3.5
Nicaragua	5.1	4.0	4.0
Panama	6.2	4.5	4.0
Paraguay	4.0	3.0	3.0
Peru	4.8	5.5	4.5
Dominican Republic	2.0	3.5	4.0
Uruguay	12.3	6.0	4.0
Venezuela (Bolivarian Republic of)	17.9	7.0	4.5
Caribbean	3.9	4.0	4.0
Total	**5.9**	**4.3**	**3.8**

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.
[a] Estimates.
[b] Projections.

Chapter II

External sector

A. International economy

1. The changing world economic situation

Global economic activity grew by 4.0% in 2004, while global trade expanded by 10.6% in real terms,[1] with both figures being among the highest recorded during the last 10 years. The buoyancy of international trade is closely linked to the relocation of many manufacturing activities from developed countries to Asian countries and shows the significance that external demand has acquired in many economies. Most forecasts indicate a slower pace of global economic activity in 2005, with GDP and world trade expected to grow by around 3.3% and 8.0%, in real terms, respectively (see figure II.1). These projections are based on the performance of the developed economies, whose levels of activity picked up between the second half of 2003 and the first six months of 2004, and have since been relatively less buoyant (see figure II.2).

During 2004 the world economy felt the full effects of the countercyclical monetary and fiscal policies deployed by the United States authorities in the wake of the stock market crisis and the recession that affected the domestic economy and the rest of the world in 2000-2001 (see figure II.3). These policies were based on a steep reduction in interest rates, an increase in public spending (with military spending playing quite a significant role) and tax cuts. Those measures staved off a fall in economic activity in the United States, but shifted the buoyant core of the economy away from non-residential investment, which had prevailed in the second half of the 1990s, towards residential investment and consumer durables (see figure II.3). The labour market's response to these stimuli was weak, however, in comparison with previous rebounds in the United States economy. Another consequence of this policy stance was the sharpening of external and fiscal disequilibria: the balance-of-payments current account deficit came in at 6.3% of GDP in the fourth quarter of 2004, while the government's deficit stood at 4.3% of GDP for the year, according to OECD estimates.

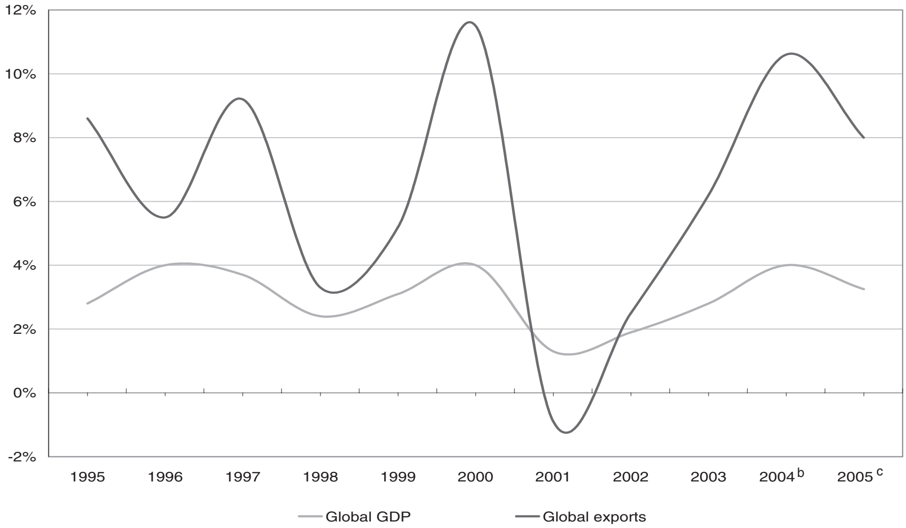
The United States' GDP grew by 4.4% in 2004 and reached a maximum year-on-year rate of 5% in the second quarter. Since then, durable consumption and residential investment have lost impetus, partly as a result of the gradual rollback of the fiscal and monetary stimulus. The shift in monetary policy occurred mid-year, when

[1] United Nations, *World Economic Situation and Prospects 2005*, New York, January 2005. United Nations publication, Sales No. E.05.II.C.2; growth of GDP is calculated by adding together national rates weighted by GDP for 2000 in dollars at the market exchange rate.

Figure II.1

GROSS DOMESTIC PRODUCT [a] AND GLOBAL EXPORTS AT CONSTANT PRICES, 1995-2005

(Annual rates of variation)



Source: United Nations, *World Economic Situation and Prospects 2005*, New York, Department of Economic and Social Affairs (DESA), 2005.

[a] Average of national GDP growth rates, weighted by GDP at 2000 prices and exchange rates.

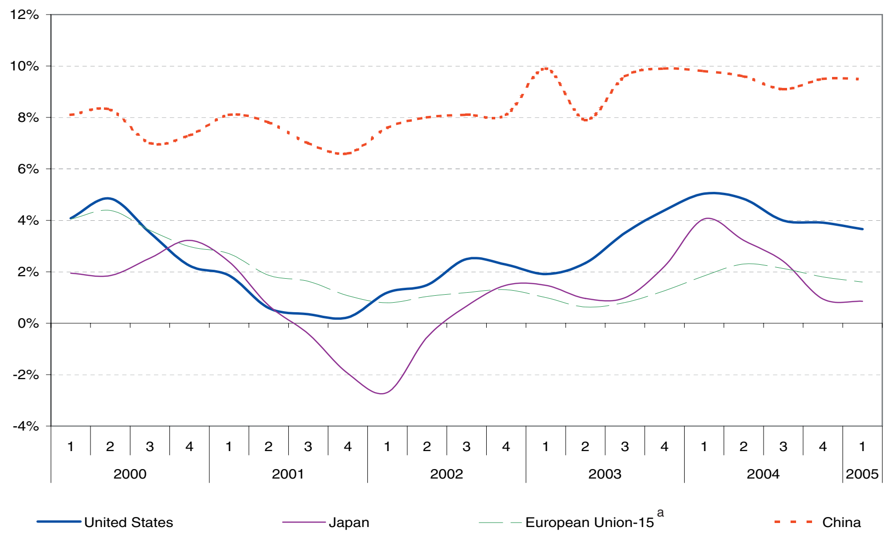
[b] Estimates.

[c] Projections.

Figure II.2

QUARTERLY REAL GDP GROWTH IN THE MAIN ECONOMIES, 2000-2005

(Quarterly year-on-year growth rates)



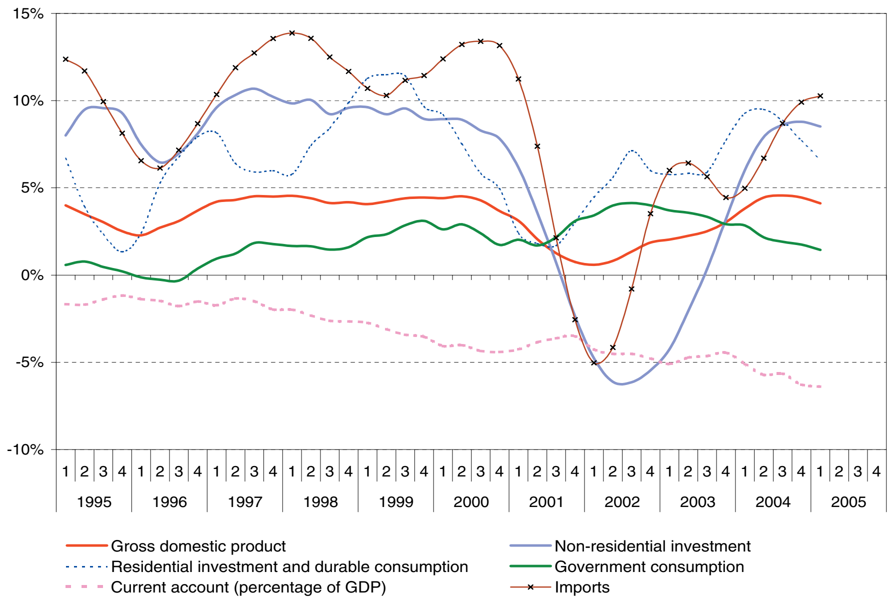
Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of figures from the United States Bureau of Economic Analysis, the Organisation for Economic Co-operation and Development (OECD), the Statistical Office of the European Communities (EUROSTAT), the Economic and Social Research Institute of Japan and the National Bureau of Statistics of the People's Republic of China.

[a] In 2000 prices and aggregated in dollars with purchasing power parities from 2000.

Figure II.3

UNITED STATES: BREAKDOWN OF BUSINESS CYCLE, 1995-2005

(Annual moving average of quarterly year-on-year rates of variation)



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of figures from the United States Bureau of Economic Analysis.

the Federal Reserve began to increase the interest rate. Consumption of non-durable goods and non-residential investment have remained relatively buoyant, however, leading to annualized GDP growth of 3.8% in the first quarter of 2005. The projections for the year overall indicate a growth rate of around 3.2%.[2]

Two salient features of recent economic conditions in the United States warrant examination. First is the government's loose monetary policy stance, which has had only a weak effect on core inflation, but a strong impact on residential property prices, which climbed by 10.9% in 2004 and 12.5% in the first quarter of 2005. This has been the driver of the wealth effect sustaining non-durable consumption and residential investment, but has also created a property bubble which, if it were to burst, would have a negative impact on the financial system and future consumption patterns. Second, the rise in the Federal Reserve interest rate has not induced a similar trend in long-term rates, due to a shift in portfolio composition in favour of long-term bonds. This shift may be attributable to high levels of liquidity and uncertainty over profitable investment alternatives fuelled by mixed trends in real variables, the petroleum price hike and a sluggish and volatile stock market. Low long-term interest rates may also be suggestive of lower growth in the future.[3]

Economic expansion in the United States has boosted its demand for imports, which has been met by various countries and by China in particular. In addition to stimulating trade, the countercyclical policy of the United States has had an indirect effect on investment in China, which increased for the second year running (by almost 20%). Low interest rates in the United States have created leeway for capital arbitrage and this, together with expectations of an appreciation of the yuan, has attracted considerable financial resources into China. Added to this are considerable income from foreign direct investment and the positive current account balance; both generated further pressures to raise the value of the currency, which the authorities contained by means of massive purchase of dollars. This situation has resulted in strong credit expansion reflected, in turn, in the phenomenon of overinvestment currently in evidence.

With a limited range of instruments to hand and faced with the threat that this process could suddenly stall, the authorities imposed administrative controls on credit and, once the Federal Reserve had shifted to a tighter stance, raised the interest rate slightly. It will be recalled that the

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2 See L.R. Klein y S. Ozmucur, "Weekly update on the U.S. economy and financial markets" [online] 20 June, 2005 <http://www.chass.utoronto.ca/link/uscqm/>.

3 See *Remarks by Chairman Alan Greenspan to the International Monetary Conference*, Beijing, 6 June 2005 and T. Wu, "The long-term interest rate conundrum: not unraveled yet?", *FRBSF Economic Letter*, 29 April 2005.

policy of maintaining a fixed exchange rate, as China did until recently, leads to official purchases of dollar-denominated assets, in other words, the “recycling” of the positive current and financial account balances to cover the United States deficit, thus helping to keep interest rates low in that country.

In China, indicators for the first part of 2005 show a pattern that differs from the gradual cooling of the economy that had been predicted. Although the authorities project a growth rate of 8% in 2005, GDP grew by 9.5% in the first semester (the same rate as in 2004). Nominal investment increased by 25.4% which, although high, was lower than the rate of 37.5% recorded in the same period of 2003. In contrast, imports slowed considerably during the first semester of 2005, with a growth rate of 14.3% compared with 37.2% in 2004. This is a very important indicator, since China’s imports (along with those of the United States) have strengthened the external sector of several other countries by boosting volumes and prices, especially as regards commodities. Notwithstanding the significance of the change in the exchange rate regime and the revaluation of the yuan in July 2005, it would be premature to draw conclusions about the effects of those measures on external trade and world financial flows (see box on this topic).

Imports by China were a key factor in Japan’s 2.6% growth rate in 2004, which compares with a rate of 1.4% in 2003, according to the latest revision. Exports were the determining factor in this expansion, although consumption and non-residential investment were also up. In the second half of the year, the Japanese economy’s activity slowed as exports lost momentum then, in the first quarter of 2005, GDP rose steeply (annualized rate of 4.9%) owing mainly to accumulation of stocks, which combined with the downturn in exports. Economic activity is expected to slow over the rest of the year.[4] Deflation and credit contraction continued to beleaguer the economy in 2004, while a slightly contractionary fiscal stance is expected in 2005. Economic growth could reach 1.6% this year, providing that non-residential investment rises and exports increase moderately.

The European Union (aggregate figures for 15 countries) recorded growth of 2.0% in 2004 (mostly occurring in the second quarter), which was a much higher rate than the 0.9% seen in 2003. Like in Japan, growth in this group of countries was buoyed by exports (5.5%) and a reactivation of investment (2.6%), which had contracted by a cumulative 0.7% over the previous three years. The first quarter of 2005 posted an annualized rate of 2.1%, but this growth was due mainly to increased external demand; Italy and the Netherlands are experiencing a recession, and, in general, domestic demand is low and unemployment high. In contrast to the United States, weak countercyclical policies have hampered a stronger recovery. The recently revised Stability and Growth Pact has thus far prevented the adoption of a more active fiscal stance, although monetary policy has been relatively loose. Whereas the appreciation of the euro in 2004 may have had a somewhat contractionary effect, its weakening in 2005 could provide a boost to exports. High petroleum prices and the political flurry over the outcome of consultations over approval of the European Constitution have left the economy highly sensitive to international market developments; in fact, projections indicate growth of around 1.5% in 2005.

The striking and unexpected increase in demand during 2004, especially in the United States and China, was the main cause of the high price of petroleum, which climbed by around 31% over the year (see figure II.4). Although supply also expanded, several links in the petroleum production chain were pushed near to full capacity, thereby making prices highly volatile and vulnerable to supply disruptions and geopolitical turbulence. Although oil prices dropped in response to a drop in demand at the end of the year, supply problems at the beginning of 2005 prompted a fresh hike, resulting in an increase of almost 40% in the first six months. Thus far these price hikes have had a relatively limited impact on activity levels and inflation, although a number of small and highly vulnerable economies have been badly affected.

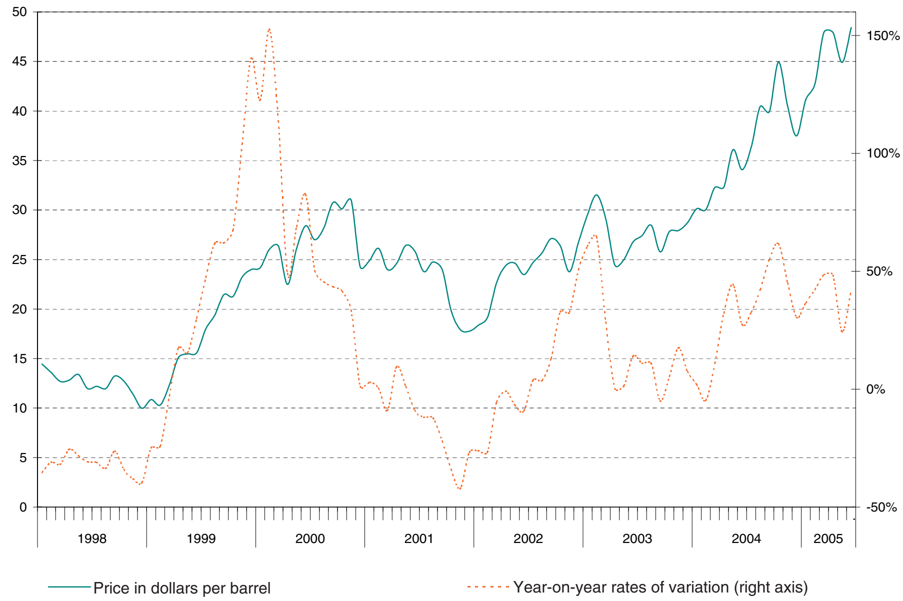
Although the global economy has recovered in a relatively orderly fashion from the recession of 2001, uncertainty and risks remain on the horizon. First, it is not clear how the disequilibria in the United States economy are to be evened out, or what the effects of the economic policy shift in process will be. The resulting uncertainty means that the possibility of an economic contraction in the United States cannot be ruled out. Second, the boom in investment in China could usher in a period of low growth that would hurt the buoyancy of world trade. Third, although high petroleum prices have had a limited impact on growth and investment thus far, further rises could slow the momentum of global economy activity. Fourth, mounting property speculation in a number of developed countries and in China poses risks to the financial system and, were it to fall off sharply, could neutralize the wealth effect that has sustained much of the growth seen in recent years, especially in the United States. Lastly, trade imbalances have begun to create protectionist pressures, which could undermine the current vigour of world trade.

[4] See Yoshihisa Inada, *Konan University Current Quarter Model Forecast for the Japanese Economy*, No. 561 and 585 [online] 23 May and 20 June, 2005 <http://www.chass.utoronto.ca/link/japancqm/>.

Figure II.4

MONTHLY PETROLEUM PRICES, JANUARY 1998-JUNE 2005

(Dollars per barrel and monthly year-on-year rates of variation) [a]



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

[a] World average, weighted by export volume.

Box II.1

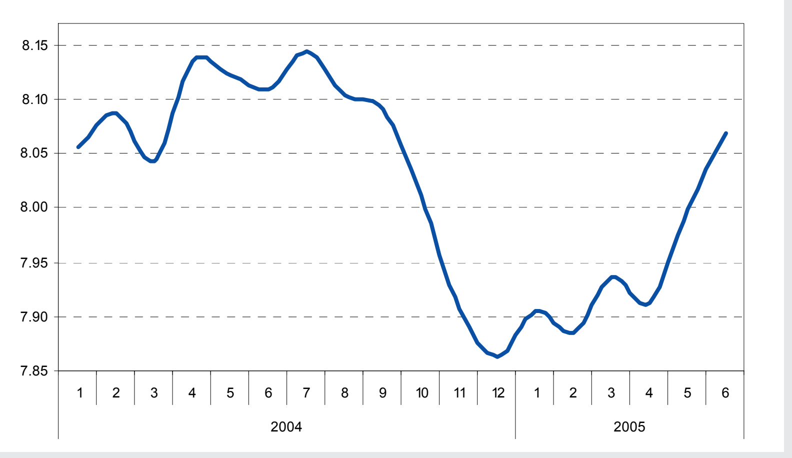
FLEXIBILIZATION OF THE YUAN EXCHANGE RATE

On 21 July 2005, the People's Bank of China changed the exchange-rate regime that had been in place in the People's Republic of China since early 1994. The fixed exchange rate of 8.28 yuan to the dollar (with a 0.3% trading band) was replaced with a "managed floating exchange-rate regime" in which the price of the yuan is linked to the movements of a currency basket. At the end of each day, the central bank will announce the following day's central parity against the dollar, around which the previous 0.3% trading band will be maintained. China's currency appreciated by around 2% after the central bank announced the reform, which brought the initial exchange rate under the new scheme to 8.11 yuan to the dollar. The reform was intended to make the foreign exchange market more flexible and may be a response to pressure on China from the developed countries and from international agencies to let the value of its currency rise.

Although the composition of the basket of currencies against which the yuan will fluctuate is not known, the evolution of China's currency may be analysed using suppositions that would have been plausible had this measure been taken at the start of 2004. The figure shows the trajectory the yuan would have followed between January 2004 and June 2005 had the exchange rate been set against a basket of currencies consisting of the dollar, the yen, the euro and the won, weighted by those currencies' shares in China's external trade in 2003. In this simulation, the exchange rate at the end of June 2005 would have been 8.07 yuan to the dollar, which is very close to the value set by the People's Bank of China in July. Although at first the Chinese currency would have appreciated strongly from the level of 8.28, continuing to rise throughout 2004 to reach 7.86 yuan to the dollar in December (an appreciation of 5% with respect to its initial value), in 2005 there would have been a depreciation caused by the strengthening of the dollar in relation to the yen and the euro. This suggests that China could maintain its competitiveness under the new scheme, given the new conditions in the world's foreign-exchange markets.

Box II.1 (concluded)

CHINA: HYPOTHETICAL TRAJECTORY OF THE YUAN AGAINST THE DOLLAR, 2004-2005 [a]



[a] On the supposition of the yuan's being pegged to a currency basket consisting of the dollar, the yen, the euro and the won, with fixed weightings based on 2003. Appreciations and depreciations are represented by negative and positive movements of the curve, respectively.

2. Effects of world growth on Latin American and Caribbean exports

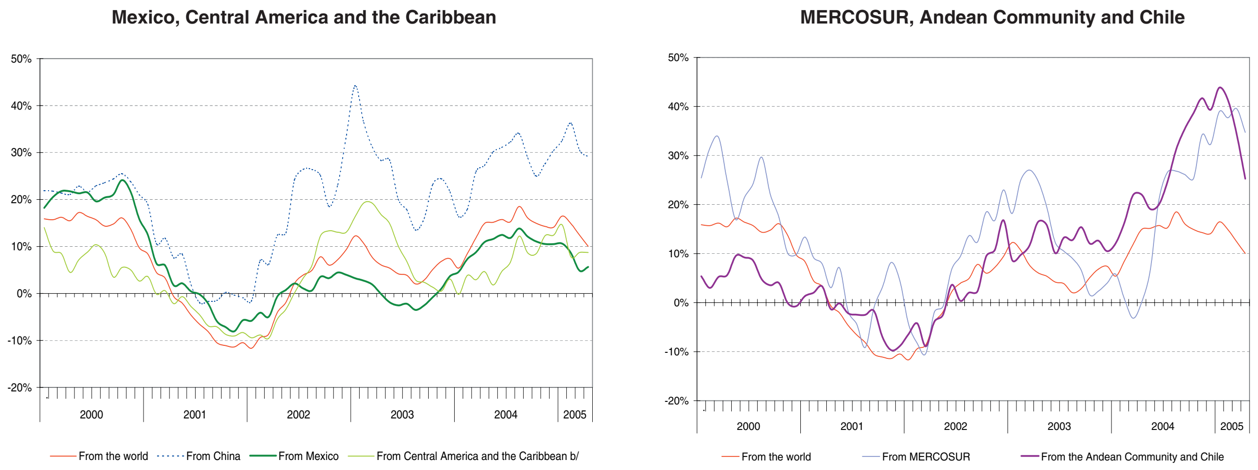
Imports by the United States and China have played an important part in passing on the benefits of world expansion to Latin America and the Caribbean. The United States' imports were highly elastic with respect to GDP variation in 2004, which favoured Latin America and the Caribbean (see figure II.5). In 2004, non-petroleum imports from the region to the United States increased by 11.9% (and by 13.2% during the first four months of 2005). This growth came in slightly below the world totals, which were 13.7% for 2004 and 13.5% for the first four months of 2005. A distinction must be made, however, between the subregions in this regard. Expansion in United States imports from Mexico, Central America and the Caribbean was significant but below the world average, while the expansion in exports from Chile and the MERCOSUR and Andean Community countries to the United States not only exceeded the world average but posted rates quite similar to those recorded by China. Mexico, Central America and the Caribbean have continued to lose market share in the United States. Excluding petroleum, Mexico's market share went down from 11.1% in 2003 to 10.5% at the beginning of 2005, Central America's share in total United States imports dropped from 1.8% to 1.6%, and Costa Rica, El Salvador and the Dominican Republic turned in a lacklustre performance in this market. The figures for the Andean Community and Chile (26.9% in 2004) were strongly influenced by price rises for a few commodities (copper, coal, gold and coffee). In the case of MERCOSUR (16.9%), Brazil accounted for 83% of overall growth, with sharp rises in certain commodities, industrial inputs and aircraft. Increased meat exports from Uruguay and Argentina also contributed to the expansion of exports from this group.

Chinese imports from Latin America and the Caribbean rose by 45.9% in 2004 (79.1% in 2003), and the region now represents 3.9% of China's total imports (compared with 2.8% in 2002 and 3.6% in 2003). The largest overall surge in China's total exports occurred in April, with smaller rises thereafter. This had a direct effect on the prices of certain commodities, including metals and soybeans (see figure II.6). Towards mid-2005, Chinese imports were growing at a year-on-year rate of almost 16%.

Figure II.5

UNITED STATES: NON-PETROLEUM IMPORTS, JANUARY 2000-APRIL 2005

(Monthly year-on-year growth rates) [a]



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of figures from the International Trade Commission of the United States (USITC).

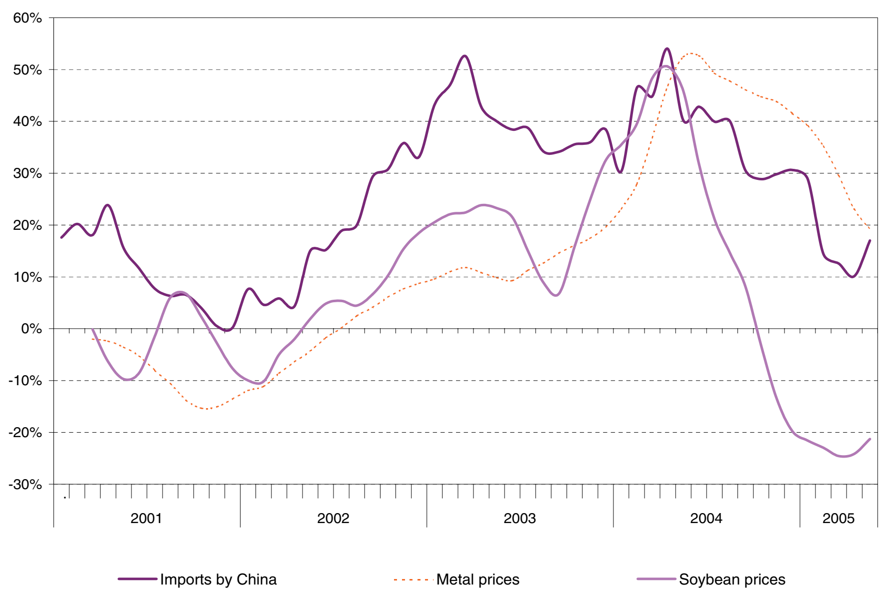
[a] Three-month moving average of the respective series, seasonally adjusted.

[b] Bahamas, Barbados, Belize, Costa Rica, Dominican Republic, El Salvador, Guatemala, Haiti, Honduras, Jamaica, Nicaragua, Panama and Trinidad and Tobago.

Figure II.6

MONTHLY IMPORTS BY CHINA AND SELECTED COMMODITY PRICES, JANUARY 2001-MAY 2005

(Three-month moving average of monthly year-on-year rates of variation)



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of customs statistics from the People's Republic of China and other official agencies.

Box II.2

FREE TRADE AGREEMENT: UNITED STATES, CENTRAL AMERICA AND THE DOMINICAN REPUBLIC

On 28 July, the Chamber of Representatives of the United States approved by a narrow margin a Free Trade Agreement with Central America and the Dominican Republic. The Agreement, which was negotiated in 2003, was signed by the governments in August 2004 and had been ratified by the United States Senate and the parliaments of El Salvador, Guatemala and Honduras. It remains to be approved by the legislatures of Costa Rica, the Dominican Republic and Nicaragua, which may occur before the end of the year.

This trade arrangement represents a new stage in process of trade liberalization, attraction of foreign investment and export promotion embarked upon by the Central American and some Caribbean countries two decades ago. A series of trade preferences had already been granted under the Caribbean Basin Initiative implemented by the United States in 1984, which provided a boost to exports and fuelled foreign direct investment. The Initiative was broadened in 2000 to compensate for these countries' loss of comparative advantage in relation to Mexico after the signature of the North American Free Trade Agreement.

Regarding access to the United States market, the new Agreement establishes free trade conditions for the vast majority of the goods produced by the other signatory countries, with the exception of small group that includes, prominently, beef, dairy products, ethanol and sugar. The duty free quota already applicable to sugar is raised considerably, while tariffs on the other products will be reduced gradually.

The Agreement established two categories of access for United States products to markets in Central America and the Dominican Republic. Goods not produced in the subregion (representing almost 70% of all tariffs) will enjoy free trade provisions with immediate effect. Goods produced in the subregion will be subject to a system of progressive tariff reduction with a horizon of 5 to 10 years for industrial goods, and 10 to 20 years for agricultural products. Quotas, grace periods and safeguards may be applied to some particularly sensitive agricultural goods. The Agreement also envisages the liberalization of trade in services, with the exception, in the case of Costa Rica, of insurance and telecoms, although the country has committed to liberalize some segments of these in due course. National treatment is to be extended to other parties in public tenders, and international provisions on intellectual property and the countries' labour and environmental legislation are to be respected.

Since the economies partnering the United States in this Agreement were already fully engaged in a process of liberalization, it will involve legal consolidation more than a change in the rules. For this very reason, the resulting export growth will probably not be so explosive as in other cases, such as when Mexico signed a free trade arrangement with the United States and Canada. The Agreement may help, however, to stem the loss of market share the signatories have experienced in the United States due to China's growing predominance there. For the textile sector, which produces a high percentage of most of these countries' exports, the Agreement is in fact a strategic instrument in the competition with Chinese goods.

3. Commodity prices

In 2004, the price index for commodities exported by Latin America and the Caribbean rose by an unusually high 29.4%, which was very similar to the figure that excludes energy products (petroleum and petroleum products, coal and gas) (see table II.1). This outcome was strongly influenced by minerals and metals, which account for 55.8% of the increase, and energy products, which represent a further 30%. Oilseeds, particularly soybeans and soy products, recorded more modest increases than in 2003 and therefore accounted for far less of the overall rise.

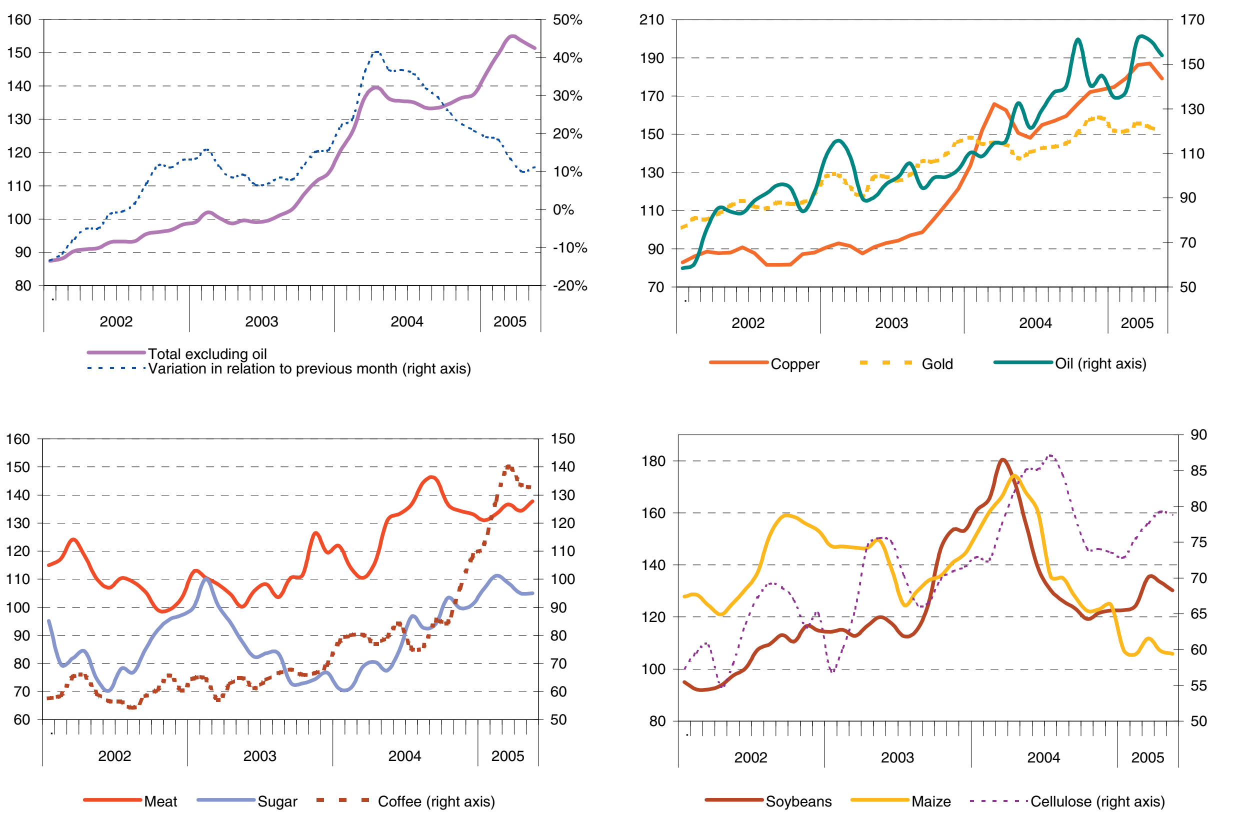
In the first five months of 2005, the overall rise was 18% which, though high, was well below last year's figure and showed drastic changes in the contributions of the components. While the effect of oilseeds and industrial raw materials turned negative, the positive contribution of food and beverages prices increased. Energy products, on the other hand, have higher growth rates than in 2004, while metals and minerals continue to contribute significantly to rises in the index. The current upward trend emerged in the second half of 2003 and carried over into the first four months of 2004 (see figure II.7), after which the year-on-year growth rates started to slow. Between April 2004 and May 2005, the 12-month growth rate (not including petroleum and petroleum products) slipped from 40% to 11%, laying to rest the phase of explosive price increases that had begun at the end of 2003.

Table II.1
LATIN AMERICA AND THE CARIBBEAN: EXPORT COMMODITY PRICES, JANUARY 2002-MAY 2005 [a]
(Percentages)

	2003		2004		First 5 months of 2005	
	Growth rate	Contribution	Growth rate	Contribution	Growth rate	Contribution
Total	**13.8**	**100.0**	**29.4**	**100.0**	**18.0**	**100.0**
Energy products	22.3	46.0	28.8	30.0	33.2	43.3
Non-energy products	10.5	54.0	29.7	70.0	14.3	56.7
Food	-6.1	-5.0	12.4	4.0	12.2	5.8
Beverages	6.9	1.8	25.1	2.9	59.5	10.7
Oilseeds	19.0	13.7	14.2	5.1	-21.0	-12.9
Industrial raw materials	9.3	6.3	7.6	2.3	-4.8	-2.1
Minerals and metals	13.9	37.2	44.2	55.8	24.4	55.3

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.
[a] Percentage variations in the price index of commodities exported by Latin America and the Caribbean, weighted by the proportion of each product in the region's exports for 2000.

Figure II.7
LATIN AMERICA AND THE CARIBBEAN: SELECTED EXPORT COMMODITY PRICES, JANUARY 2002-MAY 2005
(Index 2000=100) [a]



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of figures from official agencies.
[a] Indices weighted by the share of each product in the region's total exports in 2000.

Three patterns of price behaviour may be distinguished in the 2004-2005 period. First, the prices of some products (such as petroleum, copper and gold) have been rising significantly for a number of years now. The markets for these goods are tight and new investments attracted by the price increases have yet to mature. The petroleum industry faced an unexpected surge in demand, leading to a reduction in spare capacity that made it vulnerable to supply disruptions and geopolitical events. Demand from China, which expanded by 40% in 2004, and economic growth in the United States were the main contributing factors in this situation. Demand for copper climbed by 7.6% in 2004, whereas production expanded only 6.2%. This pattern has continued into 2005, generating further price hikes. The demand for metals is partly due to financial considerations, given that some metals function as a store of value.

The second group includes products (including some food and beverages) whose prices began to rise in mid- to late 2003 which, together with the prolonged climb in metals prices, provided a fresh boost to the index in the first part of 2005. In the case of the coffee sector, the withdrawal of many producers, following a long period of low prices, began to impact on prices in 2004. Output for the period 2004-2005 was estimated to be 2.5% lower than during the previous biennium, while demand soared. In March 2005 this market began to lose stability again, however. Meat prices have climbed in response to sanitary problems in the United States and Canada.

Lastly, the third group consists of products, including soybean and maize, whose prices dropped in 2004. The markets for these products are saturated, especially for soybeans, whose 2004-2005 harvest that was almost 15% larger than the previous year despite drought losses in Brazil (although this did boost prices slightly in early 2005).

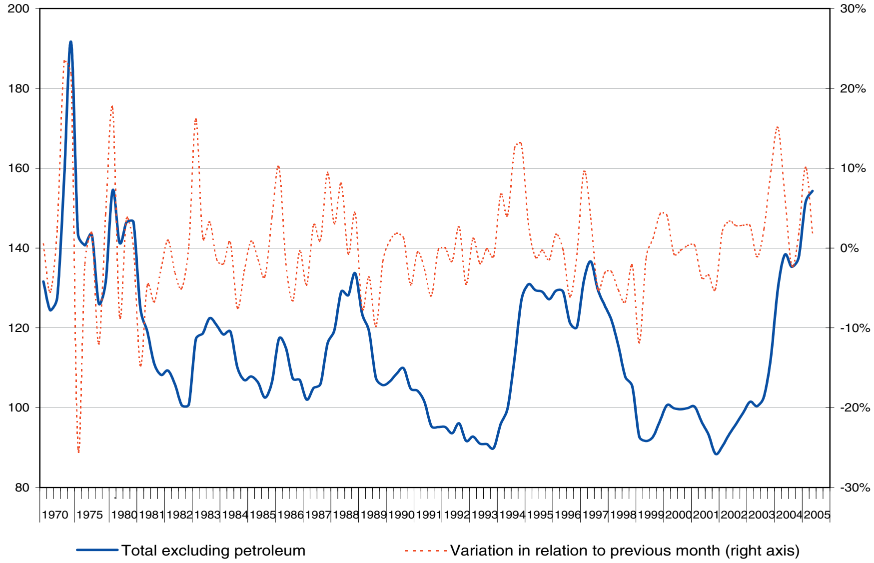
A long-term comparison (1970-2005) of non-petroleum commodity price trends shows the index for the first quarter of 2005 at a similar nominal level to early 1980 (see figure II.8). If the current bullish trend is fixed at the start of 2002, it has now run for 13 quarters with an average growth rate of 4.2%. This is the longest stretch of growth in the entire period, and may be related to a new factor of demand from China and other Asian countries.

Using United States GDP as a deflator, the purchasing power of aggregate prices in the first quarter of 2005 was only 47% of what it had been in the first quarter of 1980. Calculated in terms of special drawing rights, purchasing power was only 81% of the figure for that period. In the light of this long-term comparison, the current bullish commodity markets could hardly make up for the loss of purchasing power of the region's export commodities measured not in relation to the dollar, but either directly in terms of a basket of goods or indirectly with reference to a basket of currencies.

Figure II.8

LATIN AMERICA AND THE CARIBBEAN: PRICE TRENDS FOR NON-PETROLEUM COMMODITY EXPORTS, 1970-2005

(Index 2000=100) [a]



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

[a] Current prices. From 1980 onwards, refers to spliced data series taking 1995 and 2000 as base years; for 1970-1980, annual rates of variation back-extrapolated from the rates given in José Antonio Ocampo and María Ángela Parra, "The terms of trade for commodities in the twentieth century", *CEPAL Review*, No. 79 (LC/G.2200-P), Santiago, Chile, Economic Commission for Latin America and the Caribbean (ECLAC), April 2003. Figures for the second quarter of 2005 refer to April and May only.

B. The region

1. Balance of payments

In 2004 the region posted a surplus on the balance-of-payments current account for the second year in a row, this time amounting to US$ 18 billion, or the equivalent of 0.9% of regional GDP (see table II.2). As for the other main components of the balance of payments, the capital and financial account (including errors and omissions) yielded a deficit of around US$ 5.65 billion, bringing the overall balance to a surplus of US$ 12.35 billion, in addition to compensatory financing of US$ 8.8 billion. The counterweight to these figures was an increase in reserve assets to the tune of US$ 21.1 billion (equivalent to 1.1% of GDP). This hefty increase in reserves reflected the trend seen in other regions, particularly Asia, although it was still below the figure of almost US$ 30 billion recorded in 2003.

The positive balance on the current account reflected surpluses in the merchandise trade account (3.0% of GDP) and in current transfers (2.1% of GDP). These accounts combined registered net credits of US$ 99.4 billion, while the services trade and income accounts showed net debits of US$ 81.5 billion, with US$ 66.8 billion or 3.4% of GDP corresponding to payments of profits, dividends and interest. This is the third consecutive year that the region has achieved a positive balance in the merchandise trade account and the first year in which it has recorded a considerable expansion in total trade. The growth in

Table II.2

LATIN AMERICA AND THE CARIBBEAN: BALANCE OF PAYMENTS [a]

(Billions of dollars)

	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004 [b]
Current account balance	-37.8	-38.6	-64.4	-88.2	-54.9	-46.6	-51.4	-13.5	7.9	18.0
Merchandise trade balance	3.2	5.2	-13.1	-35.0	-6.8	3.5	-3.8	24.0	44.1	58.2
Exports, f.o.b.	229.4	257.4	286.7	283.4	299.4	359.1	343.3	346.8	377.3	463.3
Imports, f.o.b.	226.2	252.2	299.8	318.4	306.2	355.6	347.2	322.8	333.2	405.4
Services trade balance	-15.5	-15.9	-19.0	-19.0	-17.2	-17.1	-18.9	-14.1	-13.3	-14.6
Income balance	-40.8	-42.7	-47.7	-51.3	-50.3	-53.6	-53.8	-51.9	-57.8	-66.8
Net current transfers	15.2	14.8	15.4	17.0	19.4	20.6	25.2	28.5	34.9	41.2
Capital and financial balance [c]	29.3	63.9	89.2	63.4	42.6	61.2	34.2	-12.2	3.2	-5.6
Net foreign direct investment	25.8	40.3	57.6	63.7	79.3	68.9	65.1	41.4	31.7	43.9
Financial capital [d]	3.5	23.6	31.6	-0.3	-36.8	-7.7	-30.9	-53.6	-28.5	-49.6
Overall balance	-8.5	25.2	24.8	-24.8	-12.3	14.6	-17.2	-25.6	11.1	12.3
Variation in reserve assets [e]	-23.1	-26.1	-15.8	9.1	6.2	-6.9	1.0	3.2	-29.5	-21.1
Other financing	31.6	0.9	-9.0	15.7	6.1	-7.7	16.2	22.4	18.4	8.8

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.
[a] 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.
[b] Preliminary figures.
[c] Includes errors and omissions.
[d] Refers to the capital and financial account balance (including errors and omissions), minus net foreign direct investment.
[e] A minus sign (-) denotes an increase in reserves.

exports (22.9%) far exceeded the expansion observed in 2003 (8.8%), while imports surged (21.7%) to round off the recovery begun the previous year following the contraction recorded in 2002. A rise in import volumes, induced by the domestic economic recovery, was responsible for 14.5 percentage points of the overall growth rate in imports. Current transfers, mainly in the form of workers' remittances, remained buoyant during 2004, posting an upturn of US$ 6.4 billion (18.3%). The services trade balance deficit widened by 10.2% on account of higher transport costs, while the negative balance on the income account —the result of borrowing and foreign capital operations— expanded by 15.6%.

In 2004, foreign direct investment (FDI) rallied considerably, reflected in net inflows of US$ 43.9 billion, which was 38.4% higher than the US$ 31.7 billion recorded in 2003. The increase in FDI income was quite widespread across the region, encompassing several countries that had been hurt by the slump in this form of investment in 2003. Most of the countries that benefited from the rise in commodity prices recorded significant growth in these revenues. Gross FDI income increased at an even higher rate (49.5%), with the difference due mainly to a Brazilian merger operation. Net income from FDI, however, was more than offset by outflows of financial capital (sum of capital and financial balances plus errors and omissions, not including FDI), which amounted to US$ 49.6 billion (close to the high recorded in 2002). These outflows correspond partly to debt payments to non-residents and partly to external asset formation (i.e., capital outflows). Speaking in terms of the region as a whole, without entering into the situation of particular countries, the regional current account balance resulted in growth that was almost equivalent to international reserves, while net financing received (FDI, financial capital and other financing sources) was positive but very close to zero.

With the exception of Central America, the current account balance improved, although much of the surplus was attributable to MERCOSUR, particularly to Brazil, whose surplus accounted for 37% of the aggregate figure for all the countries to record positive current account balances. Although the surplus of the Andean Community and Chile is much reduced if it excludes the balance of the Bolivarian Republic of Venezuela (because of its petroleum exports), these countries nonetheless posted considerable improvements, apart from the Venezuelan contribution (see figure II.9). The balance-of-payments current account turned in a surplus in seven countries —Argentina, Bolivarian Republic of Venezuela (which has traditionally recorded a positive balance), Bolivia, Brazil, Chile, Dominican Republic and Paraguay— with a combined figure of US$ 31.6 billion (see figure II.10).

Peru's current account practically balanced out, with its deficit (together with that of Ecuador) narrowing considerably. The combined negative balance of the countries that ran deficits stood at US$ 13.7 billion. The situation of the Central American countries is somewhat delicate, since practically all of them registered deficits of over 4% of GDP for the second year running, due to the higher cost of their raw material and petroleum imports and a less buoyant export performance than that of the South American countries.

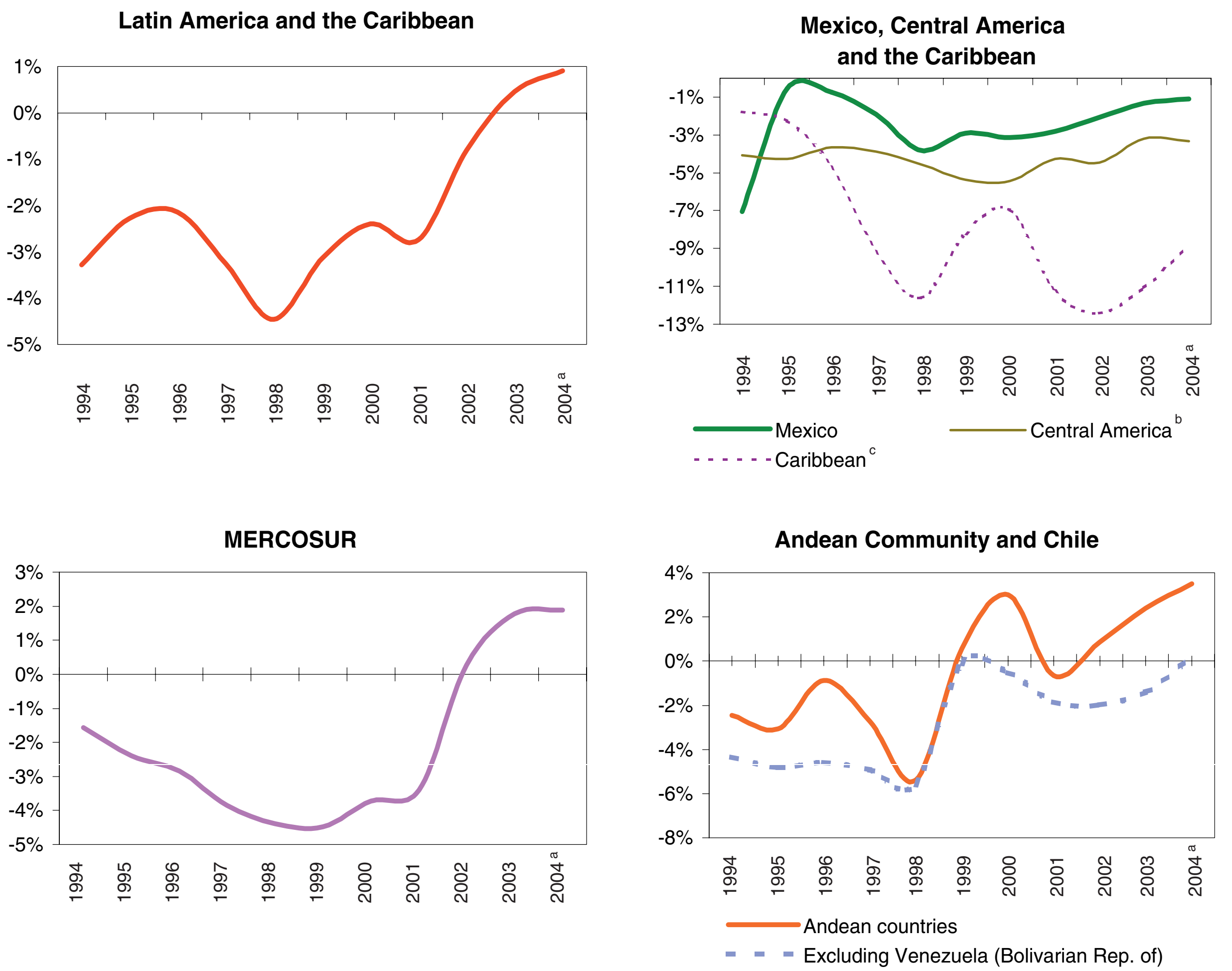
The current account deficit of the Caribbean countries (calculated as a simple average) narrowed from 11.1% of GDP in 2003 to 8.8% in 2004. With the exception of Barbados, this variable remained unchanged or improved throughout the subregion. In most cases, this was the result of an increase in current transfers and in exports of goods and services.

Judging from trends observed in the early months of the year, the region will again see a surplus on the balance-of-payments current account in 2005, this time of around 1% of GDP. Although imports are expanding more than in 2004, exports are also performing well, albeit slightly less buoyantly than last year due to the slower pace of world economic activity and less favourable market conditions for certain commodities.

Figure II.9

LATIN AMERICA AND THE CARIBBEAN: CURRENT ACCOUNT BALANCE TRENDS

(Percentages of GDP at current prices)



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

[a] Preliminary figures.

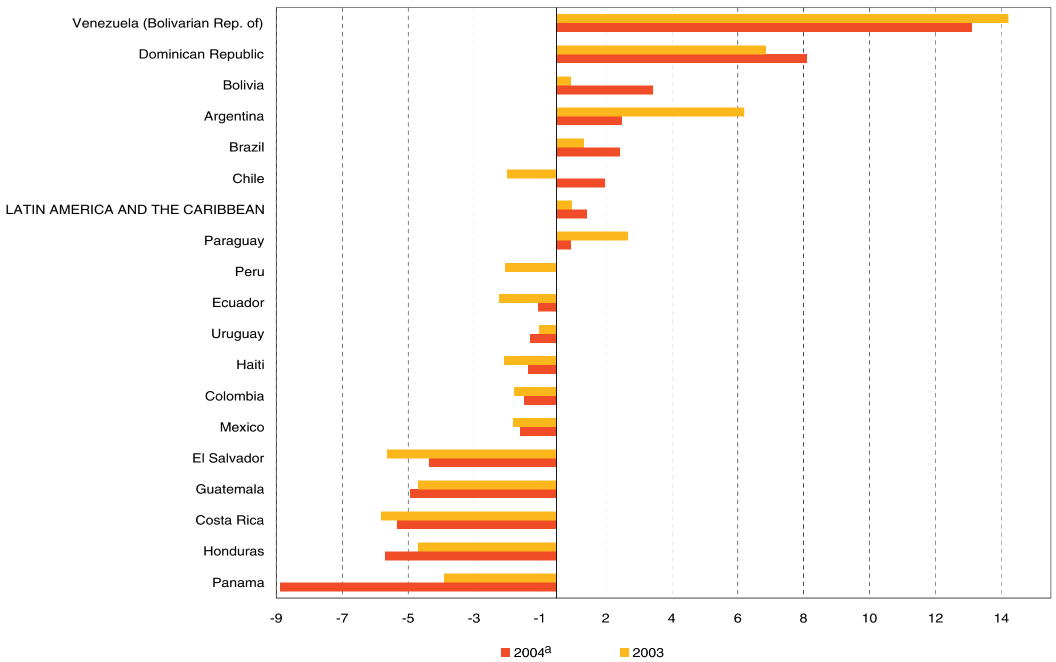
[b] Costa Rica, Dominican Republic, El Salvador, Guatemala, Haiti, Honduras, Nicaragua and Panama.

[c] Bahamas, Barbados, Belize, Guyana, Jamaica, Organisation of Eastern Caribbean States (OECS), Suriname and Trinidad and Tobago; simple average.

Figure II.10

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 and the International Monetary Fund (IMF).

[a] Preliminary figures.

2. Trade in goods and services

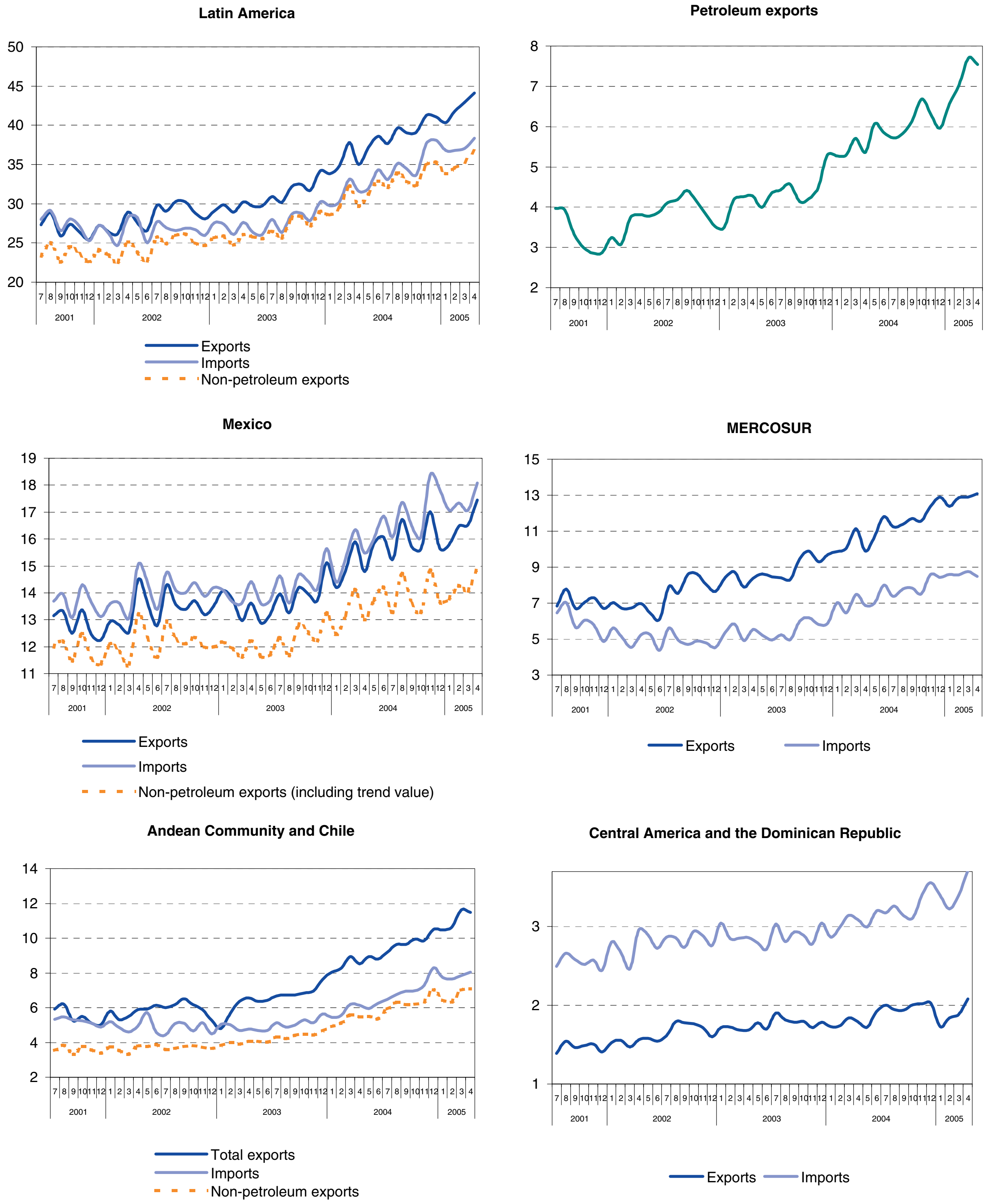
Merchandise trade in Latin America and the Caribbean has posted a surplus since 2002, reaching US$ 58.2 billion, or the equivalent of 3.0% of GDP, in 2004 (see figure II.11 and table II.3). The most striking feature of 2004 was that both imports and exports expanded at a faster rate than in 2003. Imports have been expanding on a par with exports since mid-2003, which marked the end of the downturn that began in early 2001. As a measure of the magnitude of the expansion in the region's external trade, in March 2005 exports and imports, respectively, were 40.0% and 17.6% higher than the level recorded in January 2001. Petroleum exports are a determining factor in the merchandise trade surplus, but in the last few years the region has been close to balancing its trade even independently of this effect. At the subregional level, there are marked differences between the situation in MERCOSUR and the Andean Community and Chile, on the one hand, and Mexico and Central America, on the other. As mentioned earlier, the South American economies have consistently been running surpluses, mainly thanks to strong markets for the commodities they supply. Non-petroleum exports from the Andean Community and Chile have performed particularly well. Mexico's non-petroleum exports posted a decided upturn between mid-2003 and mid-2004, at which point their growth slowed in step with trends in the United States economy. The trade balance of Central American and Caribbean countries deteriorated in the course of 2004 owing to relatively limited growth in exports and a significant rise in imports.

Growth in regional exports lost momentum in the first few months of 2005, although they continued to expand at a rate of 19.3%. This pattern was repeated in the great majority of South American countries, and was partly due to the use of stricter bases of comparison than

Figure II.11

LATIN AMERICA AND THE CARIBBEAN: MONTHLY TRENDS IN MERCHANDISE TRADE

(Billions of dollars; seasonally adjusted figures)



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

Table II.3
LATIN AMERICA AND THE CARIBBEAN: EXPORTS AND IMPORTS OF GOODS [a]
(Annual growth rates)

	2003		2004		2005 [b]	
	Exports	Imports	Exports	Imports	Exports	Imports
Total	**8.8**	**3.2**	**22.9**	**21.7**	**19.3**	**19.5**
Mexico	**2.3**	**1.1**	**14.1**	**15.4**	**10.9**	**12.9**
MERCOSUR	**19.3**	**10.4**	**27.6**	**36.6**	**22.2**	**23.0**
Argentina	15.3	54.8	16.5	61.5	14.8	32.7
Brazil	21.1	2.2	32.0	30.0	29.2	19.6
Paraguay [c]	17.1	14.6	24.4	27.2	-1.3	9.4
Uruguay	18.7	12.0	32.6	42.5	22.3	36.2
Andean Community and Chile	**11.0**	**2.6**	**39.4**	**29.8**	**29.5**	**34.5**
Bolivia	21.1	-9.3	35.3	15.7	21.5	23.6
Chile	18.4	14.0	48.8	27.8	23.4	35.2
Colombia	11.9	9.8	25.1	19.8	35.1	29.1
Ecuador	19.2	1.2	26.1	19.5	24.3	19.7
Peru	17.8	11.2	38.8	19.0	36.3	25.5
Venezuela (Bolivarian Rep. of)	1.5	-20.0	42.6	62.0	36.1	50.1
Central America and the Caribbean	**6.3**	**2.1**	**8.9**	**11.9**	**3.5**	**11.1**
Costa Rica	16.9	11.6	2.4	7.4	5.6	9.3
Dominican Republic [d]	5.9	-13.7	5.1	2.9	-2.9	26.2
El Salvador	4.4	11.1	5.6	9.6	6.7	7.3
Guatemala	8.5	6.6	12.1	16.4	13.7	8.3
Haiti [d]	21.4	13.8	13.4	6.2	28.1	44.8
Honduras	5.9	9.0	15.1	20.3	20.3	13.2
Nicaragua	9.9	7.6	21.6	17.5	13.2	26.3
Panama	-5.0	-3.0	16.6	21.2	…	…

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.
[a] Rates for 2003 and 2004 correspond to annual balance-of-payments data; rates for 2005 are preliminary monthly figures.
[b] January-April 2005 as compared with the same period of the preceding year.
[c] Includes recorded transactions only.
[d] Estimates for January to April 2005, on the basis of data on trade with the United States.

in 2004. A similar situation was seen in most Central American and Caribbean countries. Import growth, too, has slowed at the regional level, but largely reflects the situation in Mexico and MERCOSUR countries. Chile and the Andean Community, conversely, posted higher import growth rates than in 2004.

Manufacturing exports made a notable recovery in 2004, posting an expansion of 19.2% after a rate of only 0.6% in 2002 and 5.7% in 2003. This upward trend has continued into the first part of 2005 and has been fuelled mainly by the South American countries, while Mexico, Central America and the Caribbean rendered a mixed performance: the recovery of Mexican manufacturing exports has coincided with a slump in manufacturing and export activity in Costa Rica and the Dominican Republic. Although maquila exports from other countries in this subregion, including Nicaragua and Guatemala, have begun to pick up, this segment is still highly exposed to competition from China in labour-intensive goods, and this state of affairs has been exacerbated by the elimination of quotas provided under the Agreement on Textiles and Clothing in early 2005. In some cases, the Central American textile industry has focused on areas where it can withstand Chinese competition, mainly through shorter delivery times.

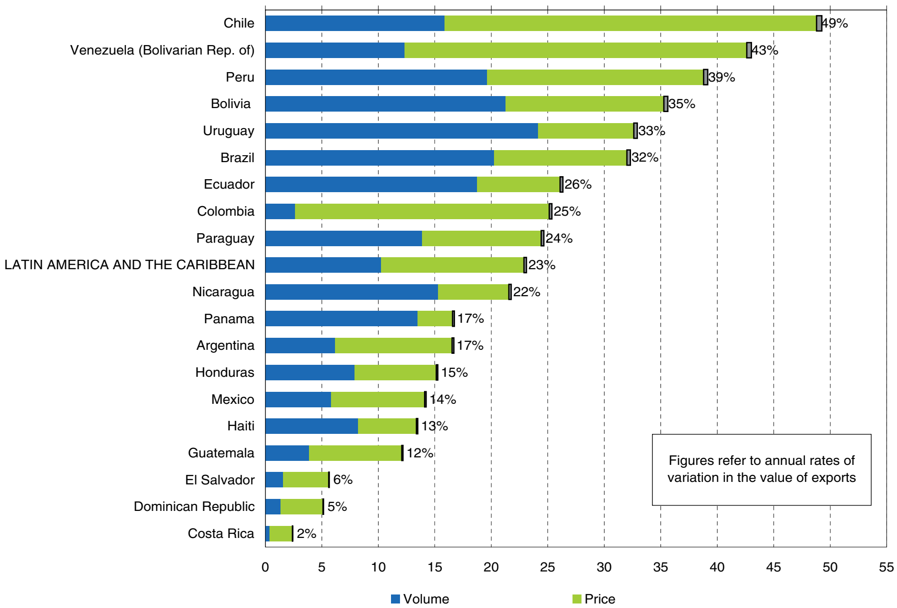
At the regional level, the effects of price and volume contributed in similar proportion to the expansion of exports, with the former contributing 12.0% and the latter, 9.7%. The price effect prevailed in several countries that benefited from the upturn in the commodity markets and in certain Central American and Caribbean countries that gained as a result of price increases for some traditional goods in the second half of the year. The strong climb in Brazil's external sales was mainly due to the effect of volumes, which was, in turn, attributable to the share of industrial goods in its export supply.

Trade in services swelled by 13.7% in 2004, largely as a result of higher freight and insurance charges for goods transport in the light of surging demand and fuel prices. The region paid out US$ 24.1 billion on transport, or 23% more than in 2003. Tourist revenues were up by 16.2%, while the sector's outflows climbed by 15.8%, pointing to a recovery of purchasing power in several economies.

After several years of sluggish activity, intraregional trade boomed in 2004 and reached record levels. Intraregional exports shot up by 33.8%, almost 11 points more than total exports, thus confirming this segment's procyclical slant. The sharpest increase was recorded in the Andean Community (58.5%) and MERCOSUR (36.2%), especially in manufactures, although the Andean Community's petroleum exports accounted for a large proportion of trade. Trade among the countries of the Central American Common Market increased by 11.8% and among the Caribbean Community (CARICOM) countries, by 16.0%. Intraregional trade (measured by the percentage of total exports going to other countries in the region) rose for the second year running, to 17.3%, although this still fell short of the record high in 1997, when it represented just over a fifth of all exports.

Figure II.12

LATIN AMERICA AND THE CARIBBEAN: MERCHANDISE EXPORTS (f.o.b.), BY UNIT PRICE AND VOLUME, 2004 [a]



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

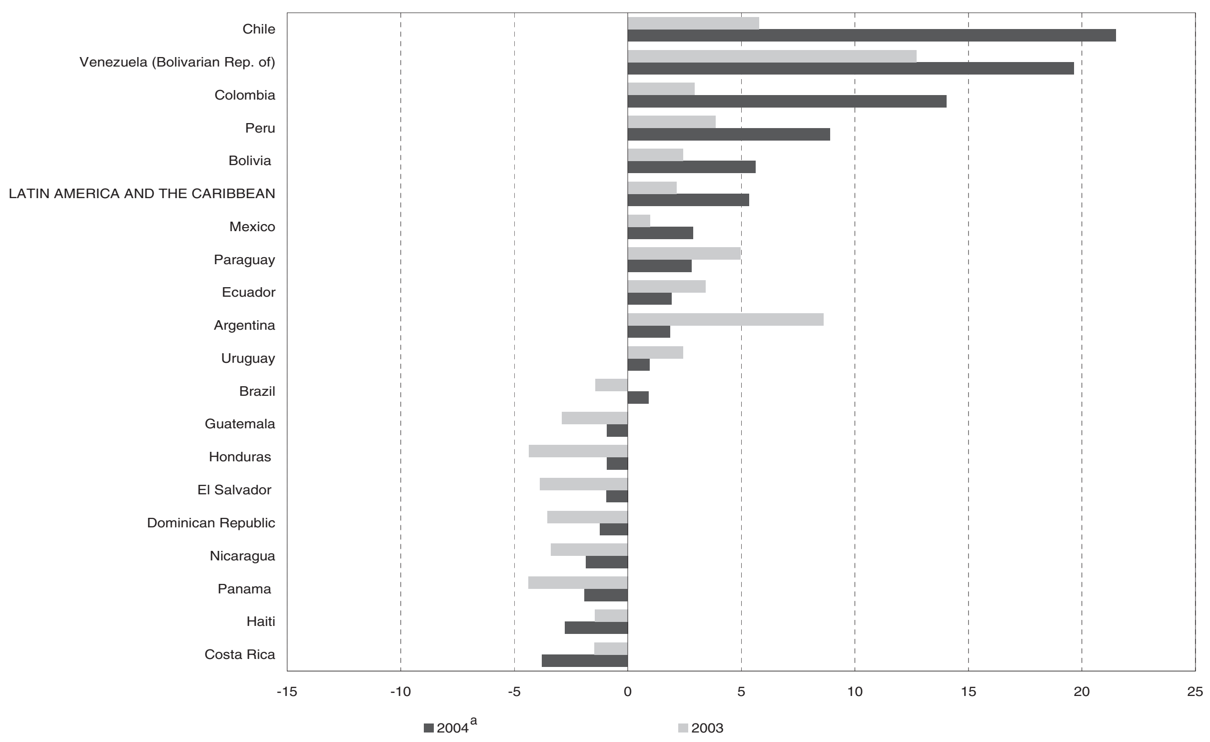
[a] Preliminary figures.

3. Terms of trade

The upward trend in the terms of trade strengthened in 2004, with a positive variation of 5.3%, which came on top of the 2.1% improvement in 2003 (see figure II.13).[5] This growth can be explained by a 12.0% rise in export prices as against a 6.3% increase in import prices. This had an effect equivalent to about US$ 24.2 billion (1.2% of regional GDP), which was greater than the variation in the merchandise trade account and the current account balance.

The prices of goods traded by the region have begun to reflect new trends emerging in markets for commodities and manufactures. China's incorporation into the world economy has had a strong impact on both sectors. On the one hand, China is having a deflationary effect on manufacturing markets due to its ability to supply manufactures at lower prices thanks to its labour-cost advantage. On the other, it has also become a major source of demand for commodities that are essential for

Figure II.13
LATIN AMERICA AND THE CARIBBEAN: TERMS OF TRADE
(Percentage variation, 2003 and 2004)



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

5 These variations in the terms of trade correspond to the new series of export and import prices which take 2000 as a base year.

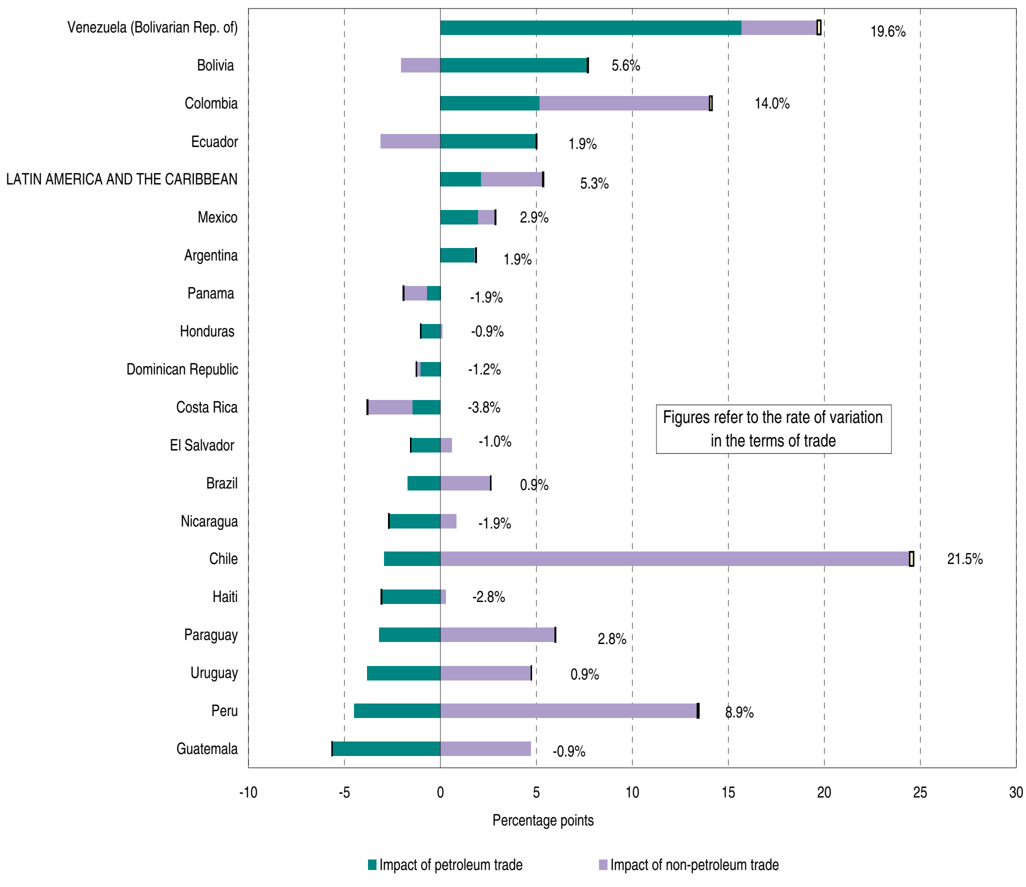
its rapid process of industrialization and for placing some of its manufactures on the international markets. If these trends continue, those countries in the region with large natural resource endowments could enjoy a long period of improvements in their terms of trade. Conversely, the structural changes occurring in the global market signify a bleaker outlook for countries that lack natural resources and are, moreover, competing with China in certain manufactures markets. The first of these groups consists of the South American countries, while the second comprises the Central American and Caribbean countries. Mexico is well placed as a petroleum exporter but not as an exporter of manufactures, in which the country has specialized.

The increase in petroleum prices has been particularly influential for regional terms of trade. Excluding the rise in petroleum prices, the terms-of-trade upturn in 2004 was 3.2%. Higher petroleum prices therefore account for 39.5% of the increase over the year (see figure II.14). The effect of oil prices differs greatly from one country to another. Chile and Peru are special cases, insofar as the rises in the prices of both countries' commodity exports easily outweighed the losses resulting from higher prices for petroleum (of which they are net importers). In a number of Central American and Caribbean countries, on the other hand, higher petroleum prices resulted in a worsening of terms of trade.

Figure II.14

LATIN AMERICA AND THE CARIBBEAN: CONTRIBUTION OF PETROLEUM AND NON-PETROLEUM PRICES TO VARIATION IN TERMS OF TRADE, 2004 [a]

(Rates of variation and percentage points)



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

4. Capital flows

In 2004 Latin America posted a surplus of close to US$ 18 billion, or the equivalent of 0.9% of regional output, on the balance-of-payments current account. This enabled the region to build up over US$ 21 billion (1.1% of GDP) in reserves, pay off of some of its external liabilities and refinance others under improved conditions. The region's accumulation of international reserves reflected the good performance of the current account and contributed, in part, to the financing of world disequilibria. The build-up of reserve assets was not limited to Latin America, however, as it was also seen in other emerging economies, particularly China. The current account surplus in 2005, of close to 1% of GDP, may be expected to go to similar ends: reduction of liabilities and build-up of reserve assets.

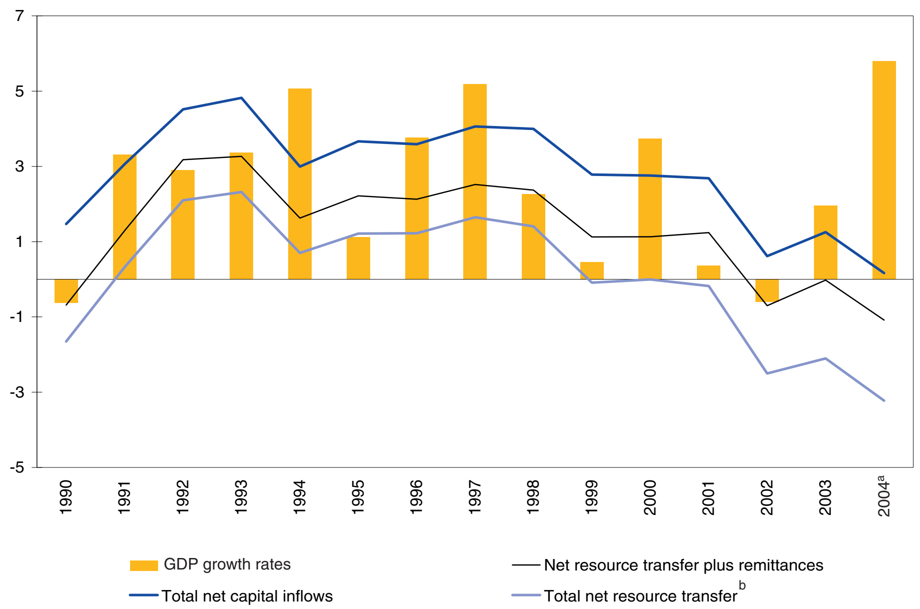
The region's external debt position improved in 2004, thanks to good growth indicators and efforts to place public finances on a sounder footing, as well as the international context of low interest rates. External debt decreased from the equivalent of 42.5% of GDP in the 33 countries of the region in December 2003 to 37.5% a year later. A number of countries' debt ratios were also improved by local currency appreciation, since much of their external commitments were dominated in dollars. The countries also took advantage of good interest rate conditions and lower spreads to lengthen maturities and issue debt in local currency.

Net inflows of foreign direct investment (FDI) came close to US$ 44 billion, representing 2.2% of regional GDP. FDI combined with debt cancellations (in the form of both bonds and loans), which represented 1.9% of output, translated into a net inward transfer of capital of US$ 3.2 billion, or the equivalent of 0.2% of GDP (see figure II.15).

Figure II.15

LATIN AMERICA: GDP GROWTH AND NET CAPITAL INFLOWS

(Percentages of GDP expressed in dollars at current prices)



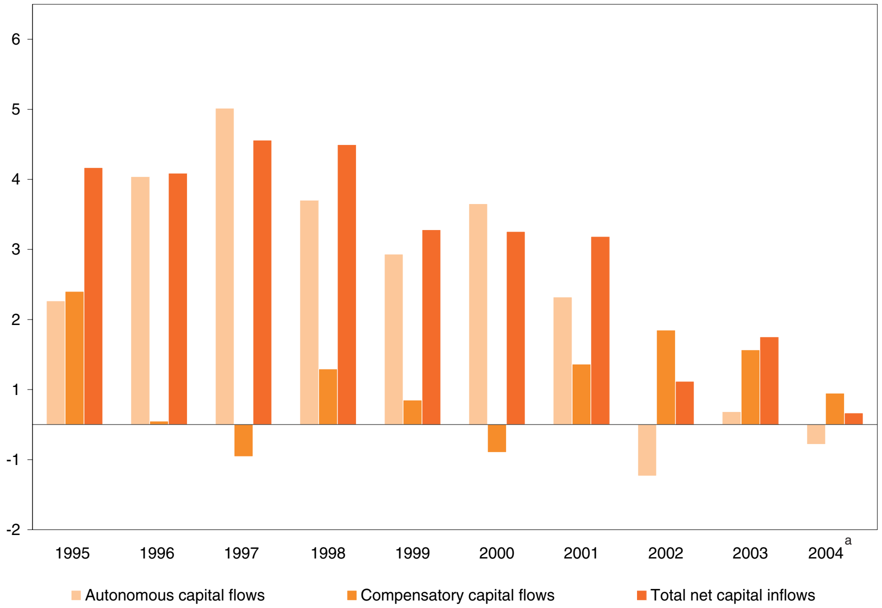
Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.

[a] Preliminary figures.

[b] Net resource transfer (NRT) equals net capital inflows minus the balance on the income account (net payments of profits and interest). Total net capital inflows equal the balance on the capital and financial account, plus errors and omissions, loans and use of IMF credit and exceptional financing. Negative figures indicate outward resource transfers.

Autonomous capital flows (capital account balance, FDI, portfolio investment, other capital, and errors and omissions) posted a deficit of US$ 5.6 billion (0.3% of GDP). Flows of compensatory capital, which include exceptional financing and the use of IMF credit, amounted to US$ 8.8 billion, or 0.5% of GDP. This figure represents a decline of 52% with respect to 2003 (see figure II.16).

Figure II.16
LATIN AMERICA: NET CAPITAL INFLOWS, BY COMPONENT
(Percentages of GDP in dollars at current prices)



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

The income balance turned in a deficit of US$ 67 billion, which was close to 3.4% of GDP. This deficit reflected interest payments in the amount of US$ 25.5 billion and remitted profits on direct investment, of US$ 29.5 billion. This last figure was 41% higher than the amount recorded in 2003 (US$ 21.5 billion) because of the strong upturn in the economies of the region.

The combination of net capital inflows of US$ 3.2 billion and a negative income balance translated into a net outward resource transfer of US$ 63.7 billion, or the equivalent of 3.3% of GDP (see figure II.17).[6]

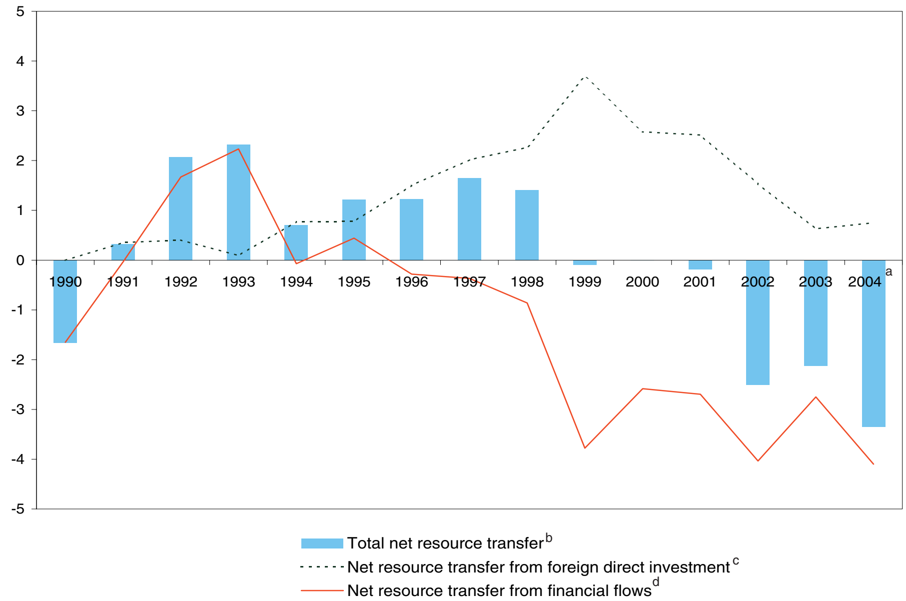
Including the increasing amount of emigrant remittances, which reached the record figure of US$ 42.25 billion in 2004, or 2.1% of regional GDP, the region received a total of US$ 45.5 billion in financing, well below the US$ 98 billion received in 1998.

[6] Net outward resource transfer was calculated using the traditional ECLAC methodology.

Figure II.17

LATIN AMERICA: NET RESOURCE TRANSFER, BY COMPONENT

(Percentages of GDP in dollars at current prices)



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

[a] Preliminary figures.

[b] Net resource transfer (NRT) equals net capital inflows minus the balance on the income account (net payments of profits and interest). Total net capital inflows equal the balance on the capital and financial account, plus errors and omissions, loans and use of IMF credit and exceptional financing. Negative figures indicate outward resource transfers.

[c] Equals net foreign direct investment (FDI) minus net profit remittances.

[d] Equals net inflows of capital other than FDI minus net interest payments.

5. Foreign direct investment

Net FDI displayed a variation of almost US$ 44 billion with respect to 2003. Inflows of FDI amounted to US$ 58 billion, which was 50% more than in 2003. However, the region received 25% of all FDI in emerging economies, in place of the 39% recorded in 2002. Also relevant is the fact that outflows of FDI rose to US$ 14 billion in 2004, which was virtually double the US$ 7 billion that left the region in 2003.

The overall variation in net FDI would be lower were it not for the purchase of shares in Mexico's BBVA-Bancomer by BBVA in a transaction worth US$ 4.6 billion. Geographically speaking, an analysis of the different trade blocs shows that FDI was more erratic in MERCOSUR in 1999-2004 than in Mexico, the Central American Common Market and the Andean Community. In fact, in MERCOSUR the coefficient of variation of FDI/GDP was 0.55 for the period, while in Mexico, the Central American Common Market and the Andean Community it was 0.30, 0.16 and 0.23, respectively. Chile was the country to receive the largest proportion of FDI in terms of gross output (8.2% in 2004). Despite the differences among the different blocs, FDI continues to be the region's main source of external financing and the most stable type of inflow, with the exception of remittances from workers living abroad. Remittances, which are not traditionally included in financial flows, but considered a category of current transfers, rose to US$ 42.25 billion in 2005, which was equivalent to 2.2% of GDP (see table II.4).

Table II.4

LATIN AMERICA AND THE CARIBBEAN: SOURCES OF EXTERNAL FINANCING, 1990-2004

(Percentages of GDP, calculated in dollars at current prices)

	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004 [a]
A. Debt	**0.7**	**1.4**	**2.8**	**2.7**	**0.7**	**2.1**	**0.9**	**0.7**	**1.4**	**-1.1**	**-0.9**	**-0.6**	**-1.2**	**-0.6**	**-1.9**
Loans [b]	-0.1	0.6	0.8	-1.2	-2.2	2.2	-0.7	0.0	-0.2	-1.8	-0.9	-0.1	-0.6	-0.5	-1.4
Other investment	-2.1	-0.4	0.3	-1.1	-2.6	0.4	-0.7	0.4	-1.0	-2.2	-0.5	-0.9	-1.9	-1.5	-1.8
Use of credit from the International Monetary Fund (IMF)	0.1	-0.1	-0.1	-0.1	-0.1	0.8	-0.1	-0.2	0.1	-0.1	-0.6	0.8	0.7	0.3	-0.3
Exceptional financing	1.9	1.1	0.7	-0.1	0.4	1.1	0.2	-0.3	0.7	0.4	0.2	0.0	0.6	0.8	0.8
Bonds	0.8	0.8	2.0	3.9	2.9	-0.1	1.5	0.8	1.6	0.8	0.0	-0.5	-0.6	-0.1	-0.5
B. Investment	**0.8**	**1.6**	**1.6**	**2.3**	**2.5**	**1.8**	**2.8**	**3.4**	**2.9**	**4.0**	**3.4**	**3.5**	**2.5**	**1.9**	**2.3**
Direct	0.6	1.0	1.0	0.7	1.5	1.5	2.2	2.9	3.2	4.5	3.5	3.4	2.4	1.8	2.2
Equities	0.2	0.6	0.6	1.5	1.0	0.2	0.6	0.6	-0.3	-0.5	-0.1	0.1	0.1	0.1	0.1
C. Other	**-0.1**	**0.1**	**0.0**	**-0.2**	**-0.3**	**-0.3**	**-0.1**	**-0.2**	**-0.3**	**-0.2**	**0.2**	**-0.5**	**-0.6**	**-0.1**	**-0.2**
Errors and omissions	-0.1	0.1	0.0	-0.2	-0.3	-0.3	-0.2	-0.2	-0.3	-0.2	0.2	-0.5	-0.7	-0.2	-0.3
Capital account	0.0	0.0	0.0	0.0	0.0	0.0	0.1	0.0	0.0	0.1	0.0	0.0	0.1	0.1	0.1
D. Workers' remittances	**1.0**	**1.0**	**1.1**	**0.9**	**0.9**	**1.0**	**0.9**	**0.9**	**1.0**	**1.2**	**1.1**	**1.4**	**1.8**	**2.1**	**2.1**
Total capital inflows (A+B+C)	**1.5**	**3.0**	**4.5**	**4.8**	**3.0**	**3.6**	**3.5**	**4.0**	**3.9**	**2.7**	**2.8**	**2.4**	**0.7**	**1.2**	**0.2**
Total capital inflows plus remittances (A+B+C+D)	**2.4**	**4.0**	**5.5**	**5.7**	**3.9**	**4.6**	**4.4**	**4.9**	**4.9**	**3.9**	**3.9**	**3.8**	**2.5**	**3.2**	**2.3**

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

[a] Preliminary figures.

[b] Includes loans from commercial banks, multilateral banks and the International Monetary Fund (IMF).

In the first quarter of 2005, in the nine countries for which data were available, net FDI amounted to US$ 7.7 billion, which was 48% less than the net inflows received by the region in the same period of 2004. Of this decline, 71%, or US$ 5.1 billion, corresponds to a downturn in net FDI inflows into Mexico.

6. External debt

At the end of 2004, the external debt balance of Latin America and the Caribbean stood at US$ 762.48 billion, of which 12% was short-term debt, 82% long-term debt and the remaining 6% was owed to IMF. This represented a significant improvement with respect to the composition of debt in the mid-1990s, when short-term debt represented around 20% of the total.

Apart from longer debt profiles, another important new development has been the growing participation of the private, with respect to the public, component of long-term debt. At the end of 2004, 69% of long-term debt was owed to private sources and 31%, to public ones, whereas at the end of 2000, public sources had accounted for 38% of the debt balance. In other words, the market has become more heavily engaged in new debt issues.

Box II.3

THE RESTRUCTURING OF ARGENTINA'S PUBLIC DEBT

At the end of 2001, the Government of Argentina announced the suspension of payments corresponding to debt instruments amounting to close to US$ 82 billion. In March 2005, it closed the exchange offer for new bonds, which was accepted by the holders of 76% of eligible securities and the exchange took place in June. As the outcome of a long and complex process, this restructuring differed from other comparable processes in the recent past insofar as: (i) the amount involved was much greater; (ii) the quantity of securities included in the exchange was also very high; (iii) the original bonds were subject to different legislative provisions; and (iv) unlike the other cases, the operation did not take place within the framework of a multi-year International Monetary Fund (IMF) programme. The long delay (40 months) between the declaration of suspension of payments and the exchange was matched by the substantive and formal complexity of the restructuring exercise.

(a) Initial conditions

Following the restructuring in 1993 within the framework of the Brady Plan, Argentina's public debt continued to increase steadily from US$ 71 billion at the end of that year to US$ 144 billion in 2001, while the interest burden swelled from some US$ 3 billion to slightly over US$ 10 billion. By the end of 2001, the debt stood at US$ 83 billion in bonds, some US$ 38 billion in liabilities incurred with multilateral and official organizations, and US$ 23 billion in bank debts and other categories. The total debt was equivalent to 54% of GDP, while interest represented 3.8% of GDP; however, these figures do not reflect the existing uncertainty as to the sustainability of the denominator of both ratios, that is, GDP in dollars.

The origin and outbreak of the macroeconomic crisis in Argentina are issues that have generated extensive debates. Indeed, exports had been in the doldrums since 1998 —at a time when initial current account deficits were high— owing partly to disruptions in international markets (the sharp fall in agricultural commodity prices; the appreciation of the dollar, to which the Argentine peso was tied; and the devaluation in Brazil, the country's main trading partner). The traumatic external adjustment that followed, achieved through a reduction in aggregate demand, exerted pressure on the financial system and the fiscal policy, which was already struggling to generate primary surpluses. Up to the late 1990s, the economy as a whole, and the public sector in particular, had little difficulty in obtaining considerable amounts of financing. Once the domestic performance started to deteriorate and the international financial climate became rarified, credit proved to be clearly procyclical. The ensuing instability finally built up to an explosive situation.

The system of currency convertibility with the dollar had become a complex web of promises and contracts expressed in that currency. In the eyes of the population, the cost of abandoning this monetary regime was extremely high, since a sudden rise in the real exchange rate would mean explicit recognition of enormous losses of wealth and would call into question all contracts, whether public or private. In any event, throughout 2001, the doubts generated by external and fiscal disequilibria fuelled a demand for foreign currency, a run on deposits and a refusal to finance the government except under exorbitant conditions. The government sought to extend the deadlines for debt servicing through a "megaswap" operation, but this implied the validation of very high interest rates and did not improve expectations. Operators' assessment of the likelihood of default resulted in very high sovereign-risk ratings, while the level of activity slumped.

The breakdown of the convertibility regime included the suspension of public debt repayments, the conversion of loans and bank deposits to pesos at different rates, and the restructuring of the deadlines of bank deposits, together with the introduction of severe restrictions on the withdrawal of funds. These measures were accompanied by intense economic turbulence as well as political and social turmoil. Separate and apart from the tone of the declaration, the timing of the announcement of the suspension of payments was difficult from the economic point of view, with serious consequences especially for lower income groups.

Prices reacted moderately to the sharp increase in the exchange rate. The sudden rise in the real exchange rate and the prolonged slump in the level of activity led to a substantial decline in GDP in dollar terms. In these circumstances, the original size of the public debt was well beyond the government's capacity to generate funds.[a] This situation persisted, despite the remarkable recovery in real GDP starting in mid-2002 and the accumulation of high primary surpluses in the fiscal accounts. In addition to the marked reduction in GDP in dollars (compared with the period of parity with the dollar), which in itself raised the debt burden, the domestic financial crisis led to the issue of new debt instruments, while the federal government assumed the debt of the provinces; at the same time, the international organizations insisted on reducing their exposure in Argentina, even when the crisis was at its most acute. The conjunction of all these circumstances fuelled a huge demand for resources.

(b) The restructuring process

In the political transition that followed the declaration of the suspension of payments, a deep uncertainty prevailed concerning the country's economic prospects. In May 2003, a new president took office and in September, his administration announced a preliminary swap scheme. Shortly before this, the government had agreed upon a three-year programme with IMF, in which quantitative targets were set for the first annual tranche only.

At various times during the restructuring process, the stakeholders involved made forceful public statements. The Argentine Government attached the utmost importance

Box II-3 (continued)

to the sustainability of the payments that it pledged to make, having determined to service the debt issued after the default and not to restructure its obligations to the international organizations, based on reasonable assumptions concerning GDP growth and the capacity for fiscal adjustment (even though the hypothesis of sustained GDP growth together with strong and persistent primary public-sector surpluses was contingent upon drastic changes in behaviour compared with historical patterns). At the same time, relying on the fiscal surpluses that were being recorded, the Government showed no urgency to complete the restructuring exercise or to regain access to international bond markets.

Bondholders, who, with the exception of local financial institutions, were quite divided, created several associations which operated in various public spheres, albeit without the government's recognition. The reaction in international financial circles was very varied: while some insisted that sustainability should be the basic criterion for restructuring, others referred to Argentina as a "test case", in which the multilateral lending agencies and developed countries should demand high payment commitments as punitive measures or as a message to other debtors.

There were shades of difference in the reaction of the developed countries also. Some countries expressed the demands of their bondholders, who called for significant improvements in the swap conditions; in other cases, the debt issue was mixed in with the matter of corporate investments in Argentina and arguments were put forward for a market solution in cases of default, without ruling out the possibility of sizable write-downs to avoid the need to resort to external funds. The main requirement by IMF was that the exchange proposal should enjoy a high degree of acceptance among bondholders. Overall, the positions and public statements of the most important agents made for an extremely complex negotiation.

The divergent positions adopted by the government and IMF as to the modalities for restructuring influenced their decision in August 2004 to suspend the execution of the programme under way. Thus, the proposal for a swap was put forward in the absence of an agreement with the Fund. IMF and the major industrialized countries opted not to participate, with varying degrees of goodwill. In any event, it was clear that the outcome of the operation could have a significant impact on the country's economic and political relations with international centres. Notwithstanding the uncertainty that this implied, the economy continued to expand strongly.

(c) The exchange operation

The government announced the outline of its offer in June 2004 and, following several months of negotiations, the offer was formalized in January 2005. The proposal provided for the issue of three types of bonds:

(i) Par bonds, for a maximum aggregate amount of US$ 15 billion, without reduction in face value, with maturity in 2038 and a fixed and growing interest rate of 1.33% in the first five years, rising to 5.25% as from 2028.

(ii) Discount bonds, totalling US$ 18.5 billion with reduction in face value of 66.3%, maturity in 2033 and an annual interest rate of 8.28%.

(iii) Quasi-par, peso-denominated bonds for a maximum aggregate amount of US$ 8.3 billion, with a 30.1% discount (with respect to the value in dollars), maturity in 2045, adjustable capital value for inflation and an interest rate of 3.31% (capitalizable in the first few years).

The par bonds and discount bonds could be denominated in pesos, in which case they would be adjusted in line with inflation, or else in dollars, euros or yen. The holders of the new bonds would receive a payment in cash for interest due and payable from 31 December 2003. "GDP-linked units" would be incorporated in the securities. These units define payments on the basis of the expansion of the economy. The estimate of "reduction of present value" resulting from the exchange offer was complex, since it depended on an assessment of repayment probability, given that moderate commitments can create expectations of higher payments than huge promises that are difficult to fulfil. In this case, the calculations done by specialists referred to a discount of between 65% and 70% that excluded the effect of the GDP-linked units.

The proposal also included a series of incentives. One of them was the provision that the funds corresponding to coupon payments on bonds not issued due to the respective bondholders' non-participation in the exchange would be used to redeem public debt. In addition, the category "most favoured creditor" was created, which entitled the owners of swapped bonds to participate in a subsequent conversion in the event that a purchase or swap offer were to be made for defaulted bonds not included in the original operation. Another provision states that for a period of six years and in the event that the economy should experience higher growth than the underlying trend, additional resources will be set aside for debt redemption, applying a criterion similar to that employed with GDP-linked coupons. Lastly, in presenting the proposal, the government announced that it would not make any other offers in the future. Congress endorsed a law which prohibited the executive power from reopening the swap once the exercise under way had been finalized.

By the end of the offer period in March 2005, bonds totalling US$ 62 billion or 76% of eligible securities were presented. The participation rate was lower than in other restructuring exercises but, given the conditions, may still be considered high. A high percentage of bondholders resident in the country participated; the lowest rates of acceptance were recorded among small European holders, apart from specialized funds involved in lawsuits. The new instruments that were to be issued

Box II-3 (concluded)

were expected to have a value of just over US$ 35 billion. The quotas for par and quasi-par bonds were covered in the operation, so that the discount bonds were defined on the basis of the remainder. Creditors opted to exchange a significant share of the bonds issued originally in foreign currency for securities in adjustable pesos, which suggested expectations of a real appreciation of the currency.

Excluding the holders who did not participate in the operation, whose bonds represented close to US$ 20 billion of the original value, the federal government's public debt should stand, after the swap, at approximately US$ 123 billion, or just over 70% of GDP; this includes some US$ 30 billion corresponding to obligations to international organizations and a similar figure corresponding to existing securities issued after 2001.

Although the debt/GDP ratio continued to be high, the operation made it possible to extend the maturity profile, the average being set at 12.5 years compared with less than 8 years in 2001. In addition, the interest burden was reduced considerably. Indeed, barring any possible effects of variation in exchange rates in the initial years, the interest should amount to US$ 3 billion, that is approximately 2% of the 2004 GDP figure. In any event, the maturity of debt instruments, especially bonds issued between 2001 and 2004 and loans from international organizations, implies a significant outflow of resources from 2005 onwards. Whether these liabilities will be refinanced depends to a large extent on negotiations with IMF, which attaches considerable importance to the treatment that would be given to those not participating in the exchange operation.

At the beginning of 2005, the volume of real GDP approached the maximum levels reached seven years earlier, although its value in dollars continued to be much lower; in 2005, however, foreign trade yielded a higher surplus and the public sector posted a large primary balance, which amply exceeded the debt servicing costs they would have had to pay in the near future. Meeting government liabilities posed requirements in terms of macroeconomic and fiscal performance which prove to be stricter than in the past, but compatible with a consolidation of the trends that have already been observed. Debt sustainability, that is to say, the government's capacity to pay the interest and to reduce the debt/GDP ratio, seems to depend on the strengthening of these trends, based on the initial conditions arising from budgetary constraints.

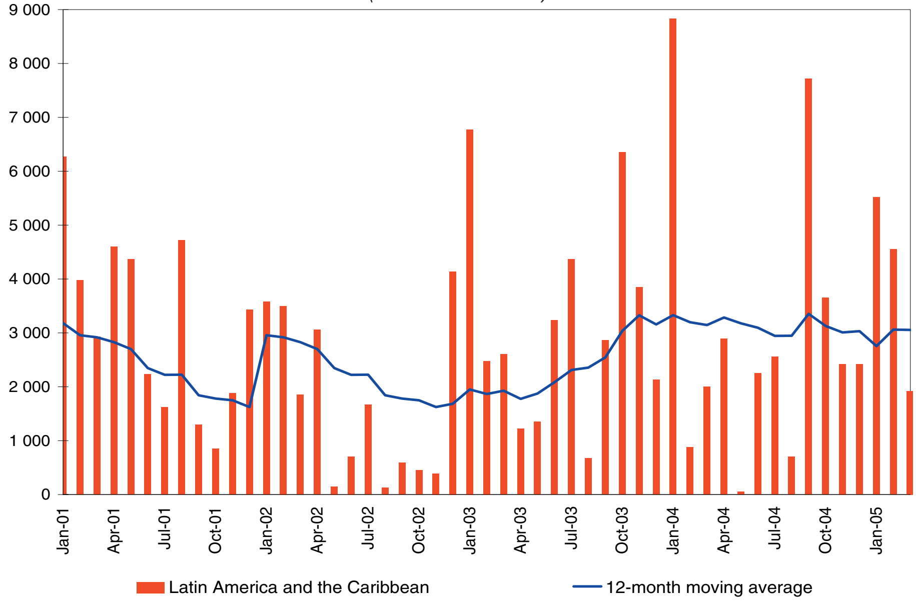
[a] The US$ 10 billion in interest on public debt recorded in 2001 was equivalent to approximately 10% of GDP in 2002 and 60% of federal government receipts in the same year.

7. The bonds market

In 2004, the international financial markets were highly liquid as a consequence of loose monetary and fiscal policies in a number of countries. In this context, and given the low interest rates available on the international market, investors' preferences shifted towards emerging market bonds in search of higher yields. Latin America thus issued a total of US$ 36 billion in international bonds (see figure II.18).[7]

[7] The region's bond issues represented 38% of all emerging economy issues in 2004. Together, these economies issued around US$ 96 billion, which was 29% more than the previous year.

Figure II.18
LATIN AMERICA AND THE CARIBBEAN: BOND ISSUES
(Millions of dollars)



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

In 2004 Brazil and Mexico headed the region's bond issues, accounting for 32% and 37%, respectively. In the case of Brazil, 51% of these issues were floated by companies (24%) and banks (27%), with the government accounting for the remaining 49%. In Mexico, sovereign bonds represented 44% of all issues, corporate bonds accounted for 54% and bank papers, the remaining 2%. The Bolivarian Republic of Venezuela, Chile and Colombia followed Brazil and Mexico in terms of the sums issued (with 8.4%, 6.5% and 4.2%, respectively, of the region's issues). Most of these corresponded to sovereign debt placed by the governments.

In 2005, up to the month of April, the region had issued almost US$ 14 billion in international bonds. Argentina issued bonds in July for US$ 500 million, in the first issuance of foreign-currency-denominated debt since the swap operation conducted in June.

Significantly, the average maturity of Latin American bond issues lengthened in 2004 and reached quite a long horizon (14.39 years) compared with the maturities of debt issues in recent years and with other emerging economy issues.[8] Coupon rates rose from July 2004 onwards and spreads narrowed. Latin American sovereign bonds were placed at an annual weighted average yield of 7.3%, which was higher than the yields seen in other emerging markets.[9] In 2005 the upward trend in these rates came to a halt, and they began to decline, in consonance with long-term rates.

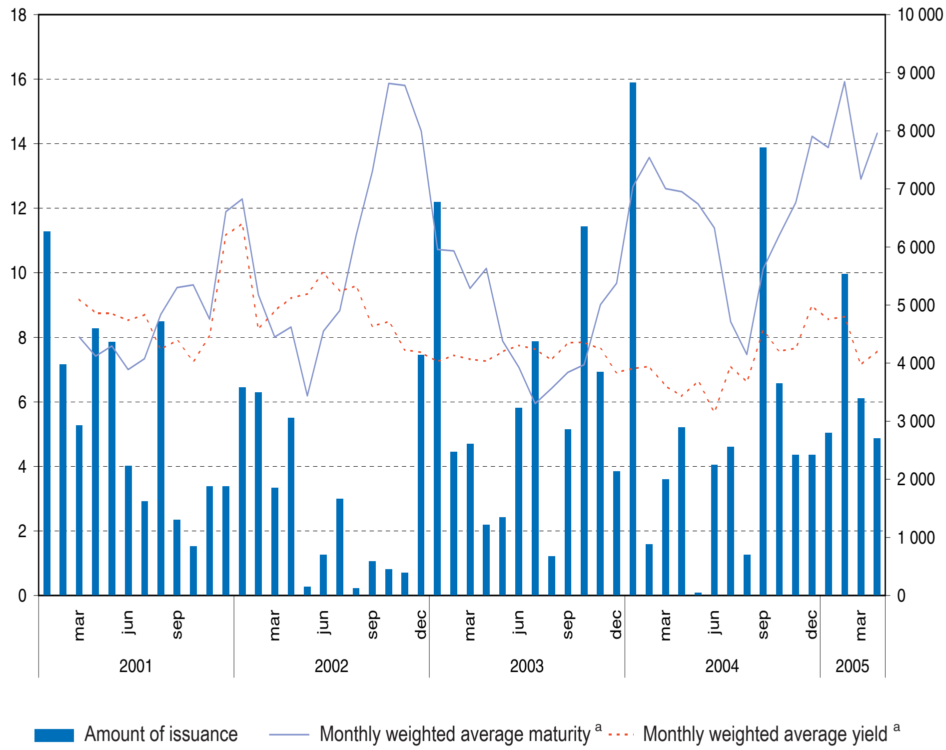
Another phenomenon observed last year was the broader range of currencies in which debt placements were made. Uruguay and Colombia, among other countries, issued liabilities in their own currencies (Colombia issued bonds equivalent to US$ 345 million in November). Similarly, in December the Inter-American Development Bank announced its first issues of bonds in Latin American currencies, including Mexican pesos, Colombia pesos and Brazilian reais. Placements in national currencies were also made by the Bolivarian Republic of Venezuela and a number of Brazilian banks.

It is unprecedented for the region to have placed liabilities at such long maturities and to have issued local-currency bonds on the international markets, and this reduces its vulnerability to external shocks. The international setting played a key part in the success of these placements (see figure II.19).

8 The maturities of sovereign issues averaged 11.64 years in emerging economies in Europe, 10.75 years in Asian and Pacific emerging economies and 6.82 years in those of the Middle East and Africa.

9 Average yields on sovereign bond issues were 6.41% in Asia-Pacific, 6.2% in the Middle East and Africa and 5.95% in European emerging economies.

Figure II.19
LATIN AMERICA AND THE CARIBBEAN: PROFILE OF BOND ISSUES
(Millions of dollars)



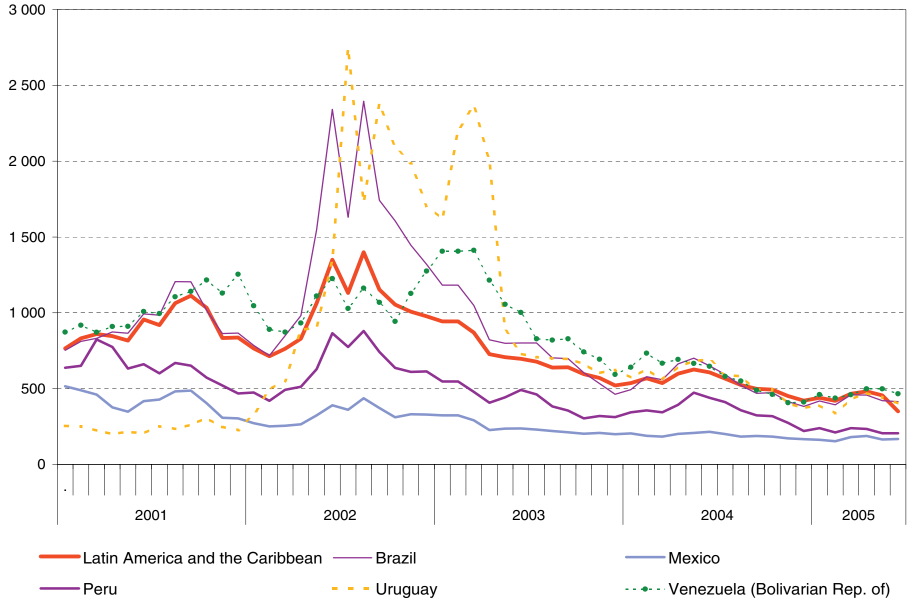
Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of information from Merrill Lynch.
[a] 3-month moving average.

8. The cost of external financing

Towards the end of December 2004, Latin America's sovereign-risk rating stood at 420 basis points, or 116 points lower than the figure at the end of January that year and well below the trend of the last few years. In the first quarter of 2005, sovereign-risk rose to reach 466 basis points at the end of March, reflecting expectations of a rise in long-term interest rates generated by continued monetary contraction in the United States. Those expectations were not borne out, however, because of lower world growth prospects and the markets' ongoing search for highly profitable investment alternatives, and rate spreads resumed their downward trend as of May 2005 (see figure II.20). At the end of June, the combined index for the region stood at 350 basis points, which was a remarkably low figure in comparison with those of recent years.

The largest drop in interest rates spreads in 2004 occurred in Argentina, which recorded a steep decline in November —after issuing details of the debt swap to the United States Securities and Exchange Commission— and in December, thanks to an upturn in expectations related to the processing of the swap. In 2005, after the debt swap became effective, Argentina's country-risk rating fell sharply, from 6,498 basis points in May to 462 in June, once the bonds in arrears were removed from the index and replaced with bonds forming part of the swap operation.

Figure II.20
LATIN AMERICA AND THE CARIBBEAN: BOND SPREADS
(Basis points)



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

Box II.4
THE HEAVILY INDEBTED POOR COUNTRIES (HIPC) INITIATIVE AND THE NEW PROPOSAL FROM THE GROUP OF EIGHT

The Heavily Indebted Poor Countries (HIPC) Initiative was launched in 1996 by the World Bank and the International Monetary Fund. The main aim of the Initiative, which was modified considerably in 1999, is to reduce the indebtedness of certain countries to viable levels. Its application is contingent upon on participating countries adopting certain economic policies, more specifically macroeconomic adjustment measures, structural reforms and social policies targeting education and health.

In 2004 net present value terms, the Initiative is estimated to have cost around US$ 58 billion, just over half of which is provided by bilateral creditors, and the remainder by multilateral lending institutions.

The countries eligible for debt relief under the Initiative are those able to receive financing only from the World Bank's International Development Association (IDA) and the Poverty Reduction and Growth Facility of the International Monetary Fund, and whose debt is unsustainable even after the full application of traditional debt relief mechanisms. Countries must also have a proven track record in implementing adjustment and reform programmes.

This initiative is implemented in four phases: two of adjustment and economic reform, with a decision point at the end of the first phase, and a "floating" completion point, which comes at the end of the second phase and is the point at which debt relief becomes effective. To receive the assistance provided for at completion point, potential beneficiaries must comply with certain criteria that vary from country to country. The length of the second stage depends on the satisfactory implementation of structural reforms agreed upon at the decision point, the maintenance of economic stability and the adoption and implementation of a poverty reduction strategy for at least a year.

Once the criteria for the second stage are fulfilled, completion point is reached and lenders must extend to the respective country all the debt relief they committed at the decision point. Multilateral, bilateral and commercial creditors commit to providing effective debt relief at the completion point, with the sum depending on how much is needed to reduce the debt to sustainable levels at the decision point. The four countries in the region that have qualified for the Initiative are Bolivia, Guyana, Honduras and Nicaragua, which have all reached completion point.

The following table shows the debt relief commitments under the Initiative for the region's countries before the proposal of the Group of Eight (G8) was formulated in mid-June.

Box II-4 (continued)

DEBT RELIEF COMMITMENTS BY GROUP OF CREDITORS, MARCH 2005

(Millions of dollars, net present value)

	Bolivia	Guyana	Honduras	Nicaragua	Total
Total	1 302	591	556	3 308	5 757
Multilateral creditors	873	368	367	1 123	2 731
World Bank	194	68	98	189	549
International Monetary Fund	84	75	30	82	271
Banks	467	117	134	387	1 105
Other [a]	128	108	77	465	778
Bilateral and other creditors	429	224	189	2 185	3 026
Date of decision point	August 1998 and January 2000	December 1997 and November 2000	June 2000	December 2000	
Date of completion point	June 2001	December 2003	April 2005	January 2004	
External public debt	4 877	1 073	4 957	5 322 [b]	16 228
Total debt relief as a percentage of total external public debt	27%	55%	11%	62%	35%

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of data from the International Monetary Fund (IMF).
[a] Includes US$ 613 million from the Central American Bank for Economic Integration and US$ 114 million from the Andean Development Corporation.
[b] Data from 30 April 2005.

Proposal from the Group of Eight

In the framework of the agreements reached at International Conference on Financing for Development (Monterrey), the Group of Eight (G8) countries meeting in June and July 2005 committed to increase their contribution to official development assistance by US$ 50 billion by 2010, and formulated a proposal to cancel all debts owed to the International Monetary Fund, the World Bank and the African Development Bank by countries that have reached the completion point under the Heavily Indebted Poor Countries (HIPC) Initiative.

The cost of this proposal to the World Bank and the African Development Bank would be covered by contributions from G8 countries and other donors, while the costs to the International Monetary Fund (IMF) would be met from its own current resources.

The G8 proposal encompasses 35 heavily indebted countries, of which 18 have already reached completion point, 9 are at decision point and 8 are at the stage before that. Should member countries of IMF and the World Bank adopt the G8 proposal, the 18 countries that stand to benefit immediately include the four countries in the region that are already part of the HIPC Initiative.

The creditors are still studying an implementation strategy for the proposal, which will be analysed at the annual meetings of IMF and the World Bank in September 2005. The amount of relief to be received by each beneficiary country will depend on the details worked out at those meetings. It will also be heavily determined by the cut-off date yet to be established. Simply for the sake of argument, this exercise uses two possible dates: (i) the date used to calculate debt in the documents concerning the respective completion points; and (ii) a date close to the June announcement by the G8 (31 May 2005). As shown in the table below, the results vary considerably depending on the cut-off date used. [a]

CALCULATION OF DEBT RELIEF UNDER G8 PROPOSAL, ACCORDING TO NET PRESENT VALUE, NOMINAL VALUE AT COMPLETION POINT AND NOMINAL VALUE IN 2005

(Millions of dollars)

	Bolivia	Guyana	Honduras	Nicaragua	Total
Net present value at completion point [a]	635	181	893	555	2 264
World Bank	463	110	744	411	
International Monetary Fund	172	71	149	144	
Nominal value at completion point [a]	1 315	295	1 403	990	4 003
World Bank	1 095	199	1 232	816	
International Monetary Fund	220	96	171	174	
Nominal value 2005 [b]	1 992	347	2 437	1 392	6 168
World Bank	298		1 989	1 164	
International Monetary Fund	1 694		448	228	
Percentage of external public debt	41%	32%	49%	26%	

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of data from the International Monetary Fund (IMF) and country information.
[a] Based on the respective completion point documents.
[b] Data available for May 2005 in the case of Bolivia, March 2005 for Guyana and April 2005 for Honduras and Nicaragua.

Box II-4 (concluded)

As shown in the table, the date is no small matter, since a cut-off date of 31 May 2005 (close to the G8 announcement) generates a debt reduction of US$ 6.168 billion in nominal terms, whereas the date used to calculate the debt balance in the completion point document gives a debt reduction of US$ 4.003 billion.

If the relief were to be made effective from completion point, in nominal terms Bolivia would be granted relief of US$ 1.315 billion, Guyana some US$ 295 million, Honduras about US$ 1.403 billion and Nicaragua approximately US$ 990 million. If it were made effective closer to the announcement of the new proposal, on the other hand, Bolivia's debt would be reduced by US$ 1.992 billion of its nominal value (or 41% of total external public debt as it stood in May 2005), Guyana would benefit from nominal relief of US$ 347 million (32% of total external debt), Honduras, a nominal US$ 2.437 billion (49% of external public debt), and Nicaragua, close to US$ 1.392 billion in nominal terms (26% of external public debt).

Another point to be clarified at the meetings due to take place in Washington, D.C. in September 2005 is how to handle the debt owed to the Inter-American Development Bank (IDB) under the Initiative. The G8 announcement does not provide for relief from IDB loans, whereas debts with the African Development Bank are to be forgiven 100%, with the costs covered by contributions from G8 member countries. The issue is of prime importance to the region's countries, given that their respective completion point documents show their debts with IDB, in nominal terms, to stand at US$ 1.383 billion in the case of Bolivia, US$ 360 million for Guyana, US$ 1.288 billion for Honduras and US$ 1.099 billion for Nicaragua.

[a] A memorandum from the central bank of Bolivia put forward a cut-off date of 31 December 2003, on the basis of measures proposed by the United Kingdom to cover 10% of the Bolivia's debt servicing with the World Bank.

Chapter III

Macroeconomic policy

A. Fiscal policy

As indicated in the *Preliminary Overview of the Economies of Latin America and the Caribbean, 2004*, the region's positive macroeconomic performance in 2004 brought about a significant improvement in countries' fiscal accounts.[1]

During 2004-2005, fiscal policy has therefore been implemented in favourable macroeconomic circumstances. As stated in previous chapters, the external context and the performance of economies in the region suggest that 2005 will see a continuation of the expansion that began two years ago, although at a slower rate than in 2004 (with an average regional growth rate of more than 4%).

Beyond the budgetary sphere, improved fiscal aggregates have partially lessened the region's external vulnerability. The lesser vulnerability, which is confirmed by debt indicator, is the result of a number of factors, including the characteristics of the present economic cycle combined with decisions taken by national authorities.

It remains to be seen whether the impressive fiscal performance is merely a result of fortunate external conditions and the higher prices of certain commodities, or whether additional factors point to a more permanent change.

The macroeconomic conditions that contributed to this positive performance include across-the-board growth in the countries' economies and price rises for certain commodities (especially petroleum and metals), which boosted the tax receipts of producer countries.

The fiscal position was also strengthened by circumstances that enabled authorities to make the most of the prevailing macroeconomic conditions. The tax structure created to deal with emergency situations was kept in place during the period of growth. At the same time, fiscal policy decisions were made and financing instruments adopted that helped to reduce the region's vulnerability.

As a result, at the end of 2004, the region's central governments achieved a weighted average primary surplus of 2.2% of GDP, as against the 1.6% surplus posted in 2003. At the same time, the overall deficit (including interest on the public debt) shrank from 1.8% to 0.9% of GDP.[2] The primary surplus is expected to remain at these levels in 2005, although a larger overall deficit is predicted on account of higher interest payments on the public debt.

1 Economic Commission for Latin America and the Caribbean (ECLAC), *Preliminary Overview of the Economies of Latin America and the Caribbean 2004* (LC/G.2265-P), Santiago, Chile, December, 2004. United Nations publication, Sales No. E.04.II.G.147.

2 The simple average of the primary surplus went from 0.1% of GDP in 2003 to 0.9% in 2004.

Table III.1

LATIN AMERICA AND THE CARIBBEAN: CENTRAL GOVERNMENT FISCAL INDICATORS

(Percentages of GDP at current prices)

	Primary balance				Overall balance				Public debt [a]					
									Central government			NFPS		
	2002	2003	2004[b]	2005[c]	2002	2003	2004[b]	2005	2002	2003	2004[b]	2002	2003	2004[b]
Latin America and the Caribbean														
Simple average	**-0.3**	**0.1**	**0.9**	**0.7**	**-3.1**	**-2.6**	**-1.6**	**-2.0**	**64.3**	**62.9**	**56.2**	**68.8**	**66.8**	**58.7**
Weighted average	**1.3**	**1.6**	**2.2**	**2.2**	**-3.7**	**-1.8**	**-0.9**	**-1.2**	**48.2**	**46.5**	**42.9**	**64.8**	**58.2**	**53.7**
MERCOSUR	0.3	1.6	2.8	3.0	-2.2	-1.5	0.5	-0.7	86.3	78.4	68.6	104.7	87.5	76.7
MERCOSUR + Chile	0.3	1.4	2.9	2.6	-2.0	-1.3	0.9	-0.2	72.2	65.3	57.1	88.2	74.0	64.7
Andean Community	-1.0	-0.6	0.0	-0.4	-4.3	-3.8	-3.0	-3.7	56.4	58.1	53.3	62.0	64.6	58.4
Petroleum-producing countries	1.8	1.5	2.0	1.2	-2.2	-2.3	-1.4	-1.5	51.1	47.9	44.0	48.7	48.8	43.0
Rest	-2.9	-1.9	-1.3	-1.0	-5.7	-4.8	-4.2	-4.4	58.1	61.5	56.4	75.2	80.4	73.7
Central America	-0.5	-0.5	0.1	-0.4	-3.0	-3.1	-2.0	-2.8	70.3	71.2	64.5	71.8	72.9	66.4
Argentina [d]	1.8	2.2	3.3	3.0	-0.3	0.3	2.0	1.0	145.9	138.2	126.5	184.4	144.8	132.7
Bolivia	-5.6	-4.7	-2.6	-2.2	-8.1	-7.3	-5.4	-5.2	77.6	86.9	79.2	79.2	93.3	85.0
Brazil [e]	2.4	2.5	3.0	2.5	-6.4	-2.5	-1.3	-1.9	41.7	37.2	34.0	65.5	58.7	54.1
Chile	-0.1	0.7	3.1	2.1	-1.2	-0.4	2.2	1.2	15.7	13.1	10.9	22.2	19.7	17.0
Colombia [f]	-1.0	-0.5	-0.3	-1.8	-4.9	-4.7	-4.3	-6.1	50.1	50.4	46.8	71.1	67.5	62.5
Costa Rica	0.0	1.4	1.4	0.9	-4.3	-2.9	-2.8	-3.5	40.8	40.0	41.4	45.4	46.4	48.7
Ecuador	2.6	2.6	1.6	1.2	-0.8	-0.4	-1.1	-1.5	51.1	47.9	44.0	55.6	51.8	47.1
El Salvador	-1.6	-0.8	0.9	-0.7	-3.1	-2.7	-1.1	-2.9	36.1	38.0	38.3	38.9	41.3	40.9
Guatemala	0.3	-1.1	0.2	-0.5	-1.0	-2.3	-1.0	-2.0	16.4	18.5	19.1	17.5	19.5	20.0
Haiti	-2.6	-2.7	-2.7	-0.8	-2.7	-2.9	-3.4	-1.5	60.3	58.3	46.2	66.6	64.4	50.5
Honduras	-3.4	-4.4	-1.8	-1.7	-5.3	-5.6	-3.1	-3.0	66.3	70.3	68.5	65.8	69.5	68.4
Mexico [g]	0.7	1.3	1.2	2.7	-1.8	-1.1	-1.0	-0.1	24.0	24.2	23.3	27.5	27.6	26.1
Nicaragua	-0.2	0.2	-0.1	-1.0	-2.5	-2.8	-2.2	-3.1	193.5	193.1	147.4	193.9	193.4	147.6
Panama	2.2	0.6	-1.3	0.0	-1.9	-3.8	-5.6	-3.6	69.0	67.0	72.4	69.4	67.3	72.6
Paraguay [h]	-1.7	0.9	2.8	0.8	-3.2	-0.4	1.6	-0.6	59.2	43.9	39.2	63.0	46.3	40.9
Peru	-0.2	0.2	0.6	0.9	-2.1	-1.8	-1.3	-1.2	46.8	47.3	43.3	...	...	...
Dominican Republic	1.1	2.9	3.9	2.2	0.1	1.3	2.4	0.4	...	...	...	23.9	44.2	25.3
Uruguay	-0.8	1.1	2.4	3.7	-4.9	-4.6	-2.5	-1.9	98.7	94.3	74.7	106.0	100.4	78.9
Venezuela (Bolivarian Rep. of)	1.0	0.3	0.8	2.5	-3.6	-4.4	-2.8	-1.8	...	...	...	41.9	45.8	39.0

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

[a] At 31 December each year, using the average exchange rate in the case of external debt. The public debt figures for the Dominican Republic include external debt only.

[b] Preliminary estimate.

[c] Official targets.

[d] National central administration.

[e] Federal government and central bank, except in 2005, when only the federal government was included.

[f] The balances do not include adjustments for accruals, floating debt or the cost of financial restructuring.

[g] Federal government and social security. For 2005, the coverage is the public sector.

[h] Central administration.

The central government figures are not, however, altogether sufficient to examine the situation of a number of the region's countries whose public sectors are more decentralized. Considering a broader governmental coverage for the region's most decentralized countries (Argentina, Brazil, Colombia and Mexico), the primary balance of the non-financial public sector increased from 3.0% of GDP in 2003 to 3.8% in 2004 (with 3.6% predicted for 2005).

The result reflects the upturns seen in these four countries' subnational government public accounts, which have been making an increasing contribution to improvements in the respective non-financial public sectors (NFPS). In 2004, the primary balance of the subnational governments in Argentina, Brazil and Colombia represented over 1% of GDP, which was the highest figure since 1990 in all three cases.[3]

[3] Nevertheless, in Argentina and Brazil the subnational government debt still represents between 15% and 20% of GDP, which is a significant proportion of the total debt of the NFPS.

1. The 2003-2004 biennium in comparative terms

Unlike in other boom periods, especially those recorded in the 1990s, the region's governments have taken advantage of the favourable economic conditions to strengthen their fiscal position. On average, GDP increased by 7.9%, fiscal revenues expanded by 3.8 % and primary expenditure fell by 2.9% in the period 2002-2004. As shown in table III.2, the pattern of primary expenditure in 2002-2004 stands in contrast to the performance in other growth periods during the last decade. Expenditure declined in the most recent period, while primary spending increased in the other periods (except 1993-1995). This cycle also displays particular traits on the income side, since it posted one of the highest rates of increase of the growth periods considered.

Table III.2

LATIN AMERICA AND THE CARIBBEAN: VARIATIONS IN THE MAIN FISCAL INDICATORS [a]

(Simple averages)

	1992/1990	1995/1993	1998/1996	2001/1999	2004/2002
Total income	3.5	4.1	0.5	3.3	3.8
Primary expenditure	1.6	-2.5	5.8	4.4	-2.9
Interest	-3.3	-4.6	2.0	-1.3	-11.0

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.
[a] Variations as a percentage of GDP.

The healthier fiscal position in 2004 was attributable to the fact that revenues had increased as a proportion of GDP since 2003 in step with trends in activity levels, while expenditure rose, on average, more slowly than the regional growth rate, dropping as a percentage of GDP.

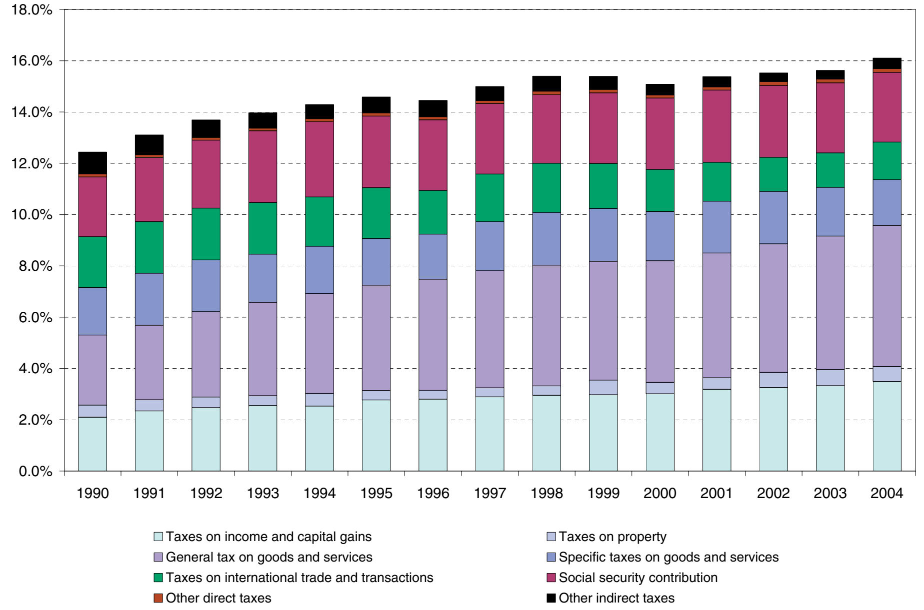
On the revenue side, this outcome resulted from a combination of several factors. On the one hand, the significant rise in the level of activity had a strong impact on tax receipts, since it not only expanded the tax base, but also led to an improvement in tax compliance. This behaviour is part of a pattern of rising tax revenues observed in recent years (as shown in figure III.1), with the 2004 tax intake being the highest of a series beginning in 1990. This was linked to the higher proportion of the tax take accounted for by general taxes on the consumption of goods and services, driven mainly by value added tax, whose average rate rose over the period from 11.7% in 1994 to 14.7% in 2005. Notably, the ceiling rates for individual, income and corporate taxes have been gradually lowered. In addition, several countries of the region have continued to fully apply taxes that are normally considered emergency measures. As well as export retention schemes in some countries, a prominent example is this is the financial transactions tax currently in use in Argentina, the Bolivarian Republic of Venezuela, Brazil and Colombia and applied in Bolivia and Peru during 2004.

In addition to this, countries also reaped the benefits of the prevailing external macroeconomic conditions and the improved prices of certain commodities, mainly metals and petroleum. This boosted the fiscal revenues of countries in which such commodities account for a sizeable proportion of total exports: Bolivarian Republic of Venezuela, Chile, Colombia, Ecuador and Mexico. Revenue from commodities makes up almost 50% of tax receipts in the Bolivarian Republic of Venezuela; between 20% and 30% in Chile and Ecuador; and between 10% and 20% in Colombia and Mexico.

Figure III.1

LATIN AMERICA AND THE CARIBBEAN: TAX BURDEN AND BREAKDOWN OF TAX REVENUE, 1990-2004 [a]

(Simple averages, percentages of total and percentages of GDP)



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

[a] In some cases, the figures for social security contributions do no correspond to central government coverage. The data for Brazil are from 2003.

On the expenditure side, the countries have, on average, exercised prudence in managing government outlays, which, in a departure from the region's habitual pattern, did not increase in real terms or follow economic growth patterns. Different reforms and decisions combined to produce this result, including the operation of macrofiscal rules (such as Brazil's Fiscal Responsibility Act and Peru's Fiscal Prudence and Transparency Act)[4] and the commitment to maintaining a medium-term fiscal surplus (Chile's structural balance rule). At the same time, fiscal policy decisions were slanted to take advantage of favourable economic conditions in 2004 and offset the slowdown in growth expected during the current year (Argentina's decision to postpone revenues from 2004 to 2005 and bring 2005 expenditures forward to 2004; Brazil's decision to raise the primary surplus target for 2004).[5]

A breakdown of expenditure shows two groups of factors in this pattern. In Argentina, Brazil, Chile and Uruguay, spending dropped as payroll and pensions expenditure increased at below-GDP rates.[6] In El Salvador and Guatemala, the drop in expenditure was attributable to a reduction of capital expenditure in GDP terms.

4 Macroeconomic trends facilitated compliance with these rules, which have yet to prove their effectiveness during recessions.

5 In Brazil, the authorities are discussing guidelines for the 2006 budget and the possibility of adopting an countercyclical adjustment mechanism whereby the NFPS primary surplus target will be reduced by 0.25% of GDP (from 4.25% to 4%) if the growth rate of GDP is below 4.5% or, if GDP growth exceeds 4.5%, raised by 0.25% to 4.5% of GDP.

6 Except for the case of Chile, this was the result of a change in relative prices owing to significant currency devaluations recorded in those countries' economies.

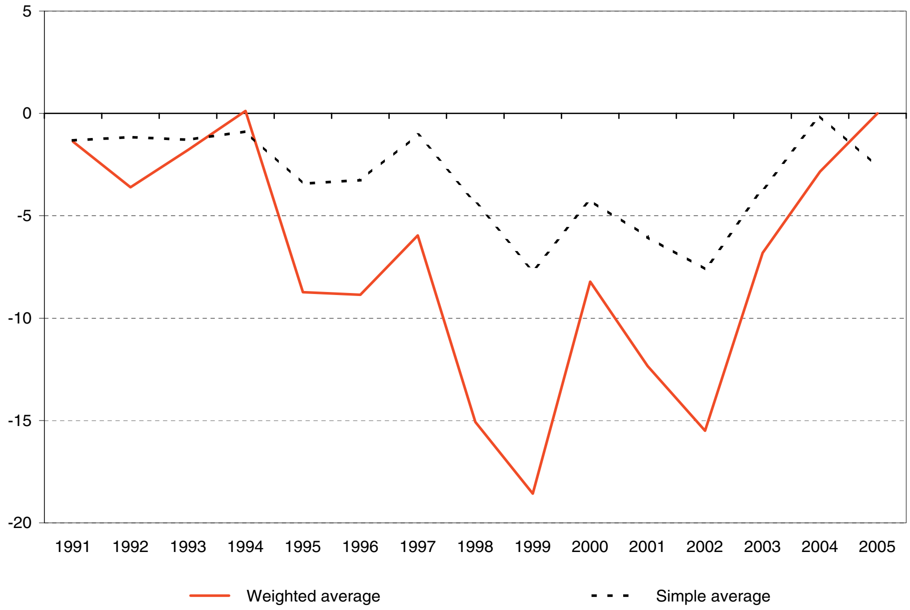
2. Public debt

As mentioned earlier, the primary balance explains only part of the fall in the public debt-to-GDP ratio (as a simple average of the NFPS debt) from 66.8% in 2003 to 58.7% in 2004,[7] since favourable economic conditions have also played a part. As for the role of growth in improving debt patterns, figure III.2 shows that the spread between the growth rate of GDP and the implicit interest rate on public debt is one of the narrowest in the series beginning in 1990. The largest spreads of the series were recorded in 1998-1999 and 2002.

Figure III.2

LATIN AMERICA AND THE CARIBBEAN: SPREAD BETWEEN GDP GROWTH RATES AND REAL INTEREST PAID ON THE PUBLIC DEBT [a]

(Simple and weighted averages)



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.
[a] This does not include data from Haiti. Spread is defined as the difference between the growth rate of GDP (measured in dollars at constant 1995 prices) and the implicit interest rate (payment on interests from the debt as a percentage of the debt balance from the previous period).

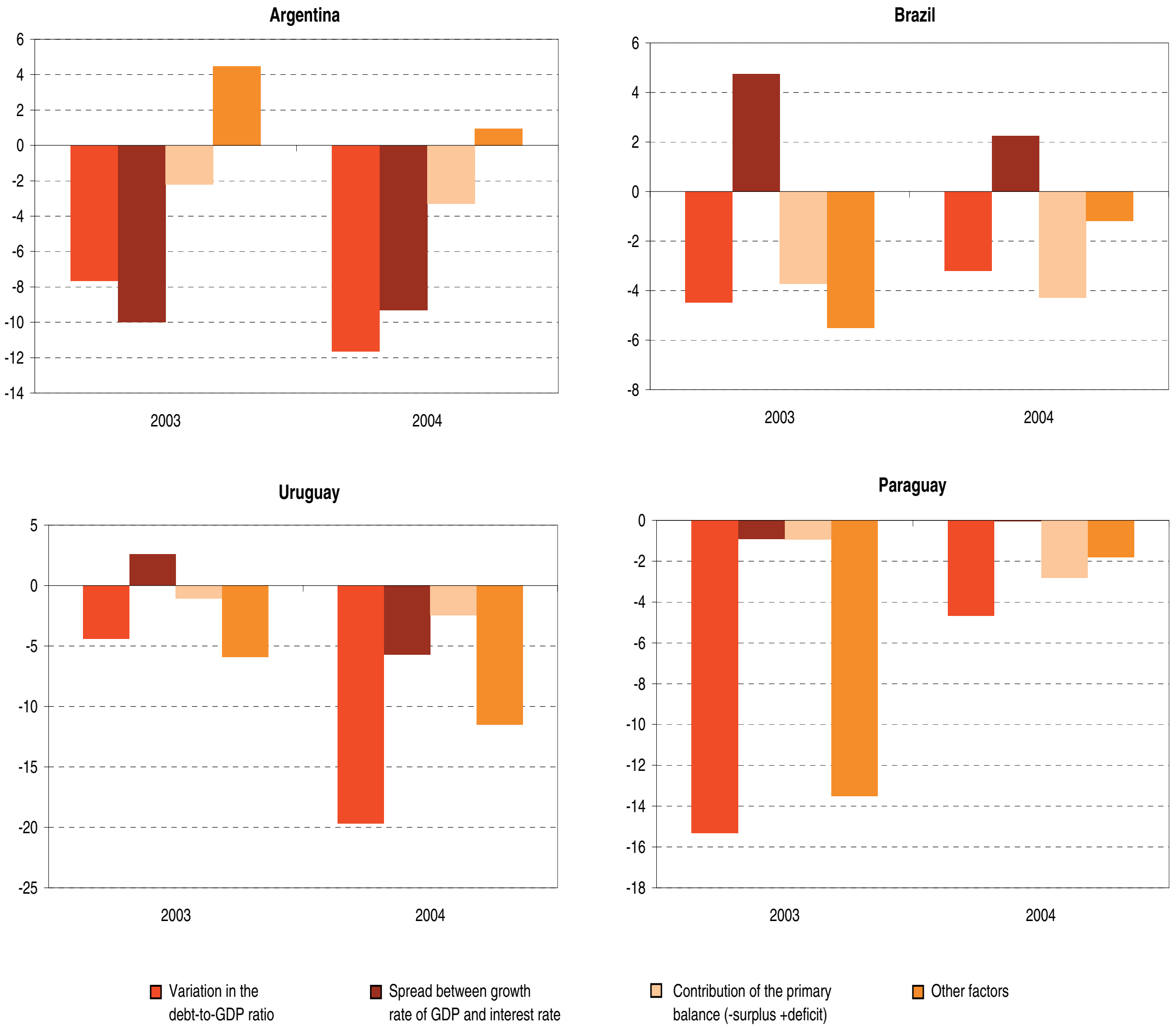
Figure III.3 shows a number of countries in which the debt-to-GDP ratio has fallen by more than the average rate. The figure distinguishes the different that contribute to the fall, namely, the spread between the rate of economic growth and the interest rate on the debt, the contribution of the public accounts through the primary balance and other factors that can affect this ratio.[8]

[7] In addition to being reflected in the public debt-to-GDP ratio, the improved fiscal position can also be seen in the increased number of countries to post a primary surplus. In 2002, 10 countries recorded a primary deficit, whereas only 6 countries did so in 2004.

[8] For a more detailed description of the methodology used in this exercise, see Economic Commission for Latin America and the Caribbean (ECLAC), *Economic Survey of Latin America and the Caribbean, 2003-2004* (LC/G.2255-P), Santiago, Chile, 2004. United Nations publication, Sales No. S.04.II.G.2 and Ricardo Martner and Varinia Tromben, “La sostenibilidad de la deuda pública, el efecto bola de nieve y el ‘pecado original”, *Gestión pública series*, No. 46 (LC/L.2150-P), Santiago, Chile, Economic Commission for Latin America and the Caribbean (ECLAC), August, 2004. United Nations publication, Sales No. S.04.II.G.75.

Figure III.3

COUNTRIES WITH SIGNIFICANTLY IMPROVED DEBT-TO-GDP RATIOS



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

These figures show the effect of each factor on debt dynamics during the past two years. In the case of Argentina, the strong upswing in activity was reflected in the fact that GDP grew faster than the interest rate. This combined with an unprecedented primary surplus to lower the debt-to-GDP ratio considerably.[9] In Brazil, the reduction in the debt-to-GDP ratio was the result of a large primary surplus while, far from contributing to the improvement in the ratio, the GDP-interest rate spread actually lessened its magnitude. In Uruguay and Paraguay, the debt-to-GDP ratio dropped owing to the combined effect of currency appreciation[10] in the wake of previous

[9] This does not include the improvement resulting from the restructuring of the national public debt in 2005. Not including the almost US$ 20 billion (face value) in holdouts, the government's public debt now stands at about US$ 123 billion (72% of GDP according to official estimates). For further details, see box II.1 on the restructuring of the Argentine debt.

[10] The appreciation of the national currency brings down the debt-to-GDP ratio to the extent that much of the debt is denominated in foreign currency.

devaluations (see "other factors" in the figure) and the primary surplus.

Another new development in the region is that authorities are less willing to conclude stand-by arrangements with the International Monetary Fund (IMF). Indeed, out of the six largest countries in the region in terms of GDP (Argentina, Bolivarian Republic of Venezuela, Brazil, Chile, Colombia and Mexico), only Colombia had a stand-by arrangement in place in mid-2005.[11] This may be attributed to an easing of financial constraints —which reduces the incentive to request loans that have conditionalities attached— and to resulting changes in how national authorities and markets perceive the significance of this type of agreement within the current cycle. During fiscal crises, an agreement with IMF (with its dual role of credit provider and reform supervisor) could signify a commitment to more orderly public accounts in the future. In the current climate, however, an outstanding loan with IMF could point to an economic problem and thus lead to loss of credibility.

In the last few years, the countries in the region have used various financing instruments to reduce their vulnerability, including the following:

- Denomination in local currency and diversification of foreign currency issues. In 2004, the World Bank and IDB issued bonds denominated in Colombian pesos, Brazilian reales and Mexican pesos, while Colombia and Uruguay placed own–currency bonds on the international markets in 2004 and 2003, respectively;
- Issues at fixed rates of interest, such as those floated by Colombia and the IDB issues in reales and Mexican pesos;
- Longer maturities;
- Collective action clauses (introduced in 2004 issues) which provide for the initiation of debt-restructuring with a qualified majority; and
- GDP-linked bonds, which Argentina included in its debt-swap offer, enabling debt servicing to be matched to the issuer's ability to pay.

3. Subregional panorama

Against this general backdrop, specific nuances may be discerned in each subregion.

The MERCOSUR countries have maintained the upward trend described in the *Preliminary Overview of the Economies of Latin America and the Caribbean, 2004*. The overall improvement (despite differences between the countries) in this subregion's primary fiscal balance (which rose, on average, from 1.6% in 2003 to 2.8% in 2004) was caused by a strong upturn in revenues; in fact, in 2004 Argentina, Brazil and Uruguay posted the highest tax revenue-to-GDP ratio for the period beginning in 1990. In addition, expenditure fell in terms of GDP as a result of a decline in spending on payroll, interest and social security. This trend is expected to continue in 2005, especially as far as the primary surplus is concerned. Expenditure on interest payments is expected to rise, however, which would bring down the overall balance in comparison with the 2004 figure.

In the Andean subregion, it is necessary to distinguish the petroleum-producing from the other countries. In 2004, the petroleum producers, Ecuador and the Bolivarian Republic of Venezuela, posted a surge in activity levels (which was much sharper in the latter country) thus boosting fiscal resources. However, both countries' expansionary spending policies in 2004 (together with tax cuts, in the case of the Bolivarian Republic of Venezuela) prevented a more significant improvement in the fiscal accounts. The other countries of the subregion continue to face difficult fiscal situations, to varying degrees, as their economic growth in 2004 fell short of the regional average. To some extent, they have succeeded in taking advantage of improved macroeconomic conditions to whittle down their deficits, but their fragile fiscal position (especially in Bolivia), calls for prudent measures to improve the sustainability of their accounts in the medium term.

[11] Stand-by arrangements have been the most commonly used arrangement in the region, sometimes in conjunction with the supplemental reserve facility. Low-income countries such as Honduras and Nicaragua have used the poverty reduction and growth facility, which carries lower interest rates.

The GDP of the Central American countries grew, but at rates below the regional average. Although the average primary result for the subregion is in balance, the situation varies from one country to another. Nicaragua is a special case, as it became formally eligible for debt relief under the Heavily Indebted Poor Countries (HIPC) Initiative in 2004 and had much of its debt written off.

The Caribbean subregion as a whole improved its fiscal position thanks to higher tax revenues resulting, in turn, from the upswing in economic activity, favourable external conditions for certain countries and the curbing of public spending. The performance of the countries was by no means uniform, however. At one extreme, Trinidad and Tobago posted a fiscal surplus (2.1% of GDP), attributable to high international petroleum prices. At the other, the smaller economies in the Organization of Eastern Caribbean States (OECS) posted an average deficit of 7% of GDP (as in previous years) excluding donations. Belize and Jamaica, in particular, engaged in fiscal consolidation efforts with a view to reducing their total public debt stock (which represents over 100% of GDP). In Belize, the fiscal adjustment —which narrowed the deficit from 10% of GDP in 2003 to 5% in 2004— consisted mainly of cuts in capital spending, while in Jamaica, spending on interest decreased and payroll expenditure was frozen.

4. Conclusions

Referring back to the opening question as to whether fiscal performance is merely the result of favourable external conditions and higher commodity prices, or whether additional factors point to a more permanent pattern, the region appears to be exhibiting a considerable number of new traits. These include the fiscal institutions beginning to take shape, tailor-made countercyclical policies, new financial instruments, a new fiscal policy agenda and greater fiscal freedom. Although the macroeconomic context was largely responsible for shaping fiscal policy, the measures implemented by the fiscal authorities fuelled the economic momentum.

However, the region continues to display a number of structural problems that are equally in need of attention, albeit in varying degrees of urgency. Notwithstanding recent revenue trends, the region still has a weak and inequitable tax structure and its fiscal effort is highly dispersed. On the spending side, the low quality of the adjustments carried out in recent years have reduced capacity for tackling outstanding problems, such as increasing the low level of public investment, improving the provision of social services and remedying the serious coverage and solvency problems observed in social security systems (see box III.1). The institutional structure lacks adequate expenditure management mechanisms, budgetary coordination between the executive and legislature and proper control mechanisms.[12] Another outstanding issue is the need for petroleum-exporting countries to take advantage of the high prices oil now commands to diversify their tax structure and strengthen their fiscal footing.

Most of the region's countries still have a very high debt-to-GDP ratio. The scenario of a still favourable international climate, albeit, probably, with lower growth rates and higher interest, will require the governments to sustain growth levels and continue with fiscal prudence measures aimed at further reducing the debt-to-GDP ratio.

A working paper prepared prior to the publication of the *Economic Survey of Latin America, 1948*, which was ultimately published in the *Economic Bulletin for Latin America*, carried the following quotation: "During the cyclical upswing, tax revenue increases and the market is favourable to the sale of public bonds. Nevertheless, the State should not only abstain from using these additional resources to increase public investments, but should restrict them in proportion to the increase in private employment, Thus during the upswing resources would be accumulated in anticipation of bad times or used to repay bank credit extended during the preceding contraction".[13] This paper drew attention to the difficulty of implementing such policies

[12] For further details on these issues, see Jesús Rodríguez and Alejandro Bonvecchi, "El papel del poder legislativo en el proceso presupuestario: la experiencia argentina", *Macroeconomía del desarrollo series*, No. 32 (LC/L.2225-P), Santiago, Chile, Economic Commission for Latin America and the Caribbean (ECLAC), January, 2004. United Nations publication, Sales No. S.04.II.G.144.

[13] Raúl Prebisch, Bases for the discussion of anti-cyclical policy in Latin America, "The economic development of Latin America and its principal problems", *Economic Bulletin for Latin America*, vol. 7, No. 1, section 7, Santiago, Chile, Economic Commission for Latin America (CEPAL), February 1962, pp. 19-24.

and the need to institutionalize them to ensure their effectiveness and durability: "For the very reason that the Latin-American countries are in full process of development, their investment projects are always larger than can be carried out with the limited means available. To maintain that, when those means increase and the opportunity of carrying out such projects presents itself, the authorities instead of seizing it should accumulate resources for the future, which may be enjoyed by their successors, would mean making the success of anti-cyclical action depend on attitudes not always compatible with sound political interest".

Although it is too early to talk of a new paradigm in the region, economic growth and the still favourable external environment provide a unique, though not risk-free, opportunity to progress towards a countercyclical approach to fiscal policy, as well as to design mechanisms for reducing the vulnerability of the region's economies and enhancing their capacity to achieve sustained growth. The region has yet to capitalize on these positive conditions by establishing fiscal institutions that can improve the medium- and long-term solvency of public finances and growth periods can thus, finally, be used to accumulate resources in anticipation of bad times.

Box III.1

INVESTMENT IN PUBLIC SERVICES: RECENT TRENDS, STATUS QUO AND POLICIES [a]

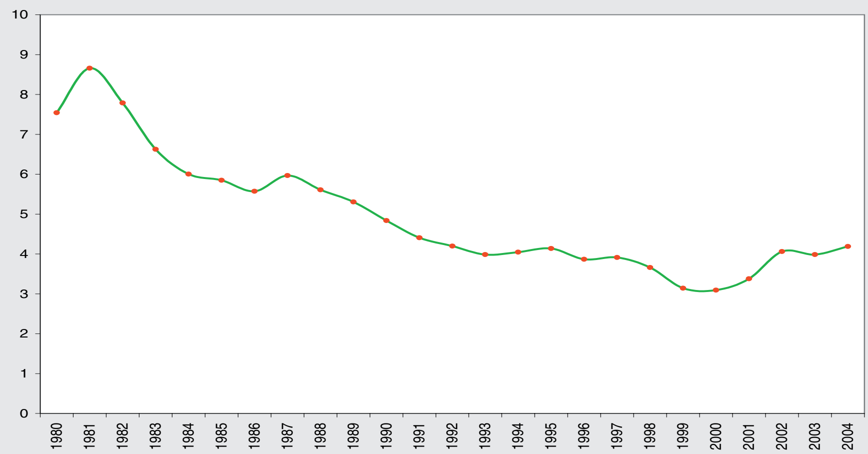
In the last decade, reforms carried out in Latin America and the Caribbean radically altered the economic structure in place hitherto, with a key part of this being the engagement of private capital in the development of utility infrastructure. Private investment, in the form of privatizations and concessions, was instrumental in the considerable development of the region's infrastructure.

Demand for these services has remained high, however, and the financial crises that have broken out since the end of the 1990s in countries both within and outside the region have interfered with private agents' investment decisions. Private investors have become highly sensitive to the financial and regulatory risk involved in this type of undertaking and tend to invest only in certain countries and particular projects. User surveys reveal mounting discontent regarding the quality and cost of the services on offer, which appears to reflect lack of competition in the markets and regulatory frameworks that have loopholes or are in some other way insufficient to protect users' rights. As a result, private capital flows going to infrastructure in Latin America and the Caribbean have fallen off sharply.

Moreover, the two traditional sources of funding for infrastructure, the public sector and the multilateral development banks, now account for only a small share of total financing. Until the end of the 1980s, funding was provided mainly by governments, which in turn received substantial assistance from multilateral banking institutions. This pattern shifted radically in the 1990s, however, when the private sector became the largest investor. As a result of fiscal constraints, public funding for investment in infrastructure is now at its lowest level in 20 years.

LATIN AMERICA AND THE CARIBBEAN (6 COUNTRIES): PUBLIC INVESTMENT, 1980-2004

(Percentages of GDP)



Box III.1 (concluded)

These constraints interfere with the disbursement of loans already approved by multilateral development banks as well, which means that not only is there a shortage of fresh funding, but flows of approved assistance have also declined. This type of financing is recorded as an expenditure in the public accounts, as, too, are the national counterpart or matching funds required for its disbursement. Under public expenditure containment policies, the budgetary appropriations to finance these contributions are habitually limited by quotas and ceilings, which delay the execution of loans and thus hinder the progress of works. Such constraints on the use of already approved bank resources motivated the *Carta de Lima* —a joint declaration by the representatives of 11 South American governments on the occasion of the forty-fifth Annual Meeting of the Inter-American Development Bank, held in Lima, Peru in March 2004— which proposes that investment funded by multilateral development bank loans should be differentiated from current spending.

Concerns over the drop in public investment relative to GDP have given rise to a number of recent proposals. A particular focus has been how public capital expenditures are entered in the accounts of countries that have some type of programme or arrangement with IMF. In practice, the aim would be to have budget controls and fiscal targets apply to current spending only, instead of total spending (which includes capital expenditures). A variation on this proposal is what is known as the "golden rule", which is based a requirement for the current account to be at equilibrium point or in surplus. Germany, the United States and the United Kingdom, among others, apply this rule today at the central government and subnational levels. It may be argued that investments and current spending are different economic phenomena and that, as such, they should be treated differently. A growth-orientated fiscal policy should therefore allow for this difference and avoid the application of limits or cutoffs for public investment in the case of projects whose rates of return will exceed the investment costs.

Following this line of thought, Easterly and Servén argue that the conventional fiscal rule —which imposes targets on the deficit, the public debt or both— does not take account of the assets generated by public investment,[b] but only of the cost of acquiring them, thus creating an anti-investment bias.[c] Fiscal control should revolve around the concept of solvency rather than deficit, as the former is more important for fiscal sustainability. It incorporates the notion that public spending, in this case public investment, must be compatible with governments' capacity to fulfil their obligations in the medium and long terms. The benefits and risks of using the current balance as a fiscal target are analysed in an IMF paper of 2004.[d]

From the above it is clear that the region's needs for infrastructure investment in new undertakings and in maintaining existing stocks exceed both the public funds available and the amounts contributed by the private sector and the multilateral banks. According to projections for the next few years prepared by Fay and Yepes of the World Bank, investment needs represent around 3% of GDP, whereas in 2001 the sum total of the resources available amounted to less than 2%.[e] Closing the gap between needs and availability will need the engagement of governments and private enterprise as well as support from multilateral institutions.

Governments have a key role to play. First, they must create the fiscal leeway to increase capital outlays from the budget, while keeping the public accounts solvent and sustainable. Second, they need to design clear public policies, regulatory frameworks and contractual criteria that take account of the needs of investors and users alike, and to develop and improve innovative mechanisms to engage the private sector. Lastly, they must assume good governance as a political commitment and a practice to inspire confidence in the private sector, protect users and reduce risks.

The private sector also has an important role in improving the region's infrastructure, through its involvement in public-private partnerships. For such programmes to be successful in practice, a high degree of coordination and trust between the public and private sectors must be ensured. These are long-term partnerships, in which, often, the only demander of the service operated by the private sector is the government itself and in which the usual risks (particularly financial risks) associated with this type of activity are transferred from the public to the private domain.

Lastly, it is essential to revitalize multilateral development bank assistance in order to reduce the region's unmet infrastructure needs. With this in mind, assistance strategies much include, first, the rebuilding of the investment loans portfolio, which has diminished considerably in recent years. Second, the multilateral banks have a special role in supporting the private sector, given their capacity to mobilize capital. They can stimulate investment in infrastructure by providing direct support to private enterprise, capital funds and financial institutions, in the form of investments of their own and through loans, including risk guarantee funds. It is essential to make good use of guarantees and instruments to protect against risk, which are necessary for private investors and governments alike.

[a] Based on Luis Lucioni, "La inversión para la provisión de servicios públicos y su financiamiento en América Latina y el Caribe: evolución reciente, situación actual y políticas", *Macroeconomía del desarrollo series*, No. 31 (LC/L.2213-P), Santiago, Chile, Economic Commission for Latin America and the Caribbean (ECLAC), 2004. United Nations publication, Sales No. S.04.II.G.135.

[b] William Easterly and Luis Servén, *The Limits of Stabilization Infrastructure, Public Deficits, and Growth in Latin America*, Standford University Press/World Bank, 2003.

[c] For a detailed analysis of possible strategies for addressing this bias, see Ricardo Martner and Varinia Tromben, "Opciones para enfrentar el sesgo anti-inversión pública", *Gestión pública series*, No. 50 (LC/L. 2321-P), Santiago, Chile, Economic Commission for Latin America and the Caribbean (ECLAC), 2005, in press. United Nations publication, Sales No. S.05.II.G.64.

[d] International Monetary Fund (IMF), *Public Investment and Fiscal Policy*, Washington, D.C., 2004 and *Public-Private Partnership*, Washington, D.C., 2004.

[e] For a more detailed analysis, see Marianne Fay and Tito Yepes, "Investing in infrastructure: what is needed from 2000 to 2010", *World Bank Policy Research Paper*, No. 3102, World Bank, 2003.

B. Exchange-rate policy

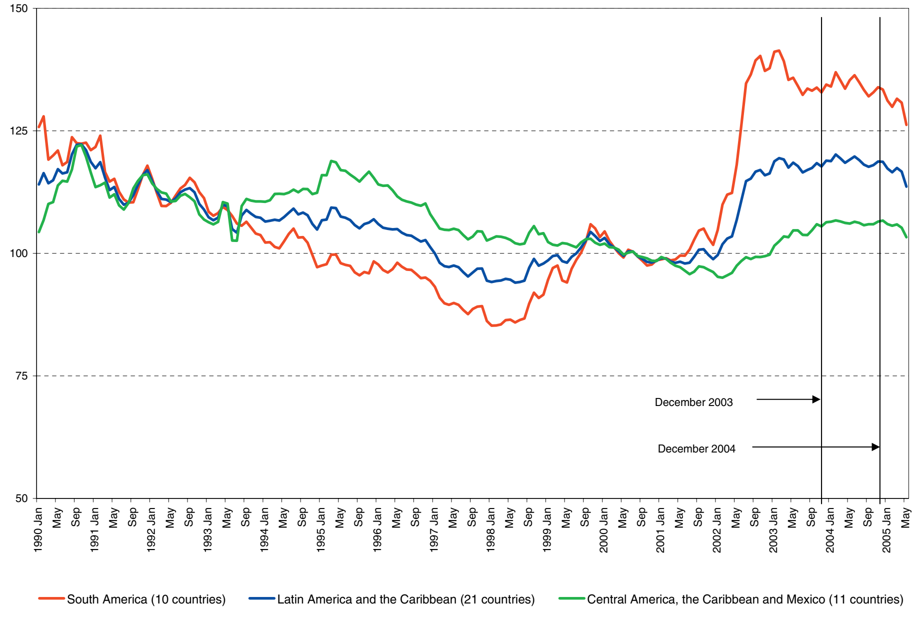
1. Regional and subregional overview

As shown in figure III.4, between December 2003 and December 2004, the currencies of the Latin American and Caribbean countries remained virtually unchanged in real effective terms with respect to the rest of the world, since they appreciated by a mere 0.2%. A more detailed examination of exchange-rate patterns in the region during 2004 shows an appreciation of 0.8% in South America's real effective extraregional exchange rate, which is defined as the real effective exchange rate excluding trade with other Latin American and Caribbean countries. Conversely, the extraregional exchange rate of those countries that trade mainly with the United States —the Central American and Caribbean countries and Mexico— depreciated slightly in real terms, by 0.3%.

Figure III.4

REAL EFFECTIVE EXCHANGE RATE NOT INCLUDING LATIN AMERICAN AND CARIBBEAN COUNTRIES [a]

(Simple averages)



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

[a] Index (2000=100).

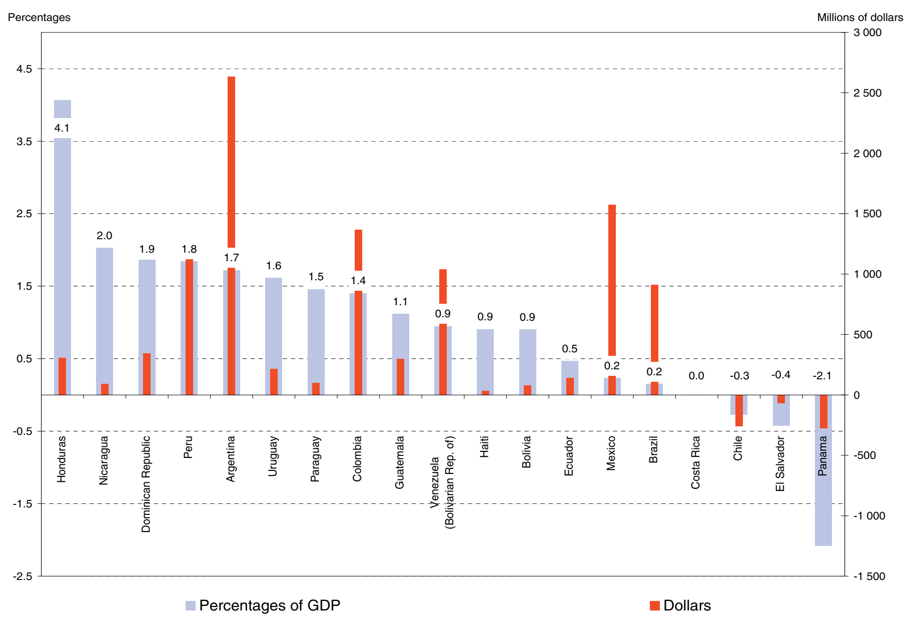
With respect to extraregional foreign currencies, real effective exchange rate movements in 2004 show a considerable appreciation of the currency in Colombia, Uruguay, Brazil and Guatemala, and depreciations of 5% or more in Paraguay, the Bolivarian Republic of Venezuela, Bolivia and Ecuador. A significant point in this period was that the United States dollar lost value in nominal terms against the Korean won (11.8%), the pound sterling (9.3%), the euro (8.1%) and the yen (3.8%). Calculations based on the average extraregional real effective exchange rate weighted by the real GDP of each country (in which Brazil, Mexico and Argentina account for 75% of the weighting) show that the currencies of Latin America and the Caribbean appreciated in real terms by 1.8% with respect to extraregional currencies.

With the dollar exhibiting weakness on the international markets as a result of fiscal and balance-of-payments disequilibria, only four of the non-dollarized economies witnessed real currency depreciation vis-à-vis the dollar between December 2003 and December 2004, namely Bolivarian Republic of Venezuela, Paraguay, Dominica and Bolivia, though the depreciation did not exceed 4% in any of these cases. At the other extreme, the real bilateral exchange rate against the dollar decreased (signifying an appreciation of the currency) by 37% in Dominican Republic and 25% in Haiti in 2004.

This regional pattern was partly attributable to favourable balance-of-payments outcomes in the Latin American countries, thanks to improved terms of trade and higher external demand for commodities, fuelled in turn by the buoyancy of the Chinese economy. In a low-inflation environment, which allowed for the adoption of more expansionary monetary policies, a number of the region's central banks built up international reserves in order to reduce the nominal appreciation of their respective national currencies. As shown in figure III.5, Peru, Colombia, Brazil and Mexico, among other countries, accumulated international reserves that were significant both in nominal terms and in relation to GDP. Despite intervention in the foreign-exchange markets, some countries (such as Colombia) were unable to prevent the nominal appreciation of their currencies in 2004 and, in a number of cases, into 2005.

Figure III.5

LATIN AMERICA AND THE CARIBBEAN: VARIATION IN NET RESERVES, 2003-2004 [a]



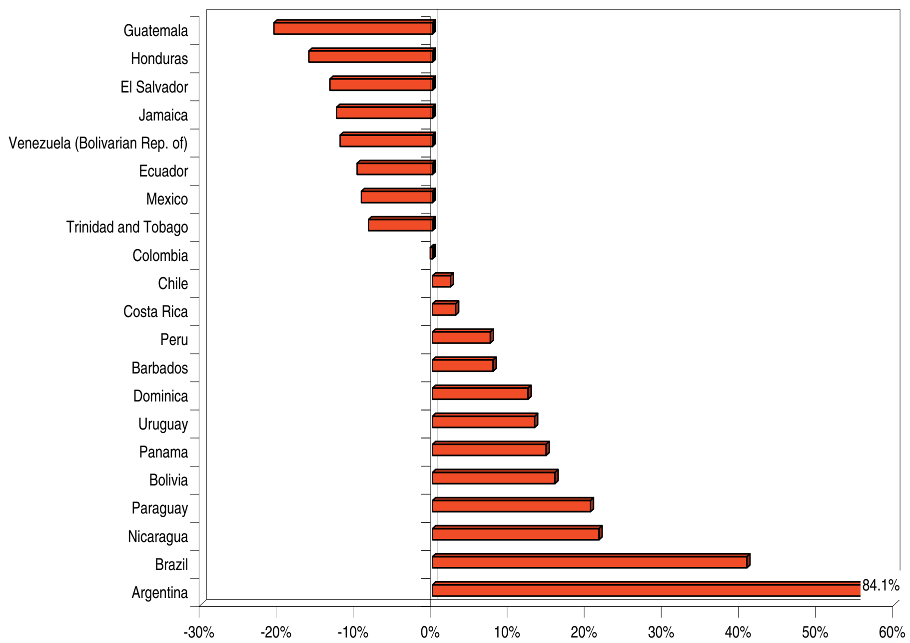
Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of figures from the International Monetary Fund (IMF).

[a] Does not include gold or reserves in the International Monetary Fund.

In the early months of 2005, the real effective extraregional exchange rate of Latin America and the Caribbean declined (a currency appreciation) by 4.3% on average with respect to December 2004. Practically all the countries experienced real effective appreciation in relation to currencies outside the region. The only exception among the 21 countries examined was the Bolivarian Republic of Venezuela, and this was due to a nominal depreciation of the bolívar decreed by the authorities in March 2005. The largest drops in the real effective extraregional exchange rate —and in the total real effective exchange rate, which includes each country's trade with other Latin American and Caribbean economies— were observed in the MERCOSUR countries, Colombia, Jamaica and Guatemala. The fact that the region's currencies posted an effective appreciation despite the gradual rise of interest rates in the United States as of the first semester of 2004 was a reflection of high international commodity prices, sharp fiscal and current-account imbalances in the United States economy, an increase in the export income of the region's petroleum-producing countries, a reduction in country-risk ratings and Argentina's debt restructuring, among other factors. As was mentioned in the introduction, the currencies of Brazil, Uruguay, Argentina and Dominican Republic rose in value by over 5% against the dollar in the first five months of 2005, with the only real depreciation of note being that of the Venezuelan bolívar, as explained above.

Despite this pattern, in the reporting period the Latin American and Caribbean countries maintained a high real effective extraregional exchange rate with respect to levels seen in the 1990s. As figure III.6 shows, today the total real effective exchange rates of the MERCOSUR countries and Bolivia exceed the figures of the 1990s, while Guatemala and El Salvador, among other countries, exhibit lower real effective exchange rates than at that time. In the specific cases of Mexico and the Bolivarian Republic of Venezuela, the average levels of the 1990s were quite high, which means that conclusions cannot readily be drawn on the basis of figures from that period alone. Comparisons between time-distant periods are further complicated by methodological changes in data calculation and by changes in the structure of trade and relative productivities, as well as other factors.

Figure III.6
TOTAL REAL EFFECTIVE EXCHANGE RATES [a]



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of figures from the International Monetary Fund (IMF).
[a] Average for January-May 2005 with respect to the historical average for January 1990-December 1999.

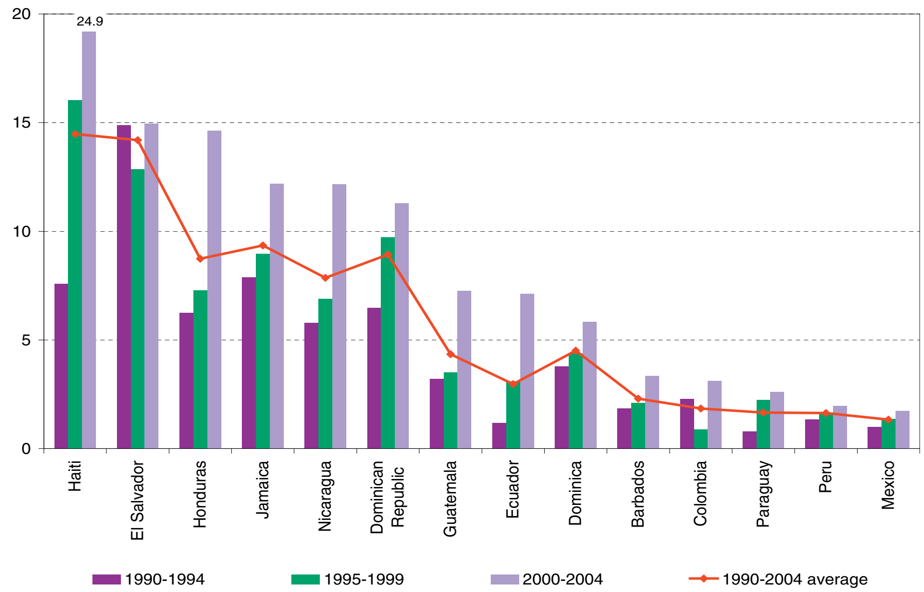
2. Emigrant remittances and the exchange rate

Remittances from emigrants have developed into highly significant sources of foreign-exchange income for a number of Latin American and Caribbean countries. Figure III.7 shows the magnitude of current transfers in the Caribbean countries, most of the Central American economies and some of South American ones, including, among others, Ecuador. It should be noted that —due to differences in measurement among countries and in the data available— net transfers were used as proximal indicators of remittances received, since remittances make up the bulk of net inward transfers in the countries mentioned.[14] In all the countries listed, with the exception of El Salvador and Colombia, transfers increased in the three periods examined. This section will look briefly at the effects that transfers of this magnitude can have on a country's real effective exchange rate.

Figure III.7

SELECTED LATIN AMERICAN AND CARIBBEAN COUNTRIES: NET INWARD TRANSFERS, 1990-2004

(Percentages of GDP)



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

Note: Data for 2004 not included for Barbados, Dominica and Jamaica.

First of all, the inflow of a large volume of foreign exchange can reduce the nominal exchange rate (causing the currency to appreciate) in the short term. If everything else remains constant, an increase in the supply of dollars in an economy reduces their relative scarcity with respect to the local currency at a given point in time and, therefore, the price of the dollar (that is, the nominal exchange rate) tends to drop. There are, however, factors that could mitigate the effect of increased supply of dollars on the local-currency dollar price. For example, a lower dollar price (a drop in the nominal exchange rate) could prompt firms to use their retained earnings to buy dollars in order to pay off their liabilities in that currency at a lower cost, which would push up demand for dollars. By the same token, a drop in the price of the dollar reduces the cost of imported as opposed to domestic inputs, which could boost demand for imports and, it follows, for the dollars to pay for them. The same goes for tradable goods consumed by

[14] For example, in 2004 workers' remittances represented 86.5% of net current transfers in Colombia and 84.7% in Ecuador.

the public. Generally speaking, however, an increase in the supply of a foreign currency does tend to reduce its price.

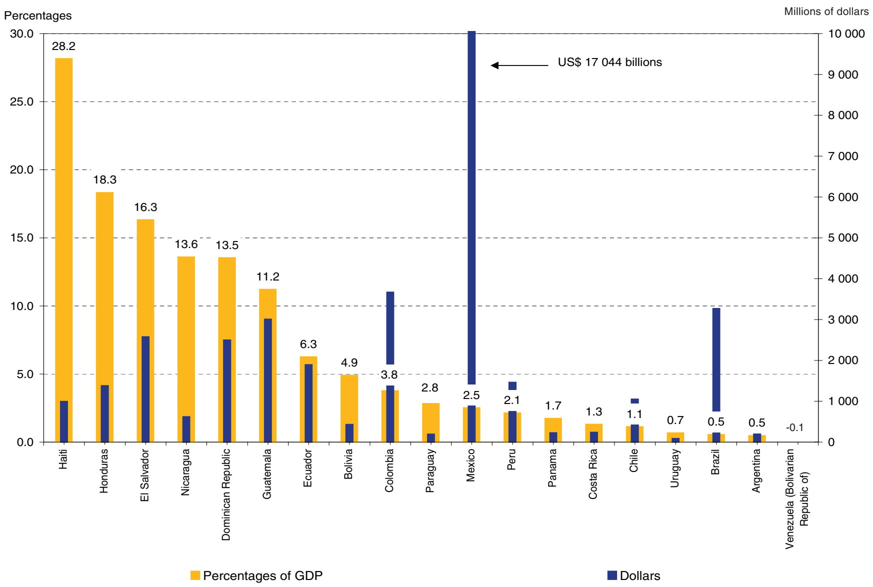
Second, another possible negative effect of large inflows of remittances has to do with the way they are used.[15] Remittances raise overall demand in the receiving country, both for tradable goods —whose local market prices are influenced or even, in a small economy, determined by their international prices— and for non-tradable goods, whose prices depend on the domestic market alone. This translates into a short-term increase in the relative price of non-tradable goods and, therefore, a drop in the real effective exchange rate (currency appreciation). If all else remains constant, this creates incentives for the expansion of non-tradable goods production and the production of the tradable goods sector tends to contract.[16] In combination, these two factors hinder the expansion of the remittance-receiving country's exports. Over long periods of time, distortions in relative prices can reduce investment in the tradable goods sector, including the commodities segment.[17]

A number of mechanisms can be used to neutralize the effects on the real exchange rate of short-term inflows of large volumes of foreign currency that result, in turn, from an improvement in commodity-exporting countries' terms of trade. One of these is to set up stabilization funds for the respective commodities, and another is for the central bank to buy and sterilize foreign currency, among other measures, to prevent excessive exchange-rate volatility. It is considerably more difficult, however, to prevent transfers of foreign currency that are significant in GDP terms and sustained over time from affecting relative prices between tradable and non-tradable goods in an economy. The phenomenon of emigrant remittances has been established for some years now in Latin America and the Caribbean. Moreover, the source of these remittances —people who emigrate, mainly to the United States, Spain, Italy and other European countries— shows no signs of drying up. In fact, as figure III.8 shows, several of the region's countries receive transfers that are very large in nominal terms as well as in relation to their economies. For all these reasons, the mechanisms used to contain temporary capital influxes are unlikely to be effective in the case of emigrant remittances.

Figure III.8

LATIN AMERICA AND THE CARIBBEAN: NET INWARD CURRENT TRANSFERS, 2004

(Including emigrant remittances)



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

15 See, among others, the classic analysis contained in Max W. Corden and Peter J. Neary, "Booming sector and de-industrialisation in a small open economy", *The Economic Journal*, vol. 92, No. 368, Royal Economic Society, 1982.

16 Incentives for sectoral allocation of the factors of production arising from relative price variation can be more limited in dual economies that have high rates of unemployment, low productivity and different kinds of distortions.

17 "Dutch disease" is a phenomenon originally associated with large inflows of foreign currency into a country following the discovery and export of natural resources such as petroleum and gas. It takes its name from the effects on the Netherlands of the exploitation of large gas reserves in the North Sea beginning in the 1960s.

This raises the question of how to ensure that, in addition to creating positive effects in the short term (such as reducing domestic poverty, increasing domestic consumption and financing short-term balance-of-payments disequilibria), capital inflows in the form of remittances do not undermine the long-term competitiveness of the economy's tradable goods sector.

The key to this lies in the fact that, although in the short and medium terms remittances increase the prices of non-tradable relative to tradable goods, their dynamic long-term effect depends on how they are used. If remittances could be invested in the export sector, the resulting increase in productivity and drop in costs in that sector could offset the exchange-rate appreciation triggered by Dutch disease.[18] If they were used to fuel the productivity of the non-tradable goods sector, this too could help to compensate for the effects of Dutch disease. Higher productivity could then increase long-run exchange-rate competitiveness, provided that the degree of competition in the non-tradable goods market allows productivity gains to be passed through to prices. This would be particularly effective in the case of activities producing non-tradable goods that represent important inputs for export industries (which include utilities, infrastructure and business services). A number of studies have found that the bulk of remittances in Latin America and the Caribbean go to finance consumer spending, however.[19] It is therefore unlikely that their long-term effect on relative prices can compensate for short-term upward pressure on the exchange rate in the region. This statement will be borne out to the extent that empirical evidence —which does appear to be emerging— shows remittances going to population groups with unmet consumption needs. In these circumstances, three lines of action are available to the State to minimize exposure to Dutch disease. First, it can create the conditions to encourage the portion of remittances not spent on consumption to be spent on capital formation. Second, it can save (by cutting spending, for example) to compensate for the increase in private spending funded by remittances. Lastly, it can attempt to minimize any distortion that could heighten the effect of the increase in the relative price of non-tradable, as opposed to tradable, goods.

The calculation of a country's equilibrium exchange rate at a given point in time is an empirically difficult proposition, which, in turn, makes it hard to determine whether or not its real effective exchange rate is at equilibrium point. Figure III.6 does show, however, that Guatemala, El Salvador and Mexico, among other countries, exhibit effective exchange rates substantially below their historical averages. Figures III.7 and III.8 show that these countries have also received large volumes of current transfers (and remittances) in the last few years.

To conclude, emigrant remittances are particularly likely to contribute to effective exchange-rate appreciation in Latin American and Caribbean countries that export mainly commodities such as petroleum, and this can also expose them to Dutch disease. Ecuador is a case in point. In 2004, Ecuador received current transfers in the amount of US$ 1.894 billion, which was equivalent to 6.3% of GDP (of which US$ 1.604 billion, or 5.3% of GDP, was accounted for by emigrant remittances) and exported US$ 3.899 billion (12.9% of GDP) in crude petroleum. Ecuador, it will be recalled, adopted the United States dollar as legal tender in January 2000.

3. Central bank intervention in the foreign-exchange market

In 2004 and 2005, the central banks of Colombia, Brazil, Guatemala, Argentina and Peru, among others, intervened (in some cases substantially) in their respective country's foreign exchange market by buying dollars. The many reasons for monetary authorities to take this type of step include the following:

(i) To reduce temporary nominal or real exchange rate volatility. By definition, this type of intervention can

[18] The Balassa-Samuelson effect of intersectoral productivity differentials on real exchange rates must also be taken into account. That is, increased productivity must compensate for a real appreciation that is greater than that directly attributable to remittances.

[19] Manuel Orozco, *Remittances to Latin America and the Caribbean: Issues and Perspectives on Development*, Report commissioned by the Office for the Summit Process, Organisation of American States (OAS), September, 2004.

occur in either direction. That is, it may consist of the buying or selling of foreign currency. It is sporadic, since its purpose is not to "defend" a fixed exchange rate or band by means of continued interventions over long periods of time, but to absorb excess amounts of foreign currency that are considered abnormal at a particular juncture, or to inject additional amounts when the opposite is true.

(ii) To meet an inflation target. In this case, the intervention is intended to take into account and to moderate the pass-through from exchange rate depreciation to inflation. The intervention is made only to the extent that exchange rate variation affects compliance with the inflation target.

(iii) To acquire reserves. This is perhaps the least clear-cut of all interventions. In theory, the purpose of intervention to build up reserves is to increase the authorities' manoeuvring room to deal with serious exchange rate misalignments. It serves to create a "war chest" that can be opened in response to sudden demand for foreign exchange in the event of abrupt changes in the expectations of economic agents, especially in countries that have a flexible exchange rate and are victims of frequent external shocks —with respect to terms of trade, for example— or domestic shocks triggered by political circumstances, among others. This "emergency stock" of foreign exchange is particularly useful in countries with highly dollarized financial systems. It has also proven effective in countries where underdeveloped domestic financial markets, liquidity constraints or other factors prevent the transaction of derivatives to guard against shocks.[20]

(iv) To maintain an explicit or implicit exchange rate parity (at a specific value or within a band, whether symmetrical or not). This can happen even in countries which have theoretically flexible exchange rates.

It is actually very difficult to ascertain the empirical magnitude of central bank intervention in Latin America and the Caribbean, especially where other State-owned financial institutions intervene in the currency market as well. It is even more challenging to pinpoint the reasons for this intervention. This last point leads to the mechanisms through which intervention affects the exchange rate. There are three of these, namely:[21]

(i) Monetary policy. If real interest rates vary, an unforeseen variation in the monetary stance that goes unsterilized will alter the exchange rate.

(ii) Portfolio balance. If portfolio assets are not perfectly substitutable, a change in relative availability causes a variation in their relative prices, that is, in the exchange rate. This is especially true in markets whose liquidity is tight, in which the central bank is a key agent.

(iii) Expectations. Although an intervention may be interpreted in many ways, a central bank's actions today lead agents to draw inferences about its probable monetary and exchange-rate policy stance in the future and may therefore alter the behaviour of those agents. Conversely, a particular intervention by the central bank today may encourage a certain reaction in the future.

An intervention is likely to be aimed at maintaining exchange-rate parity at a certain level or within a band in any of the following circumstances: when it goes on over time or involves only purchases or sales of foreign currency but not both; when the central bank already has a large stock of foreign exchange and can buy it quickly and easily in the market; and when inflation control alone does not appear to account for the measure (for example when inflation is below the established target).

A central bank's two main forms of direct and unsterilized intervention are open market buying and selling of public securities and the transaction of foreign exchange on the spot market. In 2004, as mentioned, the central banks of a number of countries opted to inject liquidity into the system by buying foreign exchange, rather than repurchasing public securities, which tends to indicate an intent to influence the nominal exchange rate, as well as the volume of the local currency supply and the rate of inflation.

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[20] For example, instead of selling dollars in the spot market, the central bank may hold a long dollar position in the futures market and a short local currency position.

[21] For a more detailed analysis see D. Archer, "Foreign exchange market intervention: methods and tactics", *BIS Papers*, No. 24, Bank of International Settlements (BIS), May, 2005.

Box III.2

HOW THE REAL EFFECTIVE EXCHANGE RATE IS CALCULATED

For some years now, in both the *Economic Survey of Latin America and the Caribbean* and the *Preliminary Overview of the Economies of Latin America and the Caribbean*, ECLAC has used nominal, real and effective exchange rates to analyse exchange rate patterns in the countries of the region. The last of these three is calculated using series prepared by the Commission.

The nominal exchange rate for a foreign currency is defined as the number of units of a particular country's currency that must be surrendered in exchange for one unit of the foreign currency at any given point in time. A country's currency depreciates in nominal terms when, at that point in time, more units of local currency must be surrendered in exchange for one unit of the foreign currency than during the reference period. Similarly, it appreciates when fewer units of local currency will buy one unit of the foreign currency. The real bilateral exchange rate with respect to a foreign currency (such as the United States dollar) is calculated by deflating the nominal exchange rate by the ratio between the rates of inflation in the two countries (one of which, in the case of the dollar, is the United States). The rate of inflation is calculated from the consumer price index. A currency depreciates in real terms when the real bilateral exchange rate index rises, and appreciates when it falls. The real effective exchange rate index is calculated by weighting the real bilateral exchange rate indexes of each trading partner by that partner's share in the country's total trade, whether exports or imports. This edition of the *Economic Survey* uses the average real effective exchange rate of exports and imports. A currency depreciates in real effective terms when the respective index rises, and appreciates when it falls.

The latest version of the real effective exchange rates series, which was used for the calculations in this section, has the following characteristics:

(i) It uses geometrical averages in all calculations requiring averages.

(ii) It takes into account trade with virtually all countries that represent more than 0.5% of the region's total trade.

(iii) In the case of the Central American countries with a maquila industry and Mexico, trade weightings are used to reflect exports and imports as faithfully as possible. To this end, the value added by the maquila industry is added to exports that do not include maquila.

(iv) Trade with the few extraregional non-petroleum producing countries that is not measured individually in the calculations and that could be significant in the case of a particular Latin American or Caribbean country is grouped with the country whose bilateral exchange rate pattern is most similar in the reporting period, in accordance with standardized statistical criteria.

It should be noted that trade in all types of goods is taken into account in the calculation of the real effective exchange rate of each country. It would be inconsistent to leave out trade in certain types of merchandise (petroleum, for example) and not others (say, metals such as copper) for some countries and not others.

For the first time, this year's *Economic Survey* incorporates a new series: the real effective exchange rates of each country with respect to the "rest of the world". For this series, the real effective exchange rate for each country in the region (and groups of countries in the region) is calculated without including either trade or real bilateral exchange rates with other Latin American and Caribbean countries. This series has been denominated "real effective extraregional exchange rate" and its purpose is to complement the analysis of each country's exchange rate patterns with respect to all its trading partners (that is, the total real effective exchange rate), in order to study how the real effective exchange rate of the region —calculated as a simple or weighted average of the real effective exchange rates of the countries— behaves with respect to the currencies of significant trading partners outside the region.

By eliminating intraregional trade from the calculation of the real effective exchange rate of each of the region's countries, a simple indicator is obtained of how the differential trends in rates of inflation and nominal exchange rates of non-regional countries affect the exchange-rate competitiveness of the region and its subregions.

C. Monetary policy

Monetary policy in the region has been handed different challenges from previous years. Massive external resources from increased exports and capital inflows have swelled the liquidity of the economies and built up the central banks' international reserves, thus pushing up the value of local currencies. To prevent excessive currency appreciation, the monetary authorities have had to sterilize the increased liquidity and inflationary effects, in some cases by means of open market operations, and conduct foreign currency transactions. The central banks have also tended to increase interest rates, following the suit of the United States Federal Reserve, but at a gradual pace that has kept these rates relatively low in historical terms.

1. The external environment

Over the last two years, as discussed in chapter II, the region's economies have been reaping the benefits of renewed growth in the external environment. This greater buoyancy has come of increased liquidity in the global economy caused, in turn, by expansionary monetary conditions in the United States, Europe and Japan, combined with hikes in military spending in the United States and in fiscal expenditures in Japan, as well as flows of portfolio resources into the United States. The economies have benefited from larger capital inflows and the narrower spreads on loans. Better terms for exports, especially of natural resources, have boosted foreign-currency returns and provided much of the fuel for growth, especially in 2004.

The situation continued to favour the region even after the Board of Governors of the Federal Reserve System decreed an increase in the federal funds rate on 30 June 2004, thereby prompting the region's central banks to begin raising monetary policy interest rates. Cautiously, the authorities began to reel in the expansionary monetary policies —based on interest rate cuts— that had been in place in most of the region's countries since 2002. Their circumspection meant that interest rates rose only moderately and, in many cases, did not diverge much from the very low rates seen in the first semester of 2004.

2. Monetary policy in the region

Control of inflation continues to be the main objective of monetary policy. Current conditions, however, are forcing a number of central banks to pursue multiple objectives and choose between two or even three policy priorities: to avert excessive currency appreciation, keep inflation on target or prevent sterilization from engendering greater fiscal problems. To these could be added a fourth —to maintain a stable spread between domestic and international interest rates.

The upswing in the global economy has raised monetary policy challenges that differ from the issues of two years ago. The Latin American and Caribbean countries have received a large amount of external funds from exports and capital flows, which have tended to swell international reserves. In many cases, the resulting monetary expansion has had to be sterilized, which has brought unwanted fiscal repercussions. External resources have tended to entail a local currency appreciation, which central banks have moderated from time to time by intervening in the foreign-exchange markets. Higher petroleum prices have compounded this situation by pushing up price indexes and, in some cases, endangering the achievement of inflation targets. The form the monetary authorities' intervention has taken has depended partly on their policy regarding inflation.

A variety of monetary policy schemes are in place in the countries of the region, broadly falling into three categories today. First, Brazil, Colombia, Chile, Peru and Mexico adopted a regime of inflation targets together with a flexible exchange rate, in which 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. This is the case of Bolivia and Uruguay, where a high proportion of deposits are denominated in dollars. This is also true in Peru, which, nonetheless, has adopted an inflation-targeting scheme. Third, the majority of the countries use a monetary aggregate as a policy instrument and even intervene in their foreign-exchange markets. Lastly, three countries have a currency system tied to the United States dollar: Panama (since 1904), Ecuador and El Salvador. These countries use the dollar as legal tender, which has meant dispensing with monetary policy altogether. Their interest rates thus vary in a very similar fashion to the international rates. In Panama, which has a highly developed and efficient banking system, interest rates are practically the same as the international rates.

Up until mid-2004, countries that were on course towards their inflation targets used monetary policy to drive the economy by means of successive interest rate cuts. Once the economy was established on an upward track, in most cases the central bank began to cautiously raise monetary policy rates, so as to avoid diverging from the international rates and reducing incentives for external capital.

Other central banks shifted to a tighter monetary policy stance in response to fresh inflationary surges. Cases in point are Mexico and Brazil, which run inflation-targeting schemes. Different factors, interestingly enough, are driving price rises in the two countries. In Brazil, demand is clearly the source of upward pressure on prices, whereas in Mexico, the pressure is coming from supply, especially of food and other commodities (except for petroleum).

Mexico's rate of inflation has breached the target of 2%-4% per year, prompting the monetary authority to further tighten its stance by means of successive rises in the rate of the main monetary instrument, a liquidity restriction known as the corto. This determines daily excess demand for funds in the banking system and thereby drains liquidity from the money market, putting upward pressure on interest rates. Although the corto was raised 10 times in 11 months, abundant liquidity from external sources detracted from its efficiency as an upward driver of interest rates. In February 2005 this induced the central bank to establish a minimum rate of interest for open-market operations for the first time in seven years.

In Brazil, the central bank withstood pressures to alter its monetary policy and increased the Special System of Clearance and Custody (SELIC) rate from 16.2% in September 2004 to 19.75% in May 2005, in an environment of high interest rates, currency appreciation, a slackening rate of economic growth and inflation that has been slow to recede. This situation has engendered a debate on the central bank's degree of autonomy, especially its power to set the monetary policy interest rate. The central bank expects annual inflation to come in below the 7% ceiling at the end of the year, which would permit a cut in interest rates. Inflation began to ease in June, allowing the central bank to keep the SELIC rate unchanged, and is expected to drop substantially —to 4.5%— around the end of the year.

Argentina's central bank intervened heavily in the foreign-exchange market in a bid to stabilize the exchange rate, given the local currency's tendency to appreciate, and sterilized the respective transactions in order to meet its monetary targets. Inflation has been further fuelled by monetary and wage pressures, however, and there is a consensus that this year's goal of keeping inflation below 8% will not be reached.

In Peru, the new sol's appreciation against the dollar led the central bank to make use of the degrees of freedom conferred by the sharp fall-off in inflation by buying US$ 2.3 billion in 2004 and US$ 1 billion in the early months of 2005. To counteract the expansion of the money supply, the central bank sterilized its dollar purchases through the placement of certificates of deposit, which will result in losses for the bank and pose a challenge to management of the public finances.

Colombia has also faced problems caused by the appreciation of its currency, leading to a sustained intervention in the foreign-exchange market. The Government also requested the central bank to sell a portion of its international reserves for bonds, triggering objections in certain circles that fear a loss of central bank independence.

3. Interest rates

(a) Nominal interest rates

Interbank operations represent an alternative to deposit-taking for financing banking operations. A close link between interbank and deposit rates thus indicates a good degree of control of monetary policy. The two rates are practically the same in Brazil, Chile, Costa Rica, Peru, Argentina and, from the second semester of 2004 on, Colombia (see figure III.9). Other countries, including Bolivia, Paraguay and Bolivarian Republic of Venezuela, record larger differences and variations. The most interesting case is that of Dominican Republic, where steep inflation in 2003 and 2004 opened up a wide gap between interbank and deposit rates, which then realigned as the counter-inflation programme took effect.

The central banks of a number of countries have, in turn, raised the interest rate they control, which has been reflected in interbank and deposit rates. The most obvious case is Chile, where the central bank has increased its monetary policy rate by over 160 basis points from the low recorded in August 2004. Nevertheless, the increases have been small and nominal rates are still low compared with previous periods.

(b) Real interest rates

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

Real interest rates can be analysed from different points of view (real deposit rates are used for consistency's sake).

First is the level of the rate. Dominican Republic has particularly high real deposit rates, of around 20% per year, which has to do with the programme to curb inflation, after the 2003 surge in inflation had translated into highly negative real rates. In Paraguay too, the crisis pushed real deposit rates above 29% in mid-2003. Brazil's real interest rates also exceeded 20% in 2003 and then stabilized in early 2004 at around 10%, where they remain today. At the other extreme is the Bolivarian Republic of Venezuela, where real deposit rates have been consistently negative or close to zero since 2002.

Second is the trend of real interest rates. In most of the countries, the real rates at the start of 2005 were lower or very similar to the figures for early 2003. This is consistent with the upturn registered in the majority of the economies. The exception is Dominican Republic, owing to the inflation control programme mentioned above.

Lastly, short-term real interest rate movements are sometimes useful for making projections of economic activity within the same period. Since the real rate is a ratio, an unforeseen jump in inflation will bring it down, as illustrated by the case of the Dominican Republic. This differs from a "normal" situation in which real rates are driven down by forces in the economy.

The prevailing trend in the last few months has been towards a rise in real lending rates, reflecting the reversal of the interest rate cycle begun by the United States Federal Reserve in June 2004 and continued by the region's central banks. Where real interest rates have come down, the reason is that inflation has risen faster than nominal interest rates; this is the case of Mexico, Chile and Paraguay.

(c) Country-specific considerations

The crisis that originated in Argentina seriously interfered with Paraguay's and Uruguay's banking system, as well as its own. The banks have been returning slowly to solvency in these three countries.

In Costa Rica, Guatemala and Honduras, higher-than-expected increases in international reserves have endangered compliance with monetary targets. The respective central banks have responded with sterilization operations and, in the case of Guatemala, with interest rate hikes.

The English-speaking Caribbean countries also felt the effects of the external factors discussed here. In general, they have received resources from abroad that have swelled liquidity and —since these monies have not been fully sterilized— international reserves. This has caused a short-term drop in interest rates which, in turn, has eased the burden of the debt.

After a contraction in real terms that lasted until the end of 2003, bank credit recorded a strong climb in 2004, steepening into 2005. The largest jump was registered in the Bolivarian Republic of Venezuela (80%), while Argentina, Brazil, Chile, Colombia and Mexico also posted rates of over 20%. Despite the favourable environment, bank credit is less developed in Latin America and the Caribbean than in other regions, which is a reflection of the frequent economic crises that have broken out there, causing severe setbacks to credit and hindering the consolidation of the sector.

Figure III.9

NOMINAL INTEREST RATES [a]

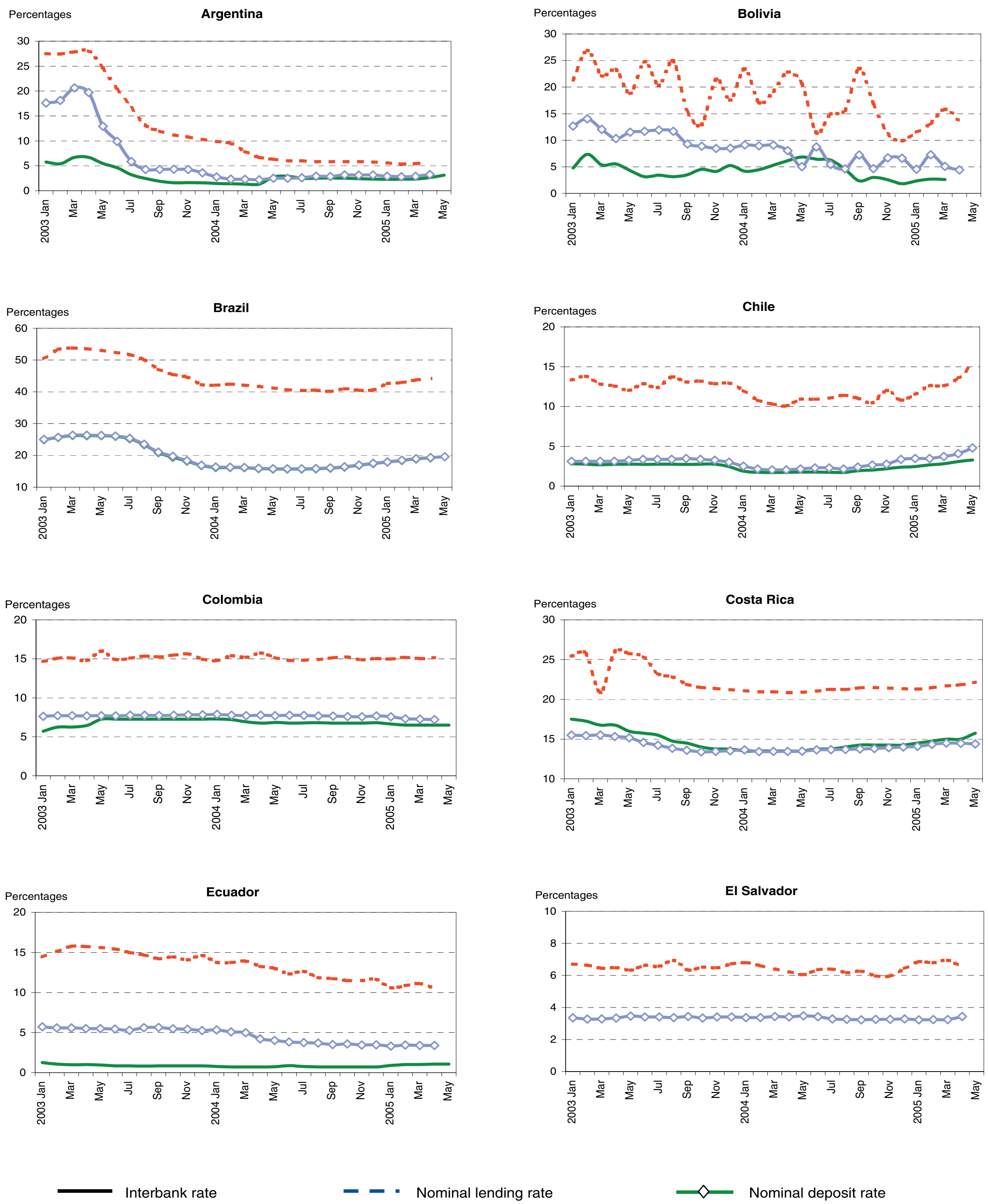
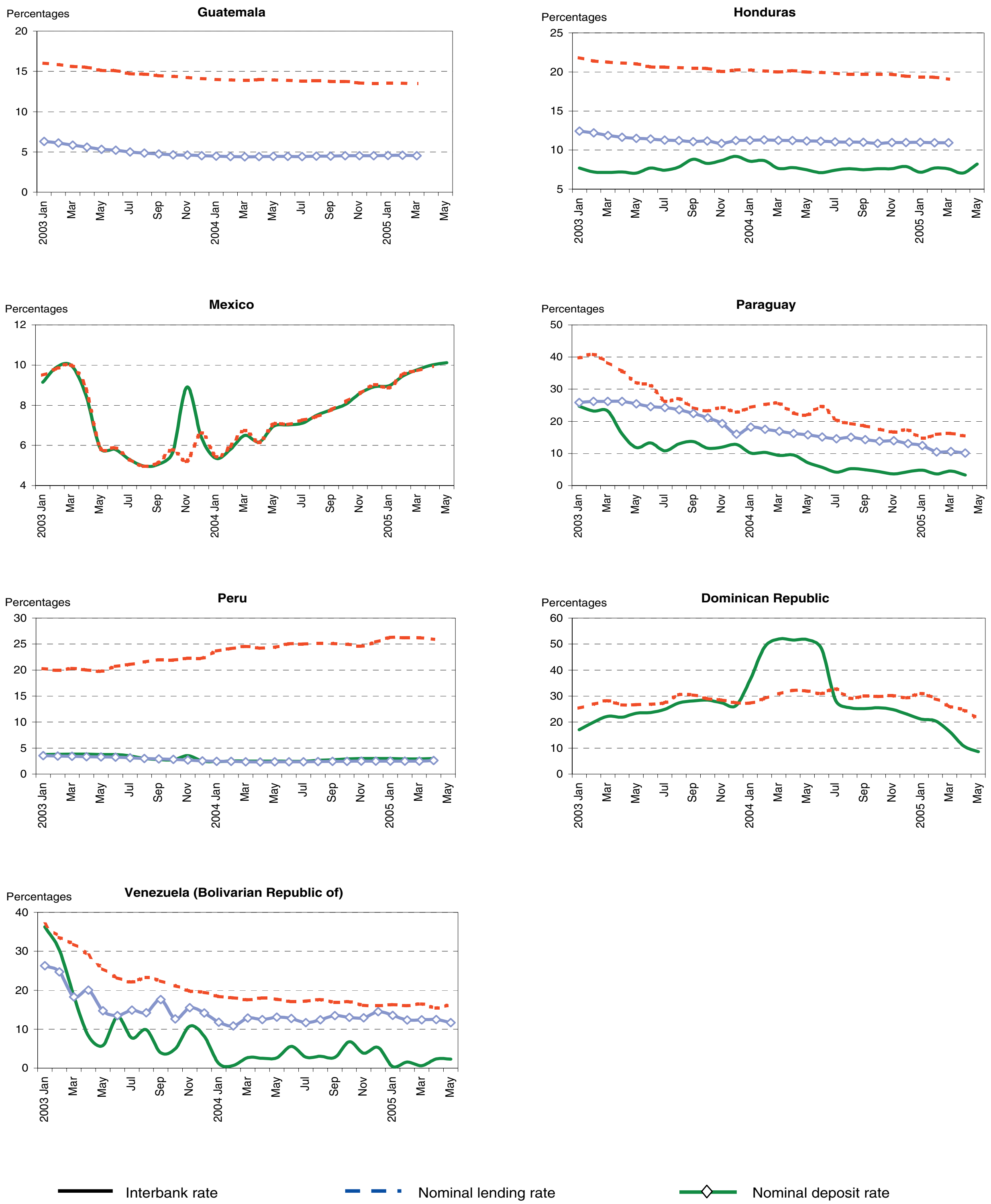


Figure III.9 (concluded)



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.
[a] Three-month moving average centered on the month shown.

Figure III.10
REAL DEPOSIT RATES [a]
(Percentages)

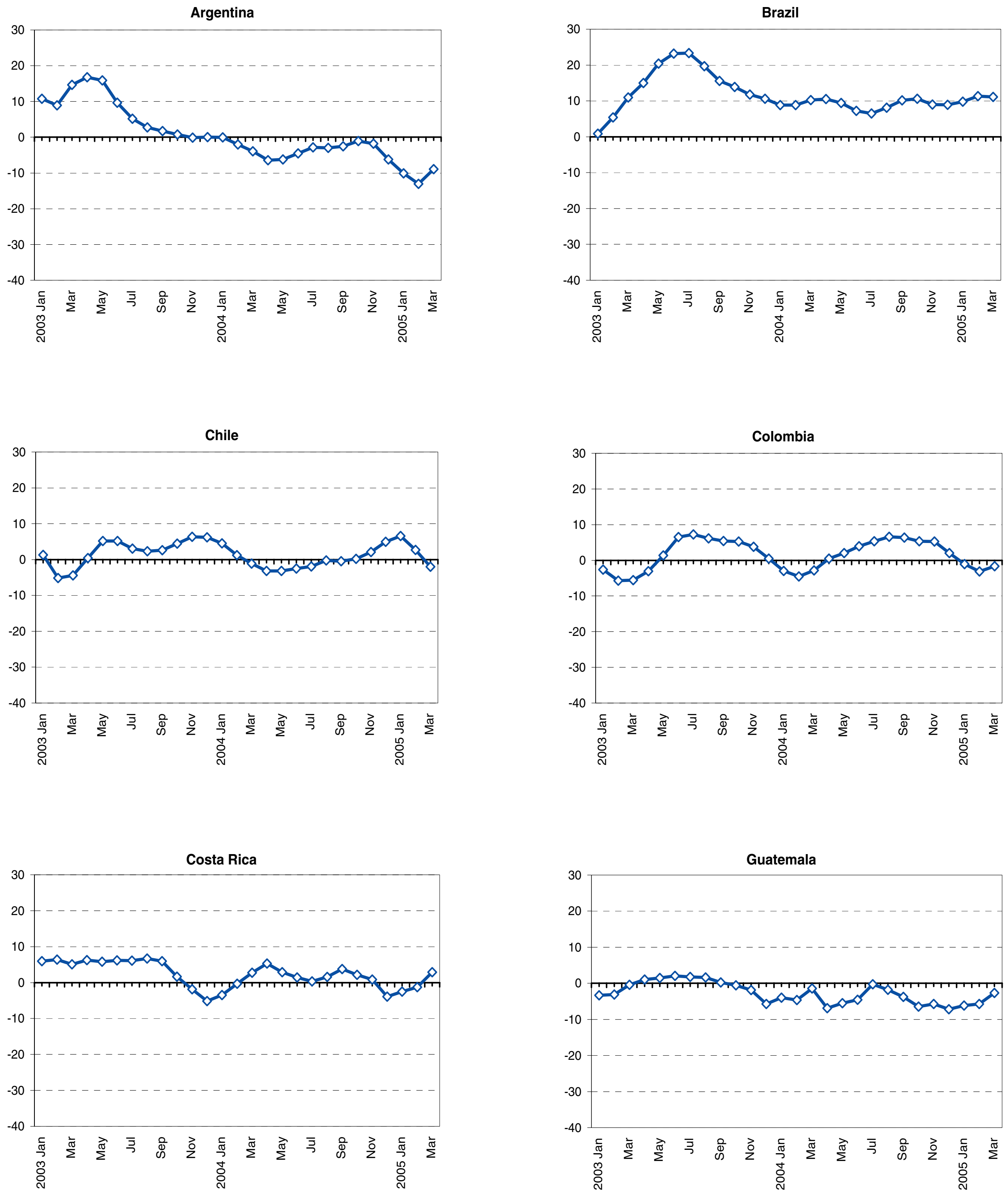
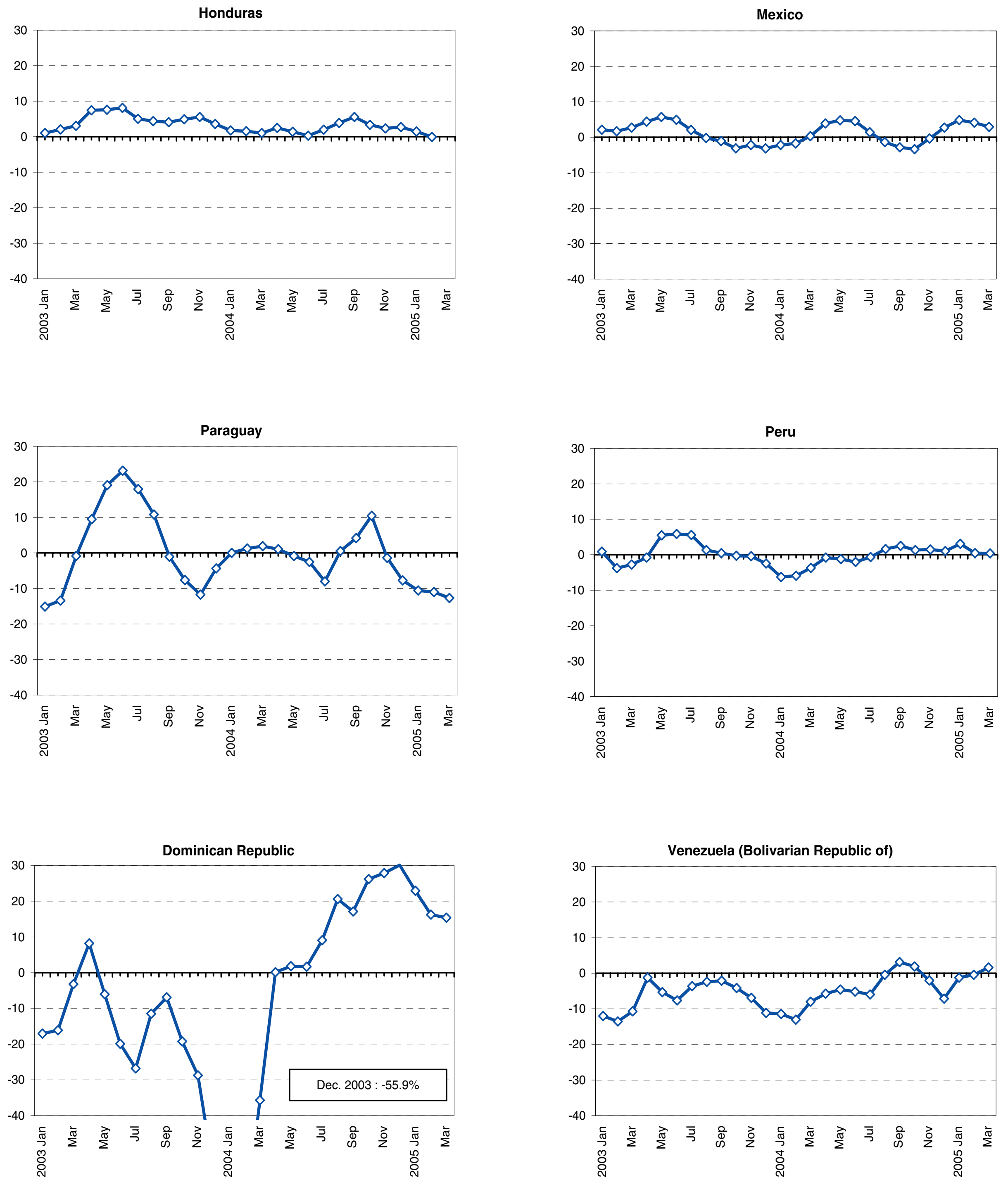


Figure III.10 (concluded)



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.
[a] Three-month moving average centered on the month shown. Real rates are calculated as r = i – p, where i is the nominal rate and p is annualized inflation.

Chapter IV

Domestic performance

A. Activity and investment

In 2004 the gross domestic product of the Latin American and Caribbean economies grew by 5.9%, while per capita GDP rose by 4.4%.[1] This performance represented an improvement on the figures for the 1998-2003 period when regional GDP grew at an average annual rate of 1.1%, which resulted in an average annual growth rate of -0.4% for per capita GDP (see figure IV.1).[2] Economic activity should remain buoyant in 2005, although with a lower rate of expansion of around 4%, similar to that recorded in the first quarter.

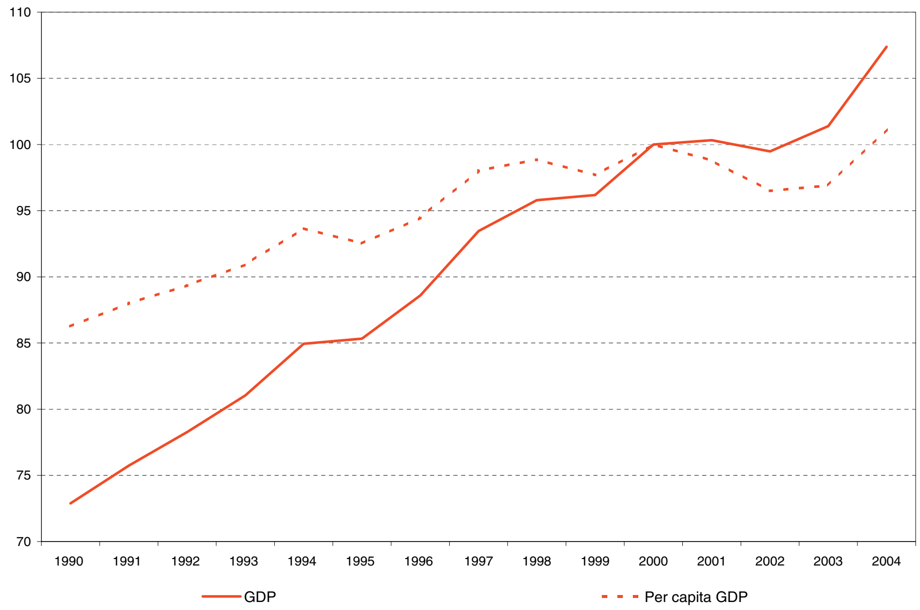
These positive regional results for 2004 reflect the performance of most of the economies since, with the exception of Haiti (-3.8%), all the Latin American and Caribbean countries turned in positive growth rates. The Bolivarian Republic of Venezuela, Uruguay and Argentina recorded the region's highest levels of growth (17.9%, 12.3% and 9%, respectively), in a continuation of the economic upturn began in those countries in 2003 following the crises of earlier years.

1 Calculated on the basis of new regional series produced by ECLAC in 2000 dollars.
2 In 2003, the GDP of Latin American and Caribbean countries was 5.9% higher than in 1998, but the region's per capita GDP was 2% lower than in that year.

Figure IV.1

LATIN AMERICA AND THE CARIBBEAN: GROSS DOMESTIC PRODUCT AND PER CAPITA GROSS DOMESTIC PRODUCT

(Millions of dollars at 2000 prices, index 2000=100)



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

The countries' economic performance reflected a fairly even upward trend throughout 2004, as levels of economic activity gradually increased and a number of countries even made up for losses sustained in the first few years of the decade (Argentina, Bolivarian Republic of Venezuela, Uruguay). The pace of economic expansion slowed in the second half of the year, however. Whereas the quarterly year-on-year growth rates of 6% or higher recorded since the fourth quarter of 2003 continued (see figure IV.2), economic expansion expressed as quarterly GDP growth in relation to the immediately preceding quarter slowed in the second half of the year, even though this variable remained positive and above 1% (see figure IV.3).[3] This slowdown continued into the first quarter of 2005, when regional GDP was up by 4.1% compared with the first quarter of 2004 and by 0.7% in relation to the last quarter of 2004.

The region's economic performance in 2004 reflected the persistence and continued effects of trends first observed in the second half of 2003. The strong expansion of the Asian economies, which was related to the acceleration of economic activity in the United States, boosted both demand and prices for the region's commodity exports, primarily minerals, metals and some agricultural products. Increased buoyancy in Asia and the United States economy was combined with a rise in activity in Japan and the European Union. The prices of commodities that are important to the region remained high throughout 2004. This heightened the terms-of-trade effect and the resulting positive impact on domestic economic activity by stimulating first an upturn in investment and later an increase in consumption. Continuingly high international petroleum prices benefited net oil exporters, helping to boost the fiscal revenues of countries whose petroleum income represents a significant proportion of the tax take.

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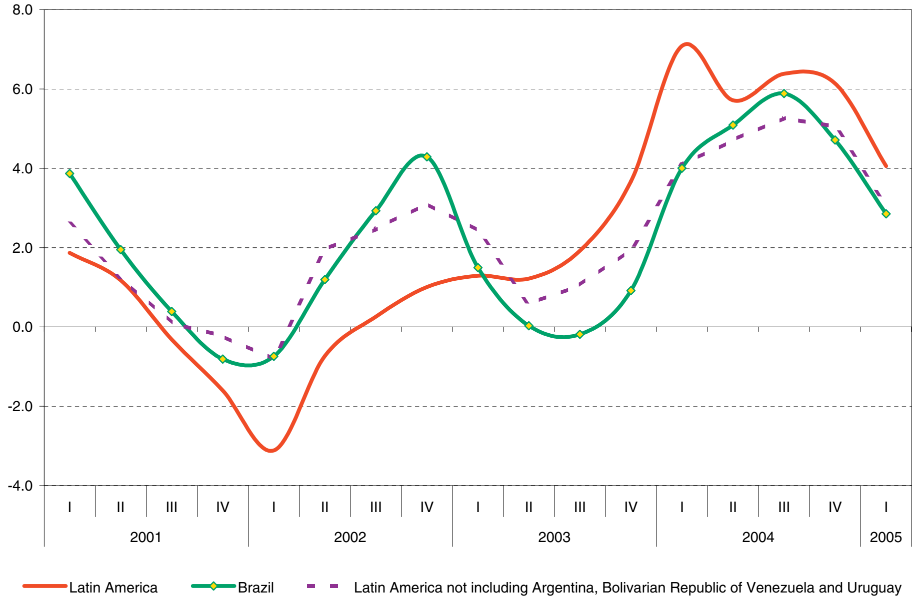
[3] In constant 2000 dollars, seasonally adjusted.

Figure IV.2

LATIN AMERICA AND THE CARIBBEAN: QUARTERLY GDP GROWTH RATES COMPARED WITH THE SAME QUARTER OF THE PREVIOUS YEAR

(Dollars at 2000 prices)

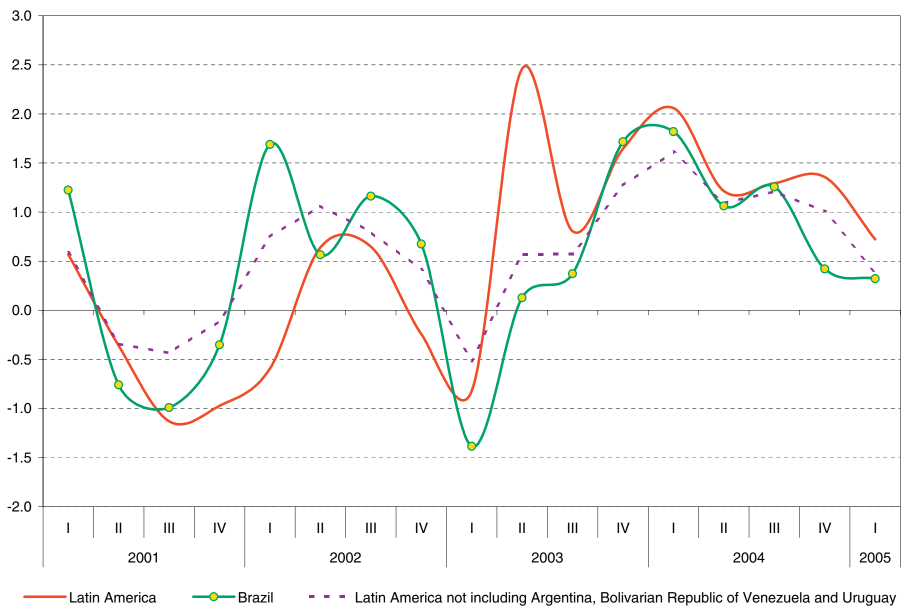


Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.

Figure IV.3

LATIN AMERICA AND THE CARIBBEAN: QUARTERLY GDP GROWTH RATES IN RELATION TO THE PRECEDING QUARTER, SEASONALLY ADJUSTED

(Dollars at 2000 prices)



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

Economic growth in 2004 was defined by the combined effect of favourable economic conditions (which contributed to the positive performance of exports) and the increase in domestic demand. The momentum that the international economy had acquired in the final quarter of 2003 continued throughout 2004, thereby pushing up both prices and international demand for commodities. In addition to this, the devaluation of the real exchange rate in most of the countries of the region during 2002 and some of 2003 helped to boost the exchange-rate competitiveness of the export sector. Despite the exchange-rate appreciations recorded during 2004, particularly in the second half of the year, exchange-rate trends continued to benefit the export sector in many countries during much of the year. Also, higher external demand pushed up the volume of external sales of Latin American countries, while continuing high prices for export commodities brought in considerable income for export sectors. The volume exported by the region grew by 12.4% in 2004, within the upward trend that exports have displayed consistently during the 1990s and the current decade. External sales accounted for 23.4% of GDP,[4] which was the highest level since 1990.[5]

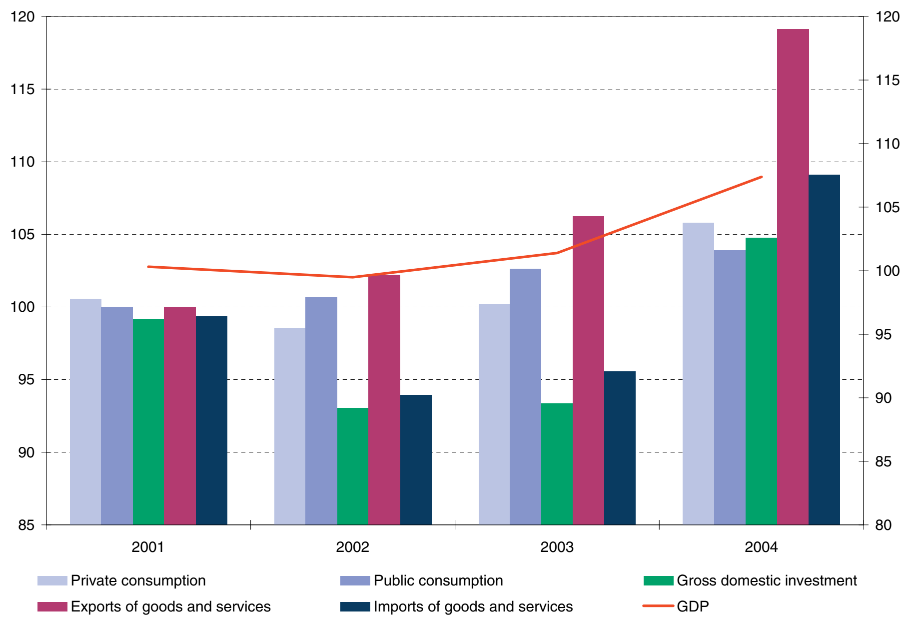
The sustained external stimulus also bolstered activities other than those directly related to exports, resulting in a larger-than-expected increase in domestic demand. Domestic demand had dropped sharply in the countries of the region, which means that some of the growth corresponds to a recovery of previous levels.[6] This was in addition to considerable increases in national income caused by the positive terms-of-trade effect. In 2004, domestic demand climbed by 6.3%, driven by a sizeable increase in investment and a rise in total consumption (4.8%), with private consumption rising 5.6% and public consumption, 1.2%. The 12.2% increase in investment made it the most buoyant component of domestic demand, with a 12.7% rise in gross fixed investment in particular.

The continuance of low interest rates and expanding economic activity facilitated investment and consumption decisions. In several of the region's countries, economic growth had a positive effect on the labour market, by improving both job creation and, slightly, wages and salaries, while helping to fuel higher private consumption. Public spending, meanwhile, was not adjusted.

Figure IV.4

LATIN AMERICA AND THE CARIBBEAN: GDP AND COMPONENTS OF EXPENDITURE

(Millions of 2000 dollars, index 2000=100)



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

4 In constant 2000 dollars.

5 Import volumes displayed a pattern similar to export volumes (calculated at constant prices). The region's degree of openness has therefore increased gradually. Calculated in 2000 dollars, the sum of exports plus imports as a percentage of GDP was 45.6%, compared with 39.5% in 1998 and 23.4% in 1990.

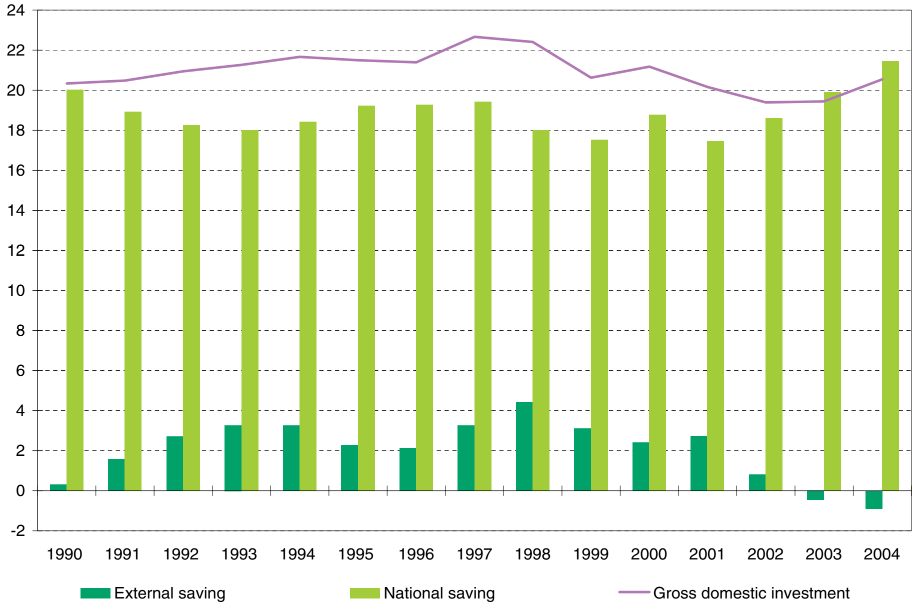
6 During 2002-2003, domestic demand accumulated a decline of 1.1% in relation to 2001 levels, reflecting a 0.4% fall in private consumption and a 5.9% drop in gross domestic investment over that period.

The upswing in investment follows several years of decline, which had resulted in a cumulative downturn of 10.4% in gross fixed capital formation in the period 1998-2003 as investment shrank in construction and machinery and equipment. In 2004, these trends were reversed as both construction and machinery and equipment rallied (particularly the latter). This was largely attributable to the low levels recorded previously, in combination with the revival of economic activity, the taking up of idle capacity (especially in the industrial sector), low rates of interest and more freely available corporate loans. The exchange-rate appreciations seen in the last few months of the year, together with higher demand, spurred a significant rise in investment in machinery and equipment, the bulk of which was imported. Gross domestic investment came in a slightly over 20.5% of GDP, however, which, though higher than the figure for 2002-2003, was similar to the 2001 rate and lower than those of the 1990s (see figure IV.5).

Figure IV.5

LATIN AMERICA AND THE CARIBBEAN: SAVING/INVESTMENT RATIO

(Percentages of GDP in current dollars)



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

The reactivation of domestic demand was reflected in the increased volume of goods imported by the region in 2004: this variable was up by 14.5%, thereby reversing the trend seen in recent years since, despite an uptick in 2003 (1.7%), the volume of goods imported by the region had posted a cumulative contraction of 4.5% in 2001-2003.

One of the most salient features of the region's economic performance in 2004 was a sharp increase in national income; measured at 2003 prices, this indicator rose by 6.7%.[7] This demonstrates the significant terms-of-trade effect, which made a significant contribution to economic performance in most of the countries In the region as a whole, the terms-of-trade effect represented around 1.2% of GDP, and its impact on gross national disposable income was even more significant, since higher net factor payments abroad were offset by a similar increase in current transfers to the region, mainly in the form of remittances from non-residents. The significance of this factor varies from one economy to another, depending on the extent to which the country's terms of trade have improved, with the effect being greater in countries whose export values are largely determined by international commodity prices.

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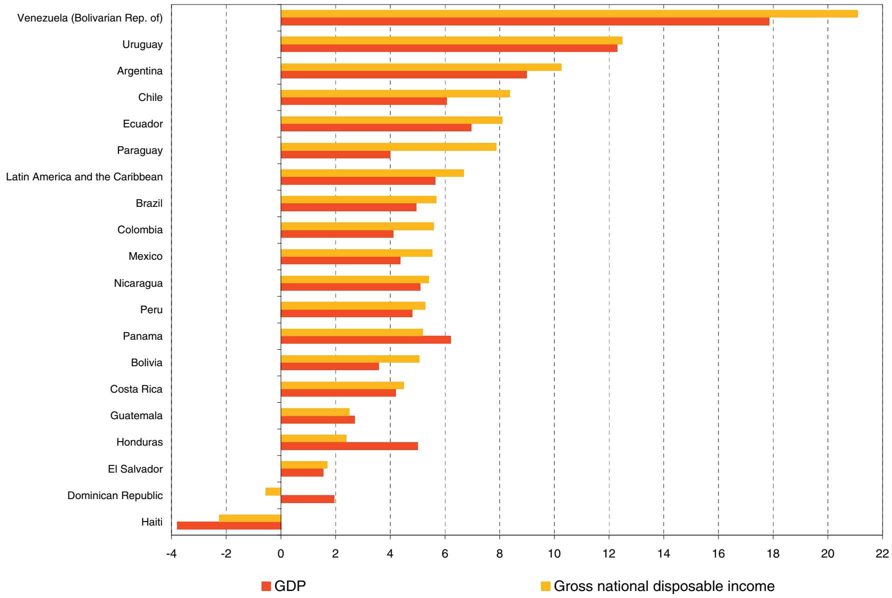
7 This represents per capita growth of 5.2% (also calculated at 2003 prices).

Figure IV.6

LATIN AMERICA AND THE CARIBBEAN: GDP AND GROSS NATIONAL DISPOSABLE INCOME, ANNUAL RATES OF VARIATION AT 2003 PRICES, 2004



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

As well as higher income, the region recorded a significant increase in saving on the strength of considerably higher national saving in several countries. In regional terms, national saving represented 21.4% of GDP, measured in current dollars, which was the highest level since the beginning of the 1990s. As in 2003, external saving was negative (0.9% of GDP), given that the balance-of-payments current account posted a surplus. A portion of domestic savings was devoted to reducing net indebtedness, by paying off external liabilities, financing the placement of capital abroad, or creating international reserves, rather than to the domestic accumulation of capital.

The positive regional performance of the components of demand was reflected in expansion of particular sectors of economic activity. At the regional level, 2004 saw increased buoyancy in the mining sector (which expanded by 5.9%) and a considerable upturn in manufacturing activity (6.4%), which had remained at a relative standstill in 2002-2003. The construction sector, which had recorded no growth since 1998, picked up considerably (8.8%), although growth was still 3.8% less than in 1998.[8] Transport and communications were also more buoyant (8.4%), reflecting increased activity in merchandise production sectors, while commerce grew (7.1%) as a result of the upturn in overall demand.

The faster pace of international economic growth also boosted tourism-related activities. The depreciation of the United States dollar in relation to the euro made tourism activities in the region relatively cheaper for visitors from countries whose currencies do not belong to the dollar area, since the prices of tourist services are usually expressed in United States dollars. This effect is particularly significant for the Caribbean countries. In addition, tourism flows shifted towards those Latin American and Caribbean countries considered to be safer, while the economic expansion in Northern hemisphere countries (and the consequent rise in their output) boosted visitor numbers from that area. The increased economic activity in Latin America also stimulated intraregional tourist and business travel by Latin Americans. This trend gathered strengthened from the appreciation of national currencies in relation to the dollar, particularly in the Southern Cone, and by the consistently low interest rates that boosted household demand for consumer loans.

8 Although construction activity increased by 0.9% at the regional level in 2000, the 1998-2003 period posted a cumulative decline of 10.9% (similar to the drop in fixed gross investment).

In 2005, regional GDP is expected to grow by around 4%, which is lower than the rate for 2004, although still higher than the average recorded in recent years. The international economic situation remains favourable, although the growth rate of the world economy is expected to slacken. The slowing of growth in external demand has begun to affect the export performance of the region's countries since, although exports have continued to grow at robust year-on-year rates in the first few months of 2005, those rates are nonetheless considerably lower than those recorded in the last quarter of 2004. The upturn in domestic demand that began in 2004 and gathered momentum in the second half of that year has continued in most countries, with imports of consumer and capital goods continuing to expand rapidly in most countries.[9] Although regional interest rates have begun to follow the upward trend seen in international interest rates, they remain at historically low levels, thus encouraging investment and consumption. Also, the greater use of installed capacity resulting from economic growth will sustain the expansion of gross fixed capital formation, while the currency appreciations recorded in several countries in the first few months of 2005 will help to lower the cost of imports, thereby fuelling domestic demand. Therefore, although the export sector is predicted to perform well in 2005, domestic demand is expected to be the driving force behind the year's growth.

1. Economic activity by groups of countries in 2004-2005

(a) Andean countries and Chile

The performance of the Andean Community countries and Chile benefited from high external demand, while still favourable international conditions boosted the increase of economic activity in industries linked to mining and hydrocarbons and spread to other branches of economic activity during the year. The significant increase in revenue, which was much higher than the rise in output, pushed up domestic demand for investment and consumption more than had been initially expected. Chile posted growth of 6.1%, which was mainly attributable to the strong performance of exports of copper and other commodities, as well as manufactures. Manufactured products received a further impetus from the free-trade agreements concluded with the United States and the European Union. Domestic demand also swelled (7.9%) on account of sharp rises in gross domestic investment, both in fixed capital (particularly machinery and equipment) and restocking. Private consumption also surged, especially in consumer goods. One reflection of the trend in domestic demand was the strong increase in the volume of goods imports (20.8%). Peru's growth rate of 4.8% was mainly thanks to a rise in export volumes (14.7%), while its gross fixed investment expanded by 7.6% and consumption by 3.5%. In terms of sectors of activity, non-resource-based manufacturing increased (7%) and metal mining expanded by 5.2% thanks to increased copper and iron production. However, the most buoyant sectors were fishing, which grew by 30.5% in 2004 compared with a contraction of 12.5% in 2003, and hydrocarbons, reflecting a 64% increase in natural gas production. Ecuador's economy grew by 6.9% in 2004 as a result of increased petroleum production after a new pipeline came on stream at the end of 2003. This, in turn, considerably swelled the volume of exports (14.1%), while private consumption increased (4.6%) on the strength of a sustained rise in family remittances. Investment edged up on account of gross fixed capital formation corresponding to (mainly imported) machinery and equipment. All of the above was reflected in a rise in the volume of imports (7.5%). In Colombia, GDP climbed by 4.1% as the construction sector continued to expand (with growth rates of over 10% recorded in the past three years) and the volume of exports also rose by 9.2%, due mainly to an expansion in shipments of industrial manufactures. Although not the largest component of exports, these manufactures grew strongly enough during the year to contribute to the buoyancy of the manufacturing industry overall, which expanded by 4.8% in relation to 2003. Gross fixed capital formation was up by 13.3% due to increased construction activity and higher investment in machinery and equipment. Private consumption climbed at a lower rate than aggregate GDP, although the consumption of durable goods nonetheless shot up (18.3%). In Bolivia, the 3.6% growth rate reflected a significant increase in

[9] According to data available for the first quarter of 2005, Brazil is an exception to this pattern as its domestic demand and merchandise imports dropped sharply in comparison to previous quarters.

export volumes (16.1%), which, in turn, was the result of a sharp rise in the production and export of natural gas (continuing the trend observed in 2003). Domestic demand, by contrast, stood still and gross fixed capital formation dropped again, although by less than in 2003. As for the performance of various sectors of activity, manufacturing expanded and construction rebounded slightly. The Bolivarian Republic of Venezuela posted the highest growth rate in Latin America and the Caribbean in 2004 (17.9%). The fastest-growing sectors were manufacturing, construction, commerce and transport, while domestic demand climbed by 28.9% in response to the rise in gross domestic investment, which corresponded to fixed investment (construction and machinery and equipment) as well as restocking, as a greater availability of foreign exchange placed imports on a more regular footing. These high growth rates largely reflect the recovery of levels recorded prior to the 2002-2003 crisis, however. Even so, the rise in gross fixed capital formation (38.8% in 2004) was insufficient to offset the 55% decline accumulated in 2002-2003, and the strong rebound in private consumption (16.6%) came in the wake of a cumulative decline of 11.2% over that period.

(b) MERCOSUR countries

There was a considerable upturn in domestic demand in the MERCOSUR countries, which was partly attributable to the rise in private consumption (boosted by improved labour indicators) and partly to the investment recovery. Increased demand from abroad stimulated greater production of agricultural goods mainly destined for export (soybean, meat and meat products and wool) and certain industrial sectors, particularly in Argentina and Brazil. Export buoyancy associated with strengthened domestic demand served to fuel activity in the manufacturing industries. Domestic demand was stimulated by the positive terms-of-trade effect, although to a lesser extent than in the Andean countries and Chile.

In Argentina, economic growth of 9% in 2004 was the result of the sustained recovery of domestic demand that had begun in 2003. The improvement in labour indicators and the rise in real wages brought about a considerable expansion of consumption, while investment continued to climb at high rates of around 35%. In terms of sectors, the annual growth was mainly due to increased activity in manufacturing, construction, trade services, transport and communications and restaurants and hotels (thanks to increased tourism activity). Yet despite the strong growth recorded in 2003-2004, overall rates of GDP and domestic demand (in terms of both investment and consumption) remain lower than those observed in 1998. Thus far in 2005, economic activity has continued to grow, although at somewhat lower rates.

Brazil grew by 4.9% in 2004, which was the highest growth rate recorded since 1994, when the economy posted an expansion of 5.9%. The expansion of economic activity was driven by a dramatic increase in the volume of exports (18%) and a considerable upturn in domestic demand. Household consumption rose by 4.1% in 2004, after a drop of 2% in 2002-2003. Public consumption remained at a standstill in real terms and gross fixed capital formation climbed by 10.9% following a 9% dip in 2002-2003. As a result of more buoyant domestic activity and the appreciation of the exchange rate during the year, imports climbed 14% in terms of volume, which was similar to the decline accumulated in 2002-2003. The agricultural sector expanded and the manufacturing industry grew significantly, mainly owing to the production of capital goods and consumer durables (mostly for export) as these expanded by almost 20%. Following three years of negative growth, construction expanded by 5.7%, although its level of activity remains 4.3% lower than in 2000. The rate of economic expansion has been slackening in 2005, with both private consumption and gross fixed investment slowing in response to the rise in interest rates seen in the second half of 2004 and early 2005 and to the standstill in real wages. Growth has slowed in the export sector, too.

Uruguay posted growth of 12.3% as a result of an upturn in domestic demand, particularly gross fixed capital formation (in terms of construction and investment in machinery and equipment) and a significant rise in the volume of exports (22.7%). Private consumption rose in line with the increase in aggregate GDP. In a breakdown by sectors, manufacturing activity shot up while agriculture expanded to a lesser degree; commerce and restaurants and hotels picked up in the wake of heightened domestic activity and tourism. Data available for 2005 show that activity has stagnated since 2004, although year-on-year growth rates remain high. Paraguay's economic activity grew by 4%, driven by the livestock sector combined with growth in communications, commerce and government services.

(c) Central America and Mexico

In 2004, the Central American countries and Mexico continued to benefit from faster growth in the United States economy and the considerable flow of remittances from non-residents. In Mexico, economic activity expanded by 4.4% on the back of construction, commerce, transport and communications and the real estate sector. High petroleum prices pushed up fiscal revenues, while greater external demand from the United States revived the maquila industry over the year. Following a cumulative drop of 5.8% in 2001-2003, gross fixed capital formation picked up by 7.5%, basically thanks to machinery and equipment, most of which is imported. Increases in employment and remittances from non-residents[10] caused private consumption to climb by 5.5% after increasing at an average rate of 2% per year between 2001 and 2003. The volume of exports swelled by 11.2%, which was slightly higher than the increase for imports, although both figures were in the same range. In the first quarter of 2005, growth rates remained positive although they were lower than previously.

The negative impact of terms of trade on national income meant that, unlike the rest of Latin America, the Central American countries did not benefit from real growth in national income in excess of GDP, although the situation varied from one country to another. Maquila performance in Mexico and a number of Central American countries received a stimulus from faster growth in the United States economy. In Honduras, the 5% GDP growth rate in 2004 was attributable to strong maquila expansion, at the same time as gross fixed capital formation expanded strongly (15.7%) due to higher investment in machinery and equipment (since construction was down). Panama's growth of 6.2% spread to all branches of economic activity, although it was steepest in export-linked sectors such as the Colón Free Zone, tourism and port services. In El Salvador (1.5%) and Guatemala (2.7%), the main engine of growth was domestic demand, mainly in the form of household consumption thanks to a significant expansion in remittances from abroad. In Nicaragua, the 5.1% increase in GDP reflected the considerable rise in public investment in construction and increased buoyancy of the export sector. Costa Rica's 4.2% growth rate was the result of greater buoyancy in sectors linked to external demand and in tourism-related activities.

(d) Caribbean economies

With the exception of Belize, Haiti, Grenada, Jamaica and Trinidad and Tobago, all the Caribbean countries turned out higher growth rates than the previous year. Such increased buoyancy is attributable to the expansion of tourism-related activities (particularly in the first half of the year), while some countries' external accounts and fiscal revenues also benefited from the rise in international commodity prices. However, output was hurt by the natural disasters that hit the region in the second half of the year, especially the hurricanes in the Bahamas, Grenada and Jamaica and, to a lesser extent, Saint Vincent and the Grenadines and Saint Lucia. Although the impact of the hurricanes was greater in those countries, virtually the entire region felt the repercussions on tourism and the production of goods, such as bananas, that are mainly exported. The Dominican Republic posted a 2% increase thanks to a rise in tourism and the higher export volumes of national goods (given sluggish activity in free zones), while the particular situation in Haiti hurt economic activity, bringing its output down by 3.8%.

Box IV.1

CHANGE OF BASE YEAR

NATIONAL ACCOUNTS OF LATIN AMERICA AND THE CARIBBEAN: NEW REGIONAL SERIES AT 2000 PRICES

The new series of regional macroeconomic aggregates used in this document take 2000 as a reference year, instead of 1995. This statistical and methodological change was made in view of the need to update and adapt the national accounts in order to describe the most recent structural changes in the regional economy in the best possible way.

Methodology used

A general procedure was adopted for calculating the regional aggregates maintaining the annual variation rates of GDP calculated by the countries, as these form the basis of the regional national accounts from the point of view of both the spending components and the sectoral origin of GDP, as well as the regional tables and accounts.

One of the advantages of this methodology is that it leaves the historical growth rates of overall GDP unchanged, while ensuring their immediate correspondence and equivalence with national data.

The methodology adopted to produce the region's national accounts at constant 2000 prices consists of retropolating and projecting the values of that year on the basis of the respective real GDP indices derived from the official series, applied to each of the main divisions of ISIC Rev. 3 and to the total. The resulting statistical inconsistency was distributed proportionately among the sectors of origin. The growth rate of total GDP is thus conserved and the sectoral changes observed in the official series at constant prices are corrected when they have a base year other than 2000.

A similar procedure was used to calculate the final balance between supply and demand of goods and services at the regional level. The values provided in local currency for the year 2000 by the countries were expressed in dollars at the current exchange rate and then retropolated and projected on the basis of the respective real GDP growth indices derived from the official series, which were applied to total spending and to each of

[10] Calculated in current dollars, the current transfers figure from the balance of payments shows that, in the period 2003-2004, emigrant remittances increased by 66% compared with the levels recorded in 2002. This surge is also a reflection of improved statistics in the measurement of flows of such remittances.

Box IV.1 (conclusion)

its components. As in the previous case, the resulting statistical inconsistency was distributed proportionately among all the categories of spending. In this case the rate of total GDP growth is also conserved and the changes observed by component of spending included in the official series at constant prices are corrected.

The data used to prepare the regional macroeconomic aggregates are produced by each of the Latin American and Caribbean countries and published by the respective national statistical office or central bank. It should be noted that some Latin American and Caribbean countries have yet to adopt the methodological recommendations of SNA 1993;[a] the accounts of others take as a reference year a statistical base that diverges from the current structure of their economy (in terms of weighting and prices). In addition, some countries lack a comprehensive estimate of the system's basic tables, such as GDP by type of economic activity and the balance between supply and demand of goods and services. Some estimates therefore had to be carried out, basically in order to standardize the levels of sectoral disaggregation and coverage or a specific spending component, as occurs with the disaggregation of fixed gross capital formation into construction and machinery and inventory changes.

The preparation of the regional series of national accounts at current and constant prices requires conversion factors to express series calculated in local currency in a common currency, so that they are comparable and can be aggregated.

There are a number of ways of converting local-currency-denominated accounts into dollars. These include the use of the annual average of the official exchange rate or of a parity exchange rate.

Bearing in mind the advantages and disadvantages of the various options, the conversion rate used in the Survey for the national accounts of Latin America and the Caribbean is the exchange rate rf, which reflects the average number of local currency units that are equivalent to one United States dollar during the reference period, as provided by the countries and disseminated by the International Monetary Fund in its publication International Financial Statistics.

Source: Economic Commission for Latin America and the Caribbean (ECLAC).

[a] See System of National Accounts 1993, United Nations, Commission of the European Communities (EUROSTAT), International Monetary Fund (IMF), Organisation for Economic Co-operation and Development (OECD), and World Bank, 1993.

B. Domestic prices

In 2004, inflation in Latin America and the Caribbean continued the downward trend observed since 2002 to give a cumulative rate of 7.3% in December, compared with 8.5% in December 2003. The regional figure for 2004 reflected lower inflation rates in the Bolivarian Republic of Venezuela (down from 27.1% to 19.2%), Brazil (down from 9.3% to 7.6%), Dominican Republic (from 42.7% to 28.7%), Ecuador (from 6.1% to 1.9%) and Haiti (from 40.4% to 20.2%). Outside this general trend, the performance of individual countries was uneven: some countries recorded inflation that, although lower than in 2003, still outpaced initial expectations and hovered around the ceiling rates established by their authorities, whereas in other countries the rate recorded in 2004 exceeded the 2003 figure outright.

Several of the region's countries posted steeper inflation in 2004 than in 2003, and a number of these experienced an increase in the rate in the first half of the year driven by higher prices for transport, housing services and fuel, largely reflecting rises in the international prices of commodities —particularly food, petroleum and fuels— and certain industrial manufactures, in addition to the higher cost of transport and insurance services. The pattern was most pronounced in the Central American countries, given their reliance on imports of petroleum, fuels and a number of raw materials. In addition, domestic price trends in several countries were affected by short-term factors: supply problems, drought, increases in the prices of regulated goods and services and burgeoning domestic demand spurred by economic growth. These factors eased in the second half of the year and this, combined with exchange-rate appreciations in the course of the year and the application of a monetary policy based on interest rate hikes in several of the countries, helped to lower the rate of inflation.

Table IV.1

LATIN AMERICA AND THE CARIBBEAN: CONSUMER AND WHOLESALE PRICE INDEXES AND VARIATION IN THE NOMINAL EXCHANGE RATE, 2003, 2004 AND 2005

	Consumer prices			Wholesale prices			Exchange rate		
	2003 [a]	2004 [a]	2005 [b]	2003 [a]	2004 [a]	2005 [b]	2003 [a]	2004 [a]	2005 [b]
Argentina	3.7	6.1	5.2	2.0	7.9	3.5	-14.8	0.8	-2.7
Bolivia	3.9	4.6	1.9				4.6	3.0	0.6
Brazil	9.3	7.6	3.2	6.3	14.7	0.9	-19.3	-7.1	-9.8
Chile	1.1	2.4	1.4	-1.0	7.8	4.3	-14.1	-4.5	0.3
Colombia	6.5	5.5	3.5	5.7	4.6	2.4	-0.2	-13.9	-3.2
Costa Rica	9.9	13.1	6.4	11.0	17.7	5.2	10.6	0.5	3.5
Ecuador	6.1	1.9	1.4	4.5	4.3	10.5	0.0	0.0	0.0
El Salvador	2.5	5.3	2.8	-0.7	13.3	1.5	0.0	0.0	0.0
Guatemala	5.9	9.2	3.7				4.9	-3.2	-2.3
Haiti	40.4	20.2	6.6				15.4	-12.7	3.1
Honduras	6.8	9.2	4.1				5.0	4.9	1.4
Jamaica	14.1	13.7	5.7				20.7	2.0	-0.2
Mexico	4.0	5.2	0.9	6.8	8.0	1.6	10.4	-0.5	-1.9
Nicaragua	6.5	8.9	5.4				6.0	5.0	1.6 [c]
Panama	1.55	1.54	1.6				0.0	0.0	0.0
Paraguay	9.3	2.8	5.2				-13.8	2.9	1.0
Peru	2.5	3.5	0.8	2.0	4.9	0.7	-1.2	-5.5	-0.8
Dominican Republic	42.7	28.7	0.8				75.6	-21.4	-2.6
Trinidad and Tobago	3.0	5.6	2.6				0.0	0.0	-0.6
Uruguay	10.2	7.6	1.9	20.5	5.1	-1.5	7.4	-9.1	-7.9
Venezuela (Bolivarian Republic of)	27.1	19.2	7.4	48.4	23.1	9.4	21.0	20.0	11.9
Latin America and the Caribbean [d]	**8.5**	**7.3**	**3.2**	…	…	…	…	…	…
Latin America and the Caribbean [e]	**9.3**	**7.7**	**3.5**	**9.6**	**10.1**	**3.5**	…	…	…

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.
[a] December of each year in relation to December of the previous year.
[b] Cumulative variation between December 2004 and May 2005.
[c] April 2005 in relation to December 2004.
[d] Weighted average.
[e] Unweighted average.

The main trends observed in the second half of 2004 were still in evidence in the first five months of 2005. In aggregate terms, international prices for food and agricultural raw materials rose at a slower rate. The prices of metals and minerals and petroleum and fuel, on the other hand, continued to rise sharply, although at lower rates than in the first half of 2004. The effect of price increases on imported products was moderated by appreciations in countries' exchange rates in relation to the United States dollar, in a trend that had been observed in the second half of 2004. With the exception of Uruguay, real salaries and wages varied little in the first quarter of 2005, and thus had a limited effect on producer costs. In addition, in the second half of 2004 and the first few months of 2005 the authorities in various countries adopted monetary policies aimed at avoiding further price increases. Against this background, the region presented a mixed panorama in terms of inflation between May 2004 and May 2005: it dropped sharply in various countries in relation to the cumulative rates of 2004, but recorded slight increases in others as a result of higher domestic demand and price adjustments in regulated services and products, combined with certain largely seasonal effects related to domestic availability of certain foods. Those countries to record the steepest declines in inflation in the first few months of 2005 were also the ones to post high rates in 2004, with a prominent example being the Dominican Republic, whose 12-month inflation rate of 0.9% in May 2005 contrasted with 65.3% for the year-earlier period. This striking reduction in inflation in the Dominican Republic is due to a smaller increase in international prices for imported commodities, the appreciation of the exchange rate, lower food prices in the domestic market and the management of fiscal and monetary policy.

Table IV.2

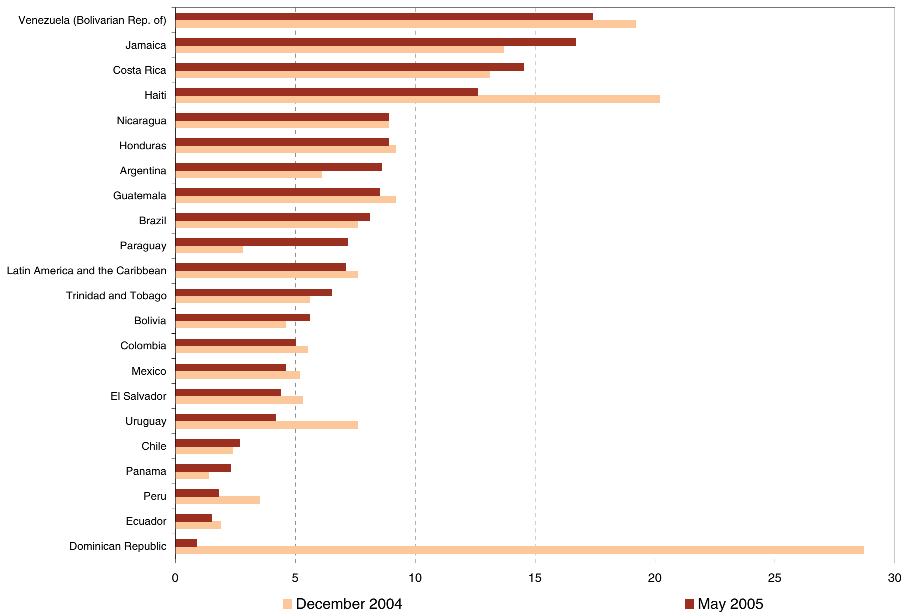
LATIN AMERICA AND THE CARIBBEAN: CONSUMER PRICES, 2004 AND 2005

	Cumulative inflation in May in relation to December of the previous year		Cumulative 12-month inflation in May	
	2004	2005	2004	2005
Argentina	2.7	5.2	4.3	8.6
Bolivia	1.0	1.9	4.4	5.6
Brazil	2.7	3.2	5.2	8.1
Chile	1.1	1.4	0.6	2.7
Colombia	4.0	3.5	5.4	5.0
Costa Rica	5.1	6.4	11.4	14.5
Ecuador	2.0	1.5	3.0	1.5
El Salvador	3.7	2.8	4.8	4.4
Guatemala	4.4	3.8	7.3	8.5
Haiti	13.8	6.6	25.4	12.6
Honduras	4.3	4.1	7.9	8.9
Jamaica	3.0	6.3	14.0	16.7
Mexico	1.5	0.9	4.3	4.6
Nicaragua	5.3	5.3	8.7	8.9
Panama	2.7	1.6	3.8	2.7
Paraguay	1.0	5.2	3.1	7.2
Peru	2.5	0.8	3.2	1.8
Dominican Republic	28.5	0.8	65.3	0.9
Trinidad and Tobago	4.8	2.6	3.1	6.5
Uruguay	5.2	1.9	9.4	4.2
Venezuela (Bolivarian Republic of)	9.0	7.4	21.8	17.4
Latin America and the Caribbean				
Weighted average	**3.4**	**3.2**	**7.1**	**6.9**
Unweighted average	**5.1**	**3.4**	**10.2**	**7.2**

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

Figure IV.7

LATIN AMERICA AND THE CARIBBEAN: 12-MONTH VARIATION IN CONSUMER PRICE INDEX, 2004 AND 2005

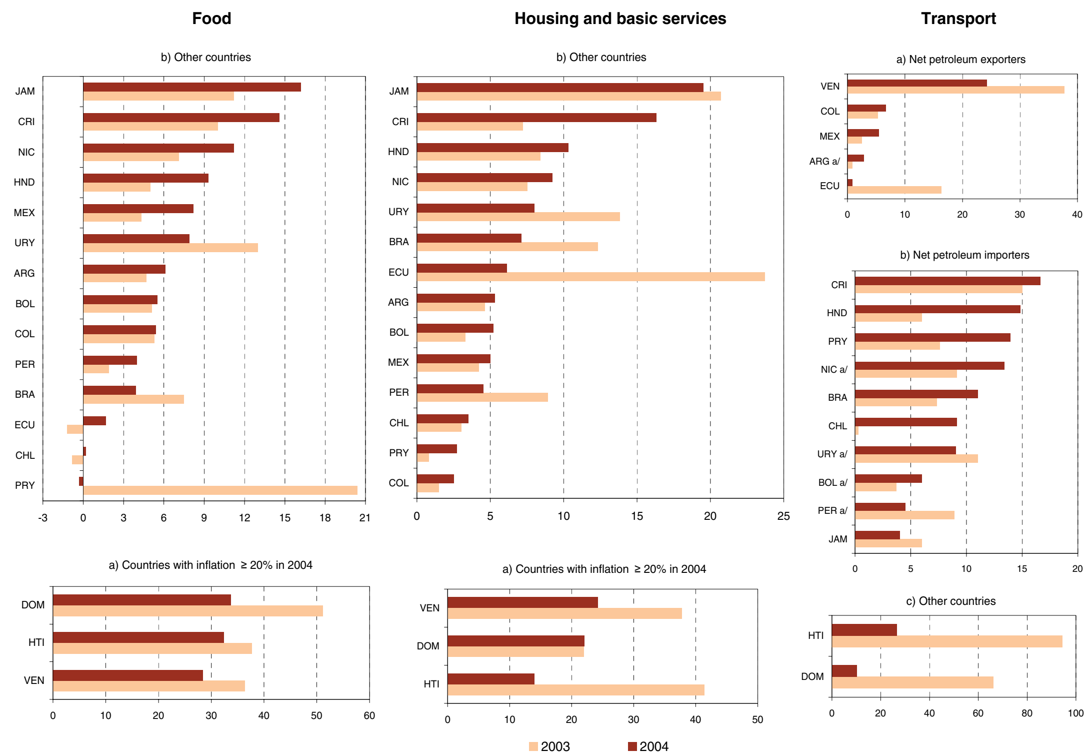


Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.

An analysis of wholesale prices[11] in the countries of the region shows that these generally outpaced consumer prices, except in Colombia and Uruguay. Since the basket used to calculate the wholesale price index consists mainly of goods, a rise in the index is reflects mainly increases in the international prices of commodities, industrial manufactures and transport and insurance costs for imports. It also shows that, however, that although domestic demand (particularly domestic consumption) grew faster than initially expected at the beginning of the year, in several countries this was not sufficient to translate into higher consumer price rises.

Figure IV.8

LATIN AMERICA AND THE CARIBBEAN: INFLATION BY GROUPS OF SELECTED PRODUCTS, CUMULATIVE VARIATION AT DECEMBER OF 2003 AND 2004



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

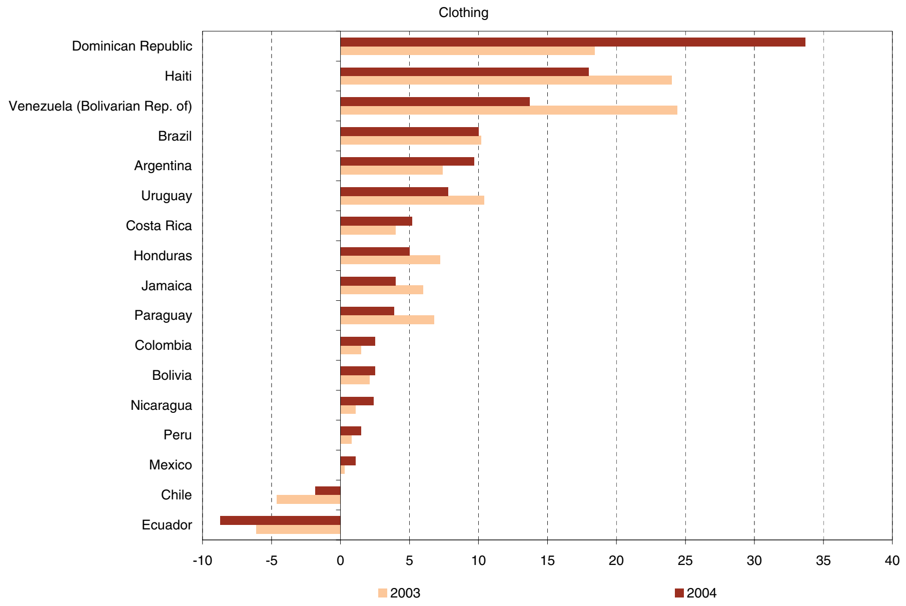
This is also reflected in underlying inflation, calculated on the basis of the consumer price index in the countries for which this indicator is available.[12] In several countries, underlying inflation rose less than overall inflation as measured by the consumer price index. This pattern was affected by the standstill in real salaries and wages in relation to 2003 and the monetary policy implemented by the authorities. The exceptions were Argentina and Chile, where underlying inflation rose by more than the overall rate. In those countries real salaries and wages rose in 2004 compared with the previous year, and this combined with higher economic growth to boost domestic demand and exert upward pressure on the prices of certain groups of products, especially clothing, or reduce price reductions as occurred in Chile, where clothing prices have been falling for several years now. This pattern occurred despite the downward trend in the international prices of these products.

11 For countries that regularly publish these data.

12 The calculation was based on a common methodology, in which fuels and petroleum products and perishable foods are excluded from the consumer price index.

Figure IV.9

LATIN AMERICA AND THE CARIBBEAN: CUMULATIVE VARIATION IN CLOTHING PRICES AT DECEMBER 2003 AND 2004



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

1. Inflation patterns by groups of countries

As mentioned above, the rate of inflation varied from one country to another. Some managed to reduce the rate considerably whereas price indexes in others were pushed up by domestic factors and high international commodity prices. The rates at which inflation increased or decreased were also uneven.

The countries of the region fall broadly into three groups in terms of their inflation patterns. The first group consists of countries in which inflation dropped considerably in 2004, even though they also recorded the region's highest rates. Haiti and the Dominican Republic posted the largest decreases from the highs they recorded in 2003: from 40.4% to 20.2% and from 42.7% to 28.7%, respectively. The high inflation of 2003 reflected the drastic currency depreciations observed that year, combined with the rise in international petroleum and fuel prices. In 2004, these trends either eased or were reversed and exchange rates against the dollar appreciated considerably in the second half of the year, while international fuel prices rose more gradually.[13] In Ecuador, inflation dropped from 6.1% in 2003 to 1.9% in 2004, which was mainly the result of the downward trend in prices of clothing, health and recreation services and household items that carried over from 2003, combined with a considerable easing of the upward trend in prices for rentals and transport, which had surged in 2003.

Inflation in the Bolivarian Republic of Venezuela dropped from 27.1% in 2003 to 19.2% in 2004 due to the real appreciation of the exchange rate, the course of economic policy, continued price controls and greater availability of goods thanks to an import expansion resulting, in turn, from an increase in the foreign exchange

[13] In the Dominican Republic, a comparison of average inflation over 2004 with cumulative inflation up to December 2004 appears to give a contradictory result, since the impact of high international fuel and petroleum prices and exchange-rate depreciation was felt in the second half of 2003 and the first six months of 2004. Average annual inflation increased from 27.4% in 2003 to 51.5% in 2004, while cumulative inflation for the year dropped from 42.7% in 2003 to 28.7% in 2004.

available to importers. Government food subsidies also helped to slow the rise in consumer prices. Price controls have successfully contained, though not eliminated, hikes in the price of certain products, since the prices of controlled products increased at the same rate as the general consumer price index. In Paraguay, the drop in inflation (from a cumulative rate of 9.8% in 2003 to 2.8% in 2004) was the result of an appreciation of the exchange rate in relation to the United States dollar in the last few months of 2003 and much of 2004. The drop in inflation also significantly lowered the costs of imports, particularly food. Nevertheless, transport prices climbed much more than overall inflation, as a reflection of the high international fuel and petroleum prices.

In the second group of countries, cumulative inflation to December 2004 was lower than the previous year, although the rate did not fall by as much as in the first group of countries. In Brazil, the CPI dropped from 9.3% in 2003 to 7.6% in 2004 as the smaller variation in food prices partly offset the increases in the prices of industrial products and in rates for regulated utilities, including electricity and telephone services.[14] In addition, the appreciation of the exchange rate, particularly in the second half of the year, benefited the prices of imported products. The same trend was observed in Uruguay and Colombia. Jamaica recorded a decline in inflation from 14.1% to 13.7% in 2004.

The third group consists of countries whose inflation was higher in 2004, mainly as a result of the rises in international commodity prices (particularly food and petroleum and fuel) and higher rates for regulated services. Although this phenomenon had an impact on inflation in several economies (including Chile, Mexico, Peru), the worst affected were the Central American countries (Costa Rica, El Salvador, Guatemala, Honduras, Nicaragua), with the 2004 figure reflecting sharp rises in the prices of food, fuel and commodities. Other factors influencing inflation included price adjustments for telephone services and the disruptions to the supply of agricultural goods in the case of Costa Rica and adverse weather conditions in Honduras. In Bolivia, the rise in the domestic price of fuels and diesel shortages had major direct and indirect effects on inflation, mainly in terms of transport costs and the prices of certain foods. In Argentina and Chile, the rise in inflation reflected increased demand resulting from the considerable expansion of economic activity.

C. Employment and wages

In 2004 the regional unemployment rate fell from 10.7% to 10.0%. This was attributable to the increase seen in the employment rates of almost all of the countries, which pushed up the regional employment rate from 52.2% to 52.8% of the working-age population. Thanks to the reactivation of the productive apparatus, most of the newly created employment consisted of waged jobs and in many countries formal-sector employment expanded.

Given the sharp deterioration in the employment situation in earlier years, however, regional unemployment levels are still high. In only a few countries —Brazil, Trinidad and Tobago and those that were recovering from serious crises (Argentina, the Bolivarian Republic of Venezuela and Uruguay) did all of the employment and unemployment variables show a definite improvement. In most of the other countries, even though job creation was stimulated by their relatively higher economic growth rates, it was more than offset by an expanding labour supply, which is why unemployment has remained high.

The continuation of a difficult labour situation, which was reflected, in particular, in high rates of unemployment, also prevented real average wages in the formal sector from locking into the recovery in growth and productivity. In fact, as a weighted average, real wages increased by a mere 0.9% and the median level stood still.

14 Extended national consumer price index.

1. Labour participation still expanding

In 2004 the upward trend in the labour participation rate that had begun in 2003 became more widespread, as this rate increased in 12 of the 17 countries for which data were available. Meanwhile, the weighted regional average was affected by the situation in Brazil, where labour participation rose sharply in 2003 but much less slowly in 2004; as a result, this measure showed the expansion of the region's labour force dropping from 0.5 percentage points in 2003 to 0.2 in 2004 (see table IV.3).

Table IV.3

LATIN AMERICA AND THE CARIBBEAN: LABOUR MARKET INDICATORS, 1995-2004

	1990	1995	1999	2000	2001	2002	2003	2004 [a]
Unemployment rate [b]								
- Weighted average	7.3	8.7	10.7	10.1	10.0	10.7	10.7	10.0
- Simple average	9.6	10.5	10.7	10.3	10.6	11.0	10.8	10.0
Overall participation rate [b c]								
- Weighted average	57.6	58.2	58.4	58.7	58.1	58.3	58.7	58.9
- Simple average	55.6	57.2	58.6	58.3	58.4	58.4	58.5	58.7
Men's participation rate [d]	74.6	74.6	74.4	73.3	73.1	72.5	72.2	72.3
Women's participation rate [d]	37.6	41.0	43.2	43.0	43.3	43.5	44.2	44.4
Employment rate [b c]								
- Weighted average	53.5	53.1	51.9	52.5	52.1	51.7	52.2	52.8
- Simple average	50.6	51.5	52.2	52.1	51.8	51.5	51.6	52.3
Real average wage								
- Weighted average	90.1	95.2	98.5	100.0	100.1	98.5	94.5	95.3
- Median	80.6	94.1	98.7	100.0	101.0	102.9	103.3	103.3
Real minimum wage								
- Weighted average	79.5	92.4	97.7	100.0	104.3	103.7	104.4	110.4
- Median	98.6	94.1	99.1	100.0	102.1	101.9	103.2	104.0

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.
[a] Official figures.
[b] Series adjusted because of the changes of methodology in Brazil (2002) and Argentina (2003).
[c] 14 countries.
[d] Simple average of 13 countries; the figures in the first column are for 1991.

The increase in the participation rate in 2003 and 2004 may be interpreted as a resumption of the trend observed in the first half of the 1990s, in which households are responding to a more comfortable economic context which is again offering more work opportunities. In fact, in many countries the labour supply behaves in a clearly procyclical manner. Economic upswings in Argentina, Chile, the Dominican Republic, Ecuador, Mexico, Peru and Uruguay brought greater numbers of entrants to the labour market in 2004, after previous declines in the participation rate. Even before that, the start of the recovery had increased labour participation in Brazil, where the rate did not rise much more in 2004. Lastly, in the Bolivarian Republic of Venezuela, Colombia and Costa Rica, the labour supply behaved countercyclically, with a decline in the participation rate following earlier increases, despite the fact that economic growth rates were relatively high. In those three countries both male and female participation rates went down, but women withdrew from the labour market in much more significant numbers. The combination of demographic growth and the higher participation rate mentioned resulted in growth of 2.6% in the urban economically active population (EAP).

2. Job creation picks up

Reflecting its close link with economic growth, the urban employment rate rose from 52.2% to 52.8% of the working-age population, which is the highest increase since 1997 and represents an expansion of 3.4% in the number of employed persons. The rise in the employment rate was fairly widespread, as it occurred in 13 out of 17 countries for which data were available (see table IV.4). For the first time since 1998, wage employment grew faster than own-account labour, which means that the growth of the regional economy as a whole was based to a large extent on the productive incorporation of labour. This distinguishes the 2004 performance from that of the previous year, as in 2003 employment also grew at a relatively high rate, but mainly in the own-account category.

Table IV.4

LATIN AMERICA AND THE CARIBBEAN: LABOUR MARKET INDICATORS BY COUNTRY, 2003 AND 2004

	Employment rate		Unemployment rate		Real average wage [a]		Real minimum wage [a]	
	2003	2004 [b]	2003	2004 [b]	2003	2004 [b]	2003	2004 [b]
Argentina	37.8	39.7	17.3	13.6	-1.9	10.1	3.3	54.5
Bolivia	54.9	…	9.2	8.5	1.7	2.4	0.8	-4.2
Brazil	50.1	50.6	12.3	11.5	-8.8	0.7	0.7	3.8
Chile	48.4	48.5	8.5	8.8	0.9	1.8	1.4	2.8
Colombia	53.8	53.2	16.7	15.4	-0.1	1.0	0.1	1.8
Costa Rica	51.8	50.9	6.7	6.7	0.4	-2.6	-0.4	-1.6
Ecuador	48.6	49.7	9.8	11.0	…	…	5.9	2.2
El Salvador	49.7	48.2	6.2	6.5	…	…	2.1	-1.4
Guatemala	59.3	…	3.4	3.1	0.4	-2.4	7.9	0.3
Haiti	…	…	…	…	…	…	33.5	-14.7
Honduras	47.4	47.6	7.6	8.0	…	…	8.6	0.8
Jamaica	57.1	56.8	11.4	11.7	…	…	…	…
Mexico	53.8	54.3	3.3	3.8	1.3	0.1	-0.7	-1.3
Nicaragua	…	…	10.2	9.3	1.9	-2.2	3.1	4.0
Panama	54.6	55.9	15.9	14.0	…	…	0.7	0.9
Paraguay	55.0	58.8	11.2	10.0	-2.0	-2.7	2.8	-3.3
Peru	61.1	61.6	9.4	9.4	1.6	-1.7	1.2	4.6
Dominican Republic	45.2	46.0	16.6	18.4	…	…	-9.5	-21.1
Trinidad and Tobago	55.2	57.2	10.5	8.6	…	…	…	…
Uruguay	48.3	50.9	16.9	13.1	-12.5	0.0	-12.4	-0.2
Venezuela (Bolivarian Republic of)	56.8	58.1	18.0	15.3	-16.7	-3.9	-11.7	14.5

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures; see the tables in the statistical appendix.
[a] Growth rates.
[a] Preliminary figures.

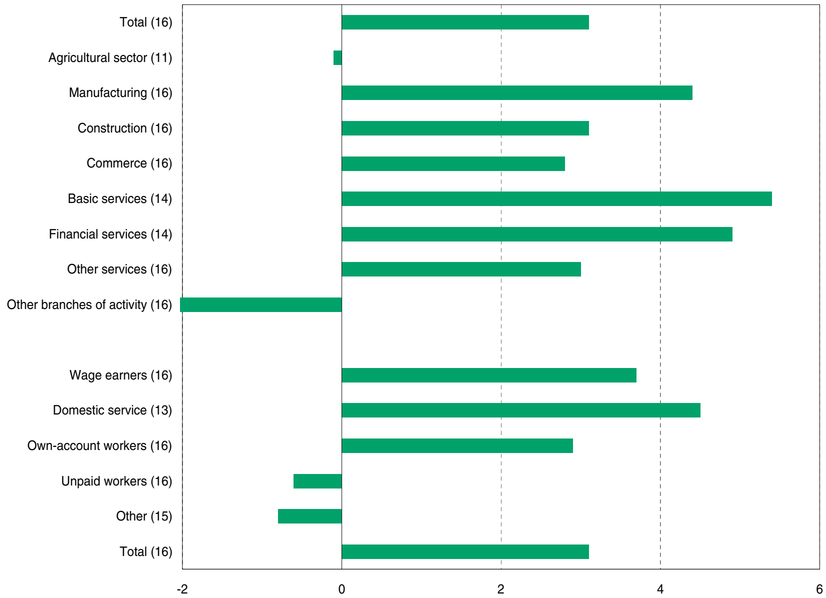
In fact, in 2004 wage employment grew by 3.7% (as a weighted average of 16 countries), while own-account labour expanded by 2.9% (see figure IV.10).[15] Accordingly, wage employment contributed two thirds of the new jobs, while 24% of new employment corresponded to own-account work (see table IV.5).

[15] This calculation is based on a different method from the one used in previous years. In some countries rural employment is included, so that the rate of job creation is slightly lower, at 3.1%, than the 3.4% that refers exclusively to urban employment.

Figure IV.10

LATIN AMERICA AND THE CARIBBEAN: GROWTH IN EMPLOYMENT BY BRANCH OF ACTIVITY AND OCCUPATIONAL CATEGORY, 2004

(Percentages) [a]



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

Note: The figures in parentheses indicate the number of countries for which data are available.

[a] Preliminary figures.

Table IV.5

LATIN AMERICA AND THE CARIBBEAN: CONTRIBUTION TO NET JOB CREATION, 2004

(Percentages)

Contribution of each branch of activity of increase in non-agricultural employment		Contribution of each occupational category to increase in total employment	
Total	**100**	**Total**	**100**
Manufacturing	24	Wage earners	67
Construction	6	Own-account workers	24
Commerce, restaurants and hotels	23	Domestic service workers	10
Basic services	5	Unpaid workers	0
Financial services, insurance, real estate and business services	13	Other categories of employment	-1
Social, community and personal services	34		
Other	-5		

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

Lastly, the significant increase in employment in domestic service may indicate an upturn in income, especially in the middle-income groups, while the contraction in unpaid family work follows a longer-term trend, in connection with higher rates of school attendance.

In many countries, the rise in wage employment was driven by the creation of jobs in the formal sector, as almost all of the countries that keep records of the number of formal wage earners show significant increases in this variable. In fact, as an annual average, the number of wage earners contributing to social security systems grew by 10.5% in Argentina, 7.0% in Nicaragua, 3.7% in Costa Rica and 3.4% in Chile. In contrast, in Mexico the rise was only 1.3%. The number of wage earners recorded in the Ministry of Labour and Employment of Brazil expanded by 5.1%, while the survey of the Peru's Ministry of Labour and Employment Promotion showed growth of 2.7% in formal employment. Although the formalization of pre-existing jobs may have contributed to the growth of formal employment in some cases, the figures do indicate that the region is not in a period of "jobless growth".

Another salient aspect of job creation in 2004 is its composition by sector of activity. The manufacturing industry recorded a significant rise in employment, the first since 2000 (see figure IV.10), which reflects the expansion of domestic demand as well as a larger amount and broader range of manufacturing exports, both in intraregional trade and going to third markets. This sector of activity contributed one quarter of new non-agricultural jobs, which is a much higher proportion than in previous years.

In some countries, the maquila industry staged a recovery. This industry was the most dynamic driver of job creation in manufacturing in the 1990s, but more recently has been badly hurt by the slowdown in the North American economy and, more importantly in the long term, by competition from China. In Mexico, which has the region's largest maquila industry, employment in the sector rose by 4.7%. A substantial debate has arisen in connection with this industry, concerning the future competitive advantages of Mexican and Central American production, based on geographical proximity to the United States and the development of segments with greater value added.

Construction was another sector to benefit from the recovery of domestic demand, with the fastest growth rate recorded since 1998. Meanwhile, jobs in commerce and in community, social and personal services increased at a slightly lower rate than overall employment, although they did represent a significant proportion of new non-agricultural jobs (57% of the total). Jobs with low entry barriers are concentrated in these sectors, which tend to predominate in periods of economic stagnation, though not all jobs in these sectors are low-productivity and poor quality.

Similarly to the pattern seen in the higher-growth years of the last decade, but in contrast to the past few years, rates of employment growth were highest (at around 5%) in financial and business services and in basic services. The two sectors together contributed almost 20% of the new non-agricultural jobs, which probably indicates a fresh impetus in the modernization of infrastructure and the productive apparatus.

3. Unemployment and other labour problems

As a result of the considerable rise in the regional rate of employment, whereas the participation rate expanded slightly, the unemployment rate dropped significantly, from 10.7% to 10.0%, in the steepest fall recorded from one year to another since 1986. This decrease meant that 800,000 fewer people were unemployed, as urban unemployment fell from 19.4 million to 18.6 million.

Nevertheless, the reduction in the unemployment rate was not a widespread phenomenon. Only in Argentina, the Bolivarian Republic of Venezuela, Brazil and Uruguay, which experienced high levels of economic growth in 2004, did the rapid growth in employment bring a steep drop in unemployment. In Colombia, too, the unemployment rate went down, but this was due more to a decline in labour participation than to the generation of new jobs. Meanwhile, in many countries (including Chile, the Dominican Republic, Ecuador, Honduras, Mexico and Peru) unemployment remained stable or even rose, as the upswing in employment was insufficient to compensate for the increase in the participation rate (see table IV.4).

It is well known that the open unemployment rate reflects only part of labour-market problems. For this reason, some countries also calculate the number of employed persons who work less than what are considered normal working hours and would prefer to work longer, which is commonly referred to "visible underemployment".

Calculations for the 12 countries for which data were available show that, in 2004, 7.9% of the urban EAP, or 14.7 million people, were visibly underemployed. Although the rate dropped by one tenth of a percentage point compared to 2003, there were 200,000 more underemployed persons, which meant that some of those entering the labour market in recovering economies were unable to meet their employment or income needs due to the conditions they encountered there.

Apart from open unemployment and the various kinds of underemployment, emigration represents a third adjustment variable in the labour market. Unfortunately, there are few data on the annual emigration flows of the region's countries. Peru provides a good example of the quantitative importance of emigration, however, since estimates based on the different numbers of Peruvians entering and leaving the country suggest that 300,000 people emigrated in 2004, a much higher figure than the 230,000 recorded in 2003. Another indicator of migration, much of it illegal, are the data on deportation. In 2003, the United States authorities identified 1,046,000 "deportable" foreigners, 957,000 of whom were Mexican. In this regard, many non-Mexican illegal emigrants do not reach the United States border. In fact, 199,000 Central Americans were deported from Mexico in 2004.

4. Wage trends

In almost all the countries, the economic recovery affected employment to a greater or lesser degree, but its repercussions on wages were minimal or zero. The exception was Argentina, where there was a real increase of over 10% in the annual average. However, the real average wage has not yet recovered the purchasing power seen prior to the crisis at the beginning of the decade. Three other countries (Bolivia, Chile and Colombia) showed rises of between 1% and 2.5%; in another three (Brazil, Mexico and Uruguay), real wages in the formal sector remained stable or increased by less than 1%; and in six (Bolivarian Republic of Venezuela, Costa Rica, Guatemala, Nicaragua, Paraguay and Peru), the purchasing power of wages declined by more than 1% (see table IV.4).

The meagre reaction of the average real wage to the upturn in labour demand is probably mainly due to the persistence, in most of the countries, of unemployment rates that are still historically high. Accordingly, the weighted average wage of 13 countries rose by 0.9%, while the median wage actually stood still. It should be recalled that the weighted regional average wage had dropped significantly in previous years and in 2004 it was at the same level as in the mid-1990s (see table IV.3).

In 2004, some countries, especially Argentina and the Bolivarian Republic of Venezuela, adopted an active wage policy, whose provisions included a significant rise in the minimum wage and, in the case of Argentina, an increase in above-minimum wages, in order to reduce poverty and stimulate domestic demand. Most of the countries retained the cautious wage policy seen in previous years, however, so that the median increased by scarcely 0.8%. In contrast, the annual real minimum wage was 5.9% higher as a weighted average, reflecting substantial real rises in Brazil and Peru, in the latter case as of the end of 2003, as well as the rises in the countries mentioned. At the beginning of 2005, Argentina and Uruguay decreed large rises in their minimum wages.

5. Trends in 2005

The unemployment rate shows a significant year-on-year improvement at the start of 2005, since it is estimated to have dropped from 10.6% in the first half of 2004 to 9.5% a year later. In contrast to the broad experience in 2004, this cannot be attributed exclusively to job creation, because the dampening of economic growth in the region slowed the year-on-year expansion of regional employment to 0.4 percentage points, by comparison with 0.6 points in the first half of 2004.

Another factor contributing to the contraction of open unemployment in the first few months of 2005 was a fall in the labour participation rate observed in six of nine countries for which data were available, amounting to a weighted average of 0.3 percentage points. The significance of this development is not immediately clear, as it has occurred in the context of rising employment which usually increases growth in the labour supply. It may be a reaction to earlier increases and, in particular, may indicate a resumption of the trend for young people to remain longer in the education system.

The improvement in the labour situation has been more widespread than in 2004, since in the first half of the year a rise in employment was recorded simultaneously with a decline in unemployment in six of the nine countries for which data were available (see table IV.6). In view of the trends towards a slowdown seen in some of the large economies, it is expected that in the second half of the year the unemployment rate's downward trajectory will lose momentum, and the annual average rate will probably come in at 9.3%, which in any case represents a second fairly steep drop in a row.

Despite the improvement in the employment and unemployment indicators, at the beginning of 2005 real wages were still not picking up. Uruguay was the only country to post a significant recovery, after steep decline that occurred earlier, while Argentina's wage rises have been slowing. The other countries for which data were available showed a slight year-on-year increase (Chile and Colombia), a stand-still (the Bolivarian Republic of Venezuela) or a small decline (Brazil, Costa Rica, Mexico and Nicaragua) in real average wages.

Table IV.6

LATIN AMERICA AND THE CARIBBEAN: UNEMPLOYMENT RATE, EMPLOYMENT RATE AND THE REAL AVERAGE WAGE (2000=100), FIRST SEMESTERS OF 2004 AND 2005

	Unemployment rate		Employment rate		Real average wage [a]	
	2004	2005 [b]	2004	2005 [b]	2004	2005 [c]
Latin America and the Caribbean	10.6	9.4	52.5	52.9	…	…
Argentina	14.6	12.8	54.2	54.7	88.1 [d]	90.0 [d]
Brazil	12.3	10.3	50.0	50.7	83.4 [e]	82.0 [e]
Chile	8.9	8.2	48.2	49.3	107.1 [e]	108.6 [e]
Colombia	16.5	15.0	52.4	53.0	101.4 [d]	102.5 [d]
Costa Rica	…	…	…	…	105.6 [e]	103.8 [e]
Ecuador	11.3	11.1	49.3	49.4	…	…
Mexico	3.7	3.9	…	…	106.6 [d]	105.9 [d]
Nicaragua	…	…	…	…	104.3 [d]	103.2 [d]
Peru	10.1	10.5	61.5	60.6	…	…
Uruguay	13.5	11.7	50.7	51.0	77.0 [e]	80.5 [e]
Venezuela (Bolivarian Republic of)	16.6	13.3	57.4	57.4	74.6 [f]	74.6 [f]

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.
[a] Index 2000=100.
[b] Estimate.
[c] Preliminary figures.
[d] Average January- April.
[e] Average January-May.
[f] Average January-March.

Chapter V

Employment problems and policies

A. Introduction

The great economic and technological changes that have unfolded over the last few decades are having major repercussions on labour markets throughout the world. Factors such as technological changes that make productive processes more flexible, supported by increasingly mobile capital and technology and the adoption of new business strategies in response to changing circumstances, are tending to diversify and polarize occupational patterns. Economies everywhere, and specifically labour markets, are under pressure to adapt to this new structural setting.

Following the severe crises of the 1980s, the countries of Latin America and the Caribbean undertook quite profound economic reforms in order to help their economies adapt to changing external conditions. Measures were taken to restructure market regulation and foster competition, while macroeconomic policies were adopted to combat inflation and facilitate sustained growth. Despite the progress achieved, investment levels in the region as a whole did not recover, and growth rates were notable for their volatility and low average levels.

As a consequence, the region's labour markets are suffering from the effects of structural changes in other factor and goods markets; the weakness of economic activity, which is the key determinant of labour demand; and volatile economic growth. As the first section of this chapter will discuss, this adverse setting is reflected in unsatisfactory labour-market performance, which has been one of the most negative aspects of the region's recent development. This diagnosis raises a series of challenges in terms of policies to improve labour-market performance. The second section of this chapter analyses progress and proposals to make such policies more efficient.

B. Trends in employment and wages since 1990

1. Labour-supply trends

Historically, demographic growth has put heavy pressure on the region's labour markets, which each year absorb ever larger age cohorts seeking work. Nonetheless, the demographic transition of the last few decades has helped alleviate this pressure and even, in the last few years, to reduce it. Whereas in the early 1970s, the region's working-age population, defined as persons aged 10 years or over, was still expanding at 2.9% per year, the rate had dropped to 1.8% in the first five years of the current decade. Growth of the working-age population has even declined in absolute terms, from a peak of 38.7 million people in 1995-2000, to 38.1 million projected for 2000-2005.[1]

The analysis shows that this trend is even stronger in the working-age population, defined for this purpose as persons aged 15 years and older, in urban areas. As a result of strong migratory flows, in the first five years of the 1970s this urban population segment grew by 4.2% annually; but 30 years later the rate had fallen to 2.4%, and is projected to drop to 2.1% in 2005-2010.

Apart from demographic trends, the variation in the participation rate (the percentage of the working-age population in the labour market) is another element influencing labour-supply growth, in which the following key medium- and long-term trends may be identified:

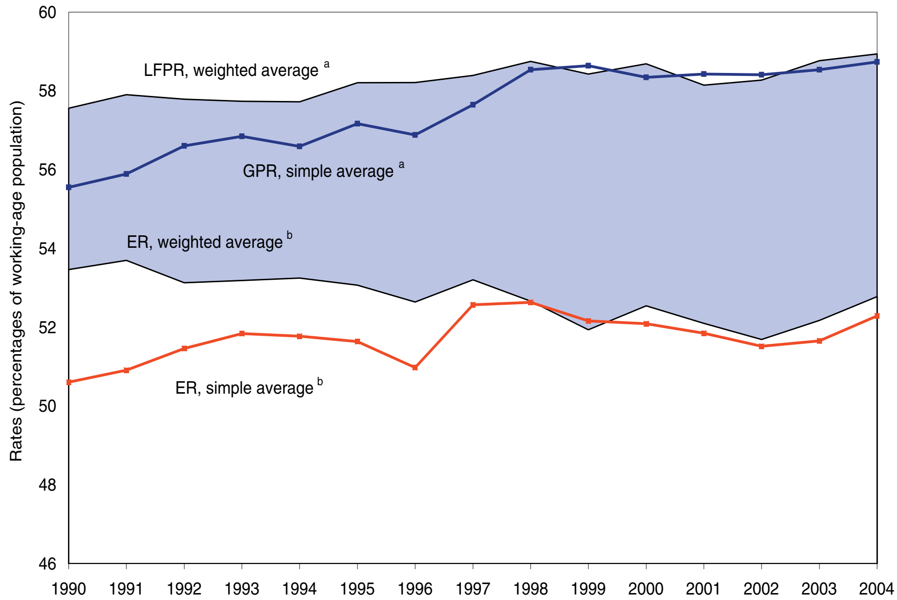
- In the last few decades, the traditionally low female participation rate has risen sharply in both urban and rural areas.
- The fact that men are staying longer in the education system is tending to contain the increase in their participation rate. Young women raised their education levels even more than men, but their labour-market participation, which is below the male rate, did not decrease; what did decline was the percentage of young women devoting themselves to household chores.
- Labour-market participation tends to fall off when individuals reach retirement age, especially where social protection systems provide significant coverage. The rise in the number of people over 65 years of age is tending to slow down the growth in labour-market participation, especially in urban areas.

Given that the first of these trends has been the strongest in most countries, an increase in the overall participation rate has prevailed as a long-term trend. Nonetheless, the participation rate normally varies in reaction to short-term economic circumstances. At the regional level, in most (though not all) of the last 15 years, it has moved procyclically. Consequently, during the low-growth years of the late 1990s and the early part of the current decade, the long-term upward course of the participation rate slackened, and labour supply trends moderated the rise in unemployment (see figure V.1).[2]

1 Economic Commission for Latin America and the Caribbean (ECLAC), "Latin America and the Caribbean: Population estimates and projections, 1950-2050", *Demographic Bulletin,* No. 73 (LC/G.2225-P), January 2004. United Nations publication, Sales No. E/S.03.II.G.209.

2 Figure V.1 displays the simple and weighted averages of both rates, which diverged in some periods.

Figure V.1
LATIN AMERICA AND THE CARIBBEAN (14 COUNTRIES): LABOUR FORCE PARTICIPATION RATE AND EMPLOYMENT (URBAN ZONES)



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.
[a] Overall labour force participation rate.
[b] Employment rate.

2. Trends in unemployment

Despite the lower pressure of labour supply stemming from demographic trends, unemployment has increased in recent years. As shown in figure V.1, job creation, measured in weighted and simple average terms, was unable to compensate for the expansion of labour supply; and unemployment, which the figure shows as the difference between the participation rate and the employment rate, expanded throughout the period. This happened especially from 1995 onwards, when a series of economic crises had serious repercussions on unemployment, which remained at historically high levels in the absence of sustained economic growth. In 2004-2005, regional unemployment eased, although it remains near two-digit levels.

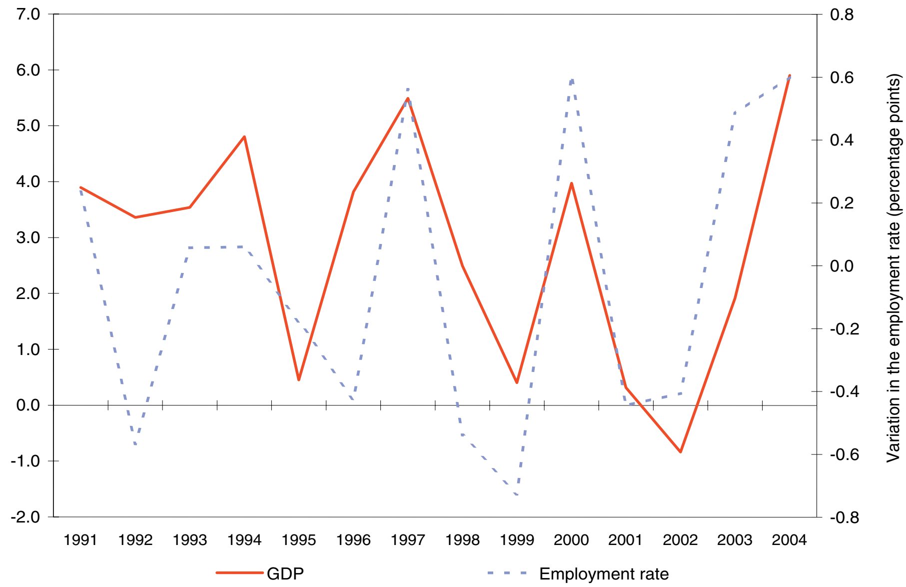
It should be noted that such a period of persistent high unemployment is unprecedented in the region: whereas previous economic crises caused sharp rises in unemployment, the rate always tended to fall back, even in times of weak economic growth such as the 1980s. In those circumstances, open unemployment was rapidly absorbed by an expansion of informal employment, but this pattern has not been repeated in recent years.

3. Employment trends

Despite the points raised in the previous section, as shown in figure V.2, economic growth has not been delinked from job creation. In fact, periods of economic recovery have always led to greater job creation, and the correlation did in fact become closer from 1997 onwards.

Figure V.2

LATIN AMERICA: ECONOMIC GROWTH AND EMPLOYMENT, 1991-2004



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

None of this is to deny that the restructuring of production and the macroeconomic traits of growth (real exchange rate trends, trade openness) have also influenced job creation, but this influence has generally been focused on specific sectors, and where is has affected the relation between growth and job creation, the effect seems to have been temporary.[3] Consequently, there is no delinking of economic growth and job creation; but nor has the employment elasticity of growth increased, as might have been expected following the economic reforms implemented in the 1980s and 1990s.[4]

Deficient economic growth was therefore the chief cause of weak job creation in 1990-2004. Aside from the increase in unemployment, other manifestations of this phenomenon —and of the population's need for more income than they could obtain from the new jobs generated by the expansion of production— included an increase in low-productivity jobs and in emigration.

As had happened in the 1980s, from 1990 onwards employment grew faster in low-productivity sectors. In the region as a whole, the share of the informal sector in urban employment rose from 42.8% in 1990 to 46.7% in 2003.[5] In fact, all categories of informal employment saw their shares of urban employment grow (i.e., non-professional, administrative or technical own account work, including unpaid family work, employment in microenterprises and domestic service). By contrast, there was a decline in the share in employment accounted for by small, medium-sized and large private enterprises as well as by the public sector.

Wage employment, which reflects labour demand most faithfully, displayed a clearly procyclical pattern, but this was not the case of own account work (see figure V.3). Part of the latter category reflects survival needs that force people into self-employment, often in precarious conditions; another part is accounted for by individuals taking advantage of favourable economic conditions to use opportunities to earn labour income. This duality is reflected in the trends in own-account work, which behave countercyclically and procyclically at different times.

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3 See, for example, the analysis of the Brazilian case in Carlos Alberto Ramos, "O emprego nos anos 90: O regime macroeconômico importa?", *Mercado de trabalho. Conjuntura e análise*, No. 22, November 2003; and Alessandro Ferreira dos Passos, Grazuiela Ansiliero and Luis Enrique Paiva, "Mercado de trabalho: evolução recente e perspectivas", *Mercado de trabalho. Conjuntura e análise*, No. 26, February 2005.

4 See Jürgen Weller, *Reformas económicas, crecimiento y empleo: los mercados de trabajo en América Latina*, Economic Commission for Latin America and the Caribbean (ECLAC)/Fondo de Cultura Económica, Santiago, Chile, 2000; and Inter-American Development Bank (IDB), *Good jobs wanted*, Washington, D.C., 2003.

5 See International Labour Organization (ILO), *Panorama Laboral 2004*, Lima, 2004. The reference to the concept of the informal sector is maintained despite its conceptual weaknesses and, especially, the difficulties involved in measuring it, because it continues to be a significant phenomenon in the region's labour markets.

Figure V.3

LATIN AMERICA AND THE CARIBBEAN: ECONOMIC GROWTH AND THE DYNAMIC OF JOB CREATION

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

Although it is acknowledged that the new technologies make it possible to achieve higher productivity than in the past in very small productive units, the gap between average labour incomes in the formal and informal sectors widened from 59% to 72% during the 1990s, measured as a simple average of the 12 countries for which data are available. This shows that the most salient feature of the expansion of the informal sector was not the emergence of highly productive activities on a very small scale, but a large number of low-productivity jobs.[6]

Underlying the large wage gap between labour incomes in the formal and informal sectors is the region's pronounced heterogeneity, which is reflected in large productivity differences. Over the last few years, this heterogeneity has actually intensified, as the most advanced productive sectors have undergone a certain amount of technological and organizational modernization, while the small-business and microenterprise segment overall has stood still in this regard.[7] In the labour market, this has further biased labour demand in favour of individuals with higher levels of education, thereby widening the wage gap between tertiary-educated and other wage earners.[8]

The last few years have seen heavy migration out of the region. Apart from the long-established flow of Mexican, Central American and Caribbean citizens to the United States, emigration out of the region has expanded sharply in response to severe economic crises. These crises, combined with differences in living standards between neighbouring countries, has also stimulated migration within the region, with examples being Nicaraguans moving to Costa Rica, and Peruvians to Chile.[9] Estimates conducted by ECLAC show that 11 of the region's countries displayed net annual emigration of at least 2 people per thousand.[10]

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6 See Víctor E. Tokman, "Las dimensiones laborales de la transformación productiva con equidad", *Financiamiento del desarrollo series,* No. 150 (LC/L.2187-P), Santiago, Chile, Economic Commission for Latin America and the Caribbean (ECLAC), October 2004. United Nations publication, Sales No. S.04.II.G.115.

7 See Economic Commission for Latin America and the Caribbean (ECLAC), *Productive development in open economies* (LC/G.2234(SES.30/3)), Santiago, Chile, June 2004.

8 See Inter-American Development Bank (IDB), *Good jobs wanted*, Washington, D.C., 2003.

9 See Economic Commission for Latin America and the Caribbean (ECLAC) 2002, *Globalization and development* (LC/G.2157(SES.29/3)), Santiago, Chile, April 2002.

10 In descending order: Guyana, Suriname, Saint Lucia, Jamaica, Guatemala, Ecuador, Nicaragua, Mexico, Trinidad and Tobago, Haiti and Peru. See Economic Commission for Latin America and the Caribbean (ECLAC), Latin America and the Caribbean: Population estimates and projections, 1950-2050, *Demographic Bulletin* No. 73 (LC/G.2225-P), January 2004. United Nations publication, Sales No. E/S.03.II.G.209.

Another worsening labour-market problem is the deterioration in social security coverage, which reflects the increasing amount of employment under substandard conditions. The proportion of wage earners paying into the social security system fell from 66.6% in 1990 to 63.6% in 2003.[11] Factors contributing to this were the aforementioned expansion of the informal sector and the reduced coverage of wage earners in microenterprises and domestic service, which dropped from 29.2% to 26.2%, while coverage in the formal sector declined by a smaller amount (from 80.6% to 79.3%).

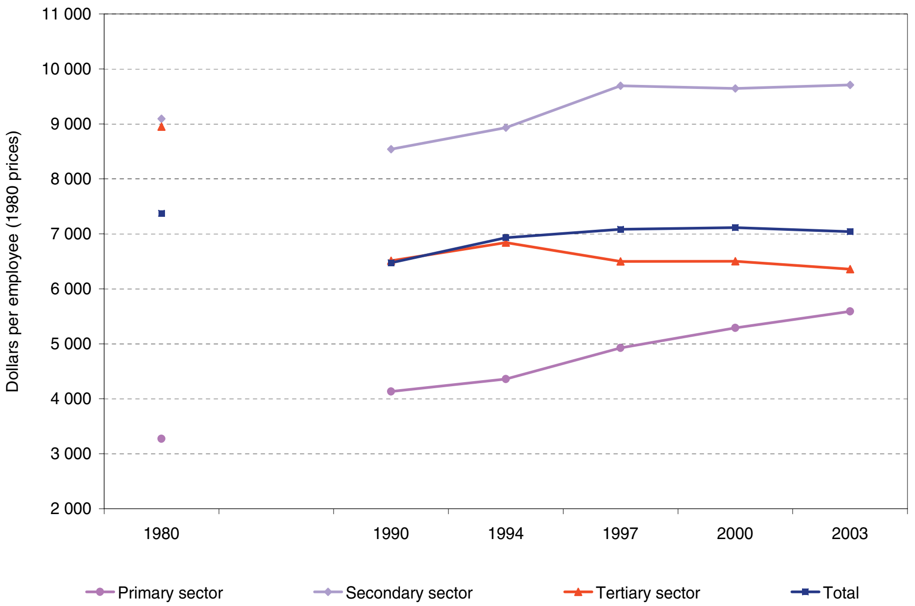
At the regional level, the trend of average real wages in the formal sector varies according to the measurement method used. Taking the median in countries for which data were available, wages increased by 28% between 1990 and 2004, thereby substantially recovering the 12% loss suffered in the 1980s. In contrast, when measured as a weighted average, the cumulative increase over the last 14 years was just 6%, representing annual growth of 0.4%.[12]

This meagre increase matches the growth of labour productivity in the region, since output per employee grew by roughly half a percentage point per year between 1990 and 2003.

Figure V.4 shows that, following a drastic fall in average labour productivity in the 1980s, output per employee rose slightly up to 1997, albeit without regaining its 1980 value. This trend is explained by a significant productivity increase in the primary and secondary sectors, against a backdrop of trade liberalization processes. It has also been found that average productivity in the tertiary sector, while hard to measure, grew for a few years only; in the wake of the tequila crisis it fell back again, reflecting the expansion of urban informality concentrated in certain branches of that sector.

Figure V.4

LATIN AMERICA AND THE CARIBBEAN: TREND OF LABOUR PRODUCTIVITY, 1980-2003



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

[11] See International Labour Organization (ILO), *Panorama Laboral 2004*, Lima, 2004.

[12] Author's calculation on the basis of official data.

Since 1997, average labour productivity has continued to grow only in the primary sector, mainly thanks to the modernization of corporate agriculture, based partly on intensive use of capital, the shedding of labour from a number of sectors in the peasant-farming economy, and the expansion of mining activity. Labour productivity growth in the secondary sector has come to a halt, while in the tertiary sector it has slipped back. As a result, average labour productivity has stood broadly still, and in 2003 it was only just above the 1990 level.

The region's inability to increase productivity and, hence, its competitiveness and economic growth, are key factors explaining the impossibility of improving labour conditions. This weakness is also reflected in the rapid slide in total factor productivity seen in many countries over the last few decades, although there were a number of more positive cases in the 1990s.[13]

Lastly, not all groups were equally affected by labour-market trends. The main reasons for this reside outside the labour market and include unequal access to a good education, problems relating to labour-market institutions, or a bias in labour demand in favour of certain types of worker. Indicators such as the higher unemployment rate, more protracted job search, difficulties in accessing certain types of job, different rates of pay for the same type of work, and the large and expanding wage gap between certain components of the labour force, reveal the need for specific measures to promote labour-market participation among the groups in question, which include women and young people, especially those of low educational levels, and ethnic minorities.

In conclusion, the expectations of better labour-market performance aroused by the economic reforms of the last few decades have not been borne out, although, contrary to certain claims, no "jobless growth" patterns have emerged. In this context, labour-market challenges can be described from two perspectives. First, from the perspective of labour as a key input in the production process, is the issue of how to maximize its contribution to speeding economic growth. Second, from the perspective of productive jobs arising from economic growth, the question is how to optimize the quantity and quality of the jobs being created. Based on this twin perspective, the challenges facing the labour market may be summarized as follows:

- To improve labour productivity as the basis for strengthening competitiveness and economic growth, which are prerequisites for improving labour-market conditions.
- To generate productive employment, i.e. employment that creates value-added and offers "decent" working conditions.[14]
- To develop mechanisms of protection against the threat of potential cutbacks in employment and incomes, in order to cope with the labour market's heterogeneity while taking account of its need to function efficiently.
- To encourage labour-market participation among groups that have specific problems in gaining access to productive work.

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[13] See Economic Commission for Latin America and the Caribbean (ECLAC), *Economic Survey of Latin American and the Caribbean, 2003-2004* (LC/G.2255-P/E), 2004, Santiago, Chile. United Nations publication, Sales No. E.04.II.G.2.

[14] The International Labour Organization has made "decent work" the strategic goal of policies aimed at improving labour-market participation, and it sees the following as key components: fulfilment of the fundamental standards approved by member countries of the institution, quality of employment, social protection and social dialogue. See International Labour Organization (ILO), *Globalization and decent work in the Americas,* Twenty-fifth American Regional Meeting, Lima, December 2002.

C. Policies for dealing with employment challenges

1. General aspects

There are three types of policy that governments can deploy to meet the challenges identified in the labour market: employment policies, labour policies and labour-market policies.[15] The first of these involve macroeconomic and sectoral instruments which act on the level and composition of output, and therefore also affect the magnitude and composition of employment and both absolute and relative wages. Labour policies define the conditions of the contractual relationship, including those governing its commencement and termination. Among other things, they include rules that define employer-worker relations and specify working conditions. Most of these rules are contained in labour laws, but there are also regulations arising from other sources, such as collective bargaining processes and jurisprudence established by the competent courts. Labour-market policies involve direct interventions in the labour market to combat or avoid unemployment and raise labour income. These are divided into active and passive policies. The main instruments of active policies are training, intermediation services and direct or indirect job creation. Passive policies usually have a social slant, involving the provision of incomes to workers who have lost their jobs. An additional purpose is to indirectly improve the efficiency of intermediation by facilitating job-seeking with less pressure from the lack of income.

What policies have been used in recent years to address labour challenges? In justifying the economic reforms proposed since the 1980s, the unsatisfactory labour performance of previous decades was blamed mainly on distortions in other goods and factor markets, and only to a small degree on the functioning of the labour market. Under this approach, policy interventions in markets were deemed to have disregarded the region's comparative advantages and discouraged labour hiring. Moreover, such demand as there was was biased in favour of more highly skilled workers, with negative consequences for the vast majority of the region's low- and medium-skilled labour force. It was therefore considered that structural reforms to eliminate these distortions would have been the best employment policies, because not only would they stimulate economic growth (the key factor in labour demand) but they would also render such growth more labour-intensive. The combined effects of the reforms could therefore help overcome the main problem of labour market, i.e. the weakness of labour demand, especially for less skilled workers. In fact, practically all of the region's countries introduced the corresponding reforms to a greater or lesser extent.[16]

This argument did not mean disregarding the role of the labour market. In fact, it was claimed that the rules applied in the region's labour markets over the last few decades probably also caused distortions that hindered labour hiring. Consequently, a flexible labour policy that eliminated distortions would also help raise the level of employment. Nonetheless, other reforms were deemed to have a greater impact, and more politically feasible to implement. For that reason, labour reforms did not form part of the "Washington Consensus", which set out the main reforms aimed at boosting economic growth and making it more stable.[17]

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15 The following paragraphs are based on Jürgen Weller, "Introducción: temas, tendencias y lecciones", *En búsqueda de efectividad, eficiencia y equidad. Las políticas del mercado de trabajo y los instrumentos de su evaluación,* Santiago, Chile, LOM/Economic Commission for Latin America and the Caribbean (ECLAC), 2004.

16 On this point see Barbara Stallings and Wilson Peres, *Growth, employment and equity. The impact of economic reforms in Latin America and the Caribbean*, Santiago, Chile, Fondo de Cultura Económica/Economic Commission for Latin America and the Caribbean (ECLAC), September 2000.

17 Apart from the indirect impact expected from reforms in non-labour markets, favourable direct effects on the functioning of the labour market were obtained from reforms that targeted mainly other markets. These include public-sector downsizing, making the supply of goods and services more efficient, and tackling the fiscal deficit, while also reducing the distorting impact of public-sector employment on the labour market; and a minimum-wage policy based on counter-inflationary targets. See John Williamson, "What Washington means by policy reform", *Latin American Adjustment: How Much Has Happened?*, John Williamson (ed.), Washington, D.C., Institute for International Economics, 1990.

The limited effects of the series of reforms set out in the Washington Consensus led some institutions to confer renewed importance on labour policy for job creation and economic growth.[18] Labour-market flexibility formed part of the proposals contained in a second generation of reforms aimed at eliminating regulations and strengthening competition.[19] In fact, many countries reformed their labour legislation during the 1990s, although the scope of the changes varied.[20] More widespread still were efforts to increase the efficiency of labour-market policies, a topic that is analysed further below.

Before reviewing policy options, it is worth reflecting briefly on the nature of the labour market. According to economic theory, labour markets differ from other markets because the "good" being traded is the labour force. Importantly, the labour force is both a factor of production and the means used by most households to generate the bulk of the income they need for survival and well-being, which brings in social norms and ethical considerations. Moreover, the labour market is often marked by incomplete and asymmetric information, high transaction costs and uncertainty.

In view of these specific characteristics, all the countries have developed a framework of labour institutions with the twin objective of stimulating efficient functioning of the labour market and protecting the legitimate interests of the people participating in it —especially workers, who are typically seen as weaker agents.

Over the last few decades, the socio-economic context of labour-market institutions has changed significantly. This has fuelled an intense debate on the reforms needed to enable such institutions to best fulfil their twin objective under the new conditions. Much of the debate revolves around how labour-market institutions should respond to ongoing economic changes, especially the integration of markets and technological changes that heighten competition and speed up commercial and financial interactions, while shortening the time available for firms to adapt to market changes. Nowadays, few would deny that the labour-market institutions of the past need changing, or maintain that protection policies can be retained or deepened within systems developed in earlier decades; indeed, many countries are taking measures to adjust these systems to the new setting.

Clearly, labour-market institutions cannot be conceived in a vacuum; they need to be structured taking into account the socio-economic context and evolution in each country. Disregard for these elements can lead to poor legitimacy or scant compliance with the corresponding regulations, with unwanted side-effects. Accordingly, when protection measures are introduced, account needs to be taken of the possible secondary effects that could undermine both the efficiency of the market and the well-being of the weakest groups.

Furthermore, deregulation measures aimed at improving the functioning of the labour market should allow for a clear appreciation of the potential social costs and their distribution. It is worth reiterating that the particular traits of the labour market remain relevant and that minimal regulation is not an optimal solution. Rather than deregulating this market, institutions and policies need to be adapted in order to best fulfil its twin objective in a new socio-economic setting.

Within this general framework, the following sections review the policies available to the authorities to address the four challenges mentioned, referring only to policies that are directly related to the labour market. This is not to diminish the importance of employment policies and the role of economic growth as a necessary condition for creating productive jobs. On the contrary, ECLAC has set forth detailed proposals to encourage high, sustained and less volatile economic growth, and for the development of a competitive productive structure based increasingly on the incorporation of innovations and new technologies.[21] This section therefore analyses measures that complement such policies, particularly in terms of labour and labour-market policies. As mentioned above, these involve, first, strengthening the market's contribution to improving the region's productive capacity, and, second, overcoming shortcomings in job creation and income generation.

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18 See Economic Commission for Latin America and the Caribbean (ECLAC), *Una década de luces y sombras. América Latina y el Caribe en los años noventa*, Bogotá, D.C., Alfaomega, 2001.

19 On second-generation reforms, see for example, Inter-American Development Bank (IDB), "Informe de progreso económico y social", *Informe 1996*, Washington, D.C., 1996; John Williamson, "Revisión del consenso de Washington", *El desarrollo económico y social en los umbrales del siglo XXI,* Luis Emmerij and José Núñez del Arco (eds.), Inter-American Development Bank (IDB), Washington, D.C., 1998, and J. Luis Guasch, *Labor market reform and job creation. The unfinished agenda in Latin American and Caribbean countries*, World Bank, Washington, D.C., 1999.

20 For a comparative view of reforms to labour legislation since 1990, see María Luz Vega Ruiz (ed.), *La reforma laboral en América Latina. Un análisis comparado*, International Labour Organization (ILO), Lima, 2001.

21 See Economic Commission for Latin America and the Caribbean (ECLAC), *Productive development in open economies* (LC/G.2234(SES.30/3)), Santiago, Chile, June 2004.

2. Policies to improve labour productivity

Increasing labour productivity depends on multiple factors, many of which are not directly related to the labour market. These include improving the coverage and quality of education systems, and the incorporation of new technologies and ways of organizing production.

The aspects most closely linked to the labour market include vocational training and the development of labour relations that help stimulate labour productivity.

In many countries, vocational training has undergone sweeping changes. One important aspect of these has been the diversification of the organizations providing training, with private institutions now playing an increasingly significant role, while the public sector focuses on financing and other issues through tax incentives, and on regulating the activity.[22] In addition, measures have been taken to adapt training activities to demand patterns; and in many cases training has been stepped up for personnel who are already skilled but are strategically important for their firm's competitiveness. Specialized vocational training programmes have also been implemented for unemployed groups with specific problems (young people and women with low levels of schooling), or those employed in unproductive activities earning low incomes (specific occupations, self-employed workers and microentrepreneurs).

On the other hand, labour-market reforms that reduced job stability and increased staff turnover had a negative influence on training activities in firms.[23] Many of the recent (often still quite superficial) changes in vocational training systems respond to market changes that have had three main consequences: (i) obsolescence or, at least, declining importance of many trades and techniques in which workers used to be trained, because of far-reaching transformations in technology; (ii) whereas in most countries' training systems originally focused on preparing workers for the manufacturing industry, nowadays the vast majority of new jobs arise in the services sector, which has very different and much more varied needs; and (iii) the pace of technological change means that it no longer suffices to train workers once in a specific task and, at most, have them attend an occasional refresher course; vocational training systems nowadays must allow for frequent training throughout an individual's working life.

These changes have important implications for the development of an efficient training system. First, the existence of more varied training needs makes it hard to apply the old schemes of "planning" for professional training, requiring instead the development of broad-ranging supply in the training market. For this to function efficiently the following is needed: (i) a system of training incentives, including tax breaks; (ii) a quality control system that serves to certify the competency of training providers that satisfy explicit experience and quality standards, but does not prevent the entry of new firms; and (iii) a training quality control system, based on a recognized scheme of results certification. Fulfilment of these requirements would help to improve vocational training and make its outcomes transparent.

Second, the greater difficulties involved in the medium- and long-term planning of vocational training requires an sustained effort from the relevant agents to project future requirements. Obviously this requires broad engagement of the private sector, to ensure that services are clearly responsive to demand. Nonetheless, enterprises are often unsure of their future needs in a setting of rapid technological change, so cooperation between the public and private sectors can help develop longer-term perspectives.[24] Moreover, the region's structural heterogeneity is reflected in the varied needs of different types of firm and this is a situation that must be approached in a flexible manner.

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[22] For recent changes in vocational training and the corresponding debate, see María Angélica Ducci, "Training and retraining in Latin America", *Labor Market Policies in Canada and Latin America. Challenges of the New Millennium,* Albert Berry (ed.), Kluwer Academic Publishers, Boston/Dordrecht/London, 2001; Gustavo Márquez, "Training the workforce in Latin America: what needs to be done?", *Labor Market Policy Briefs Series*, Sustainable Development Department, Inter-American Development Bank (IDB) 2002, and Guillermo Labarca (ed.), *Reformas económicas y formación,* Inter-American Research and Documentation Centre on Vocational Training/German Agency for Technical Cooperation/ Economic Commission for Latin America and the Caribbean (CINTERFOR/GTZ/ECLAC), Montevideo, 2003.

[23] Juan Chacaltana and Norberto García, "Reforma laboral, capacitación y productividad. La experiencia peruana", *Working paper*, No. 139, Lima, International Labour Organization (ILO), 2001.

[24] Anne Caroline Posthuma, *Diálogo social, formación profesional e institucionalidad,* Inter-American Research and Documentation Centre on Vocational Training (CINTERFOR), Montevideo, 2002.

Third, firms often fear that if they provide vocational training for their workers, another firm might hire them and thus reap the benefit of the investment, especially in a context of higher labour turnover. In this case, programmes for activity-specific segments, such as those offered by chambers of commerce, could reduce the attendant risks.[25] Such programmes would focus on developing specific human capital for a given activity. Schemes of this type should engage the sector's SMEs which tend to find it hard to obtain good training.[26]

Vocational training is fundamental for productive participation by young people with medium and low levels of education. Since the 1990s, several of the region's countries have developed relatively short programmes targeting this group, combining technical training with practical experience in firms.[27] These programmes have achieved relatively positive results, especially in comparison with the traditional training modalities available for this group of young people.[28] Nonetheless, the large-scale expansion of such initiatives, apart from the scarcity of available resources, would pose management challenges, i.e., maintaining the quality of training and finding enough eligible firms interested in participating in the programme.

In terms of labour relations as a way of encouraging productivity, there is an ongoing debate over which model most efficiently responds to the new market characteristics. Generally speaking, it is acknowledged that there is no single unsurpassable model that works in all societies with the same optimal results. The best solution tends to be the outcome of a process of continuous search within each firm, especially in very diverse and heterogeneous countries such as those of Latin America and the Caribbean, in which a wide variety of labour models coexist.[29]

In any event, there is consensus that, at least in firms which are operating in more volatile markets and incorporating new technologies, labour relations must be less rigid and more participatory than those prevailing in the Taylorist production model if the full potential of these technologies is to be realized. Certain characteristics of the new productive patterns, including just-in-time synchronization with demand, magnify the effect of any interruption in the process, which encourages the achievement of a minimal degree of consensus within the firm.[30] In many Latin American and Caribbean countries, however, labour relations are characterized by a history of confrontation —often fuelled by repression and violence— and mistrust. It will therefore be necessary to promote a gradual strategy to change labour relations which, rather than having immediate consequences on such relations and on labour productivity, would help to nurture the trust that could form the basis for negotiating deeper changes. New mechanisms of dialogue between business and union organizations could contribute to this.[31]

An example of this type of initiative is the introduction of participatory wages —a measure recommended by ECLAC more than a decade ago, but never applied on a sufficiently widespread basis.[32] This proposal, which is based on linking part of wages to productivity, would encourage workers to make a greater contribution to increasing productivity, while guaranteeing that they would benefit from the corresponding progress. The mistrust that this mechanism arouses may stem partly from the scant use that has been made of it. To implement the proposal, it would be advisable to proceed initially by linking productivity to a small fraction of wages. This would make it possible to introduce the system without large risks for either party. Negotiations between firms and workers'

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25 In some countries, such as Brazil, Mexico and Peru, vocational training was organized with a sectoral perspective at an early stage, whereas other countries came more decisively to that approach later. See María Angélica Ducci, "Training and retraining in Latin America", *Labor Market Policies in Canada and Latin America. Challenges of the New Millennium,* Albert Berry (ed.), Boston/Dordrecht/London, Kluwer Academic Publishers, 2001.

26 In "El mercado laboral en Perú: problemas y propuestas", Economic Commission for Latin America and the Caribbean (ECLAC), unpublished, Norberto García proposes a structure for a labour training system in Peru.

27 Programmes of this type include ChileJoven (not currently operating), ProJoven in Peru and Proyecto Joven in Argentina.

28 Juan Chacaltana and Denis Sulmont, "Políticas activas en el mercado laboral peruano: el potencial de la capacitación y los servicios de empleo", *Políticas de empleo en Perú*, vol. 1, Norberto García and others (eds.), Lima, Consorcio de Investigación Económica y Social (CIES), 2004.

29 See, for example, Timothy F. Bresnahan, Eric Brynjolfsson and Lorin M. Hitt, "Tecnología de la información, organización del lugar de trabajo y demanda de trabajadores calificados: evidencia a partir de datos de empresa", *Reformas y equidad social en América Latina y el Caribe. Reports on the first phase of the Social Equity Forum*, Carlos Eduardo Vélez and Paz Castillo-Ruiz (eds.), Washington, D.C., Inter-American Development Bank (IDB), 2004.

30 Obviously one cannot speak of a widespread introduction of new and flexible technological patterns, which would stimulate changes in labour relations. Nonetheless, there are trends in that direction which could have effects transcending the business domain.

31 Organizations committed to corporate social responsibility, which are gaining a growing presence in the region, could play a significant role in this regard.

32 Economic Commission for Latin America and the Caribbean (ECLAC), "Social equity and changing production patterns: an integrated approach", *ECLAC books,* No. 32 (LC/G.1701/Rev.1-P), Santiago, Chile, August 1992. United Nations publication, Sales No. S.92.II.G.5.

representatives would need to clearly define the productivity indicators to be used and how they are be calculated. It is also important for the flexible component of the wage to be included in taxable income, to prevent workers' social protection being diluted (especially pensions).

Another component that warrants a greater role in collective bargaining is training, as discussed in the previous section. Given its growing influence on enterprise productivity and competitiveness, on which the improvement of labour conditions depends in many ways, this is a field in which the interests of workers and employers could converge, thereby helping to generate trust.

The high degree of heterogeneity across sectors of production tends to require more decentralized collective bargaining processes at the firm level. This is not to cast doubt on the function or existence of social stakeholder organizations. In many cases, existing labour legislation does offer the possibility of altering labour relations through negotiations in a specific firm. The largest enterprises take advantage of this possibility more frequently, without aiming for greater overall flexibility —contrary to what is often claimed by their representatives in business associations. Instead, the strategies deployed reflect a permanent search for an appropriate balance between flexibility and regulation in firms.[33] [34] Generally speaking, decentralized collective bargaining processes are more conducive to developing the trust needed to redefine labour relations through consensus.

Lastly, as well as aspects relating directly to the labour market, as mentioned above, policies would be needed to improve the productivity of the informal sector, in order to reduce the region's high level of structural heterogeneity. Given the large proportion of informal activity in many of the region's countries, job creation in the formal sector alone cannot be expected to meet the need for productive employment. Two aspects link this issue to the labour market. The first is labour training, as discussed above. The second involves introducing less stringent labour regulations for microenterprises, in order to encourage their formalization and thereby facilitate access to credit and technical assistance, among other services, which would lead to higher productivity. Experience shows that for these measures to be effective they need to form part of a broader set of incentives and controls on compliance with current regulations. The lower cost of formalizing labour relations could be insufficient on its own, if the process also entails much higher costs elsewhere, particularly in the tax domain.[35]

3. Generating productive employment

Creating productive employment depends largely on private enterprise. For that reason, a favourable macroeconomic climate and positive expectations regarding the trend of the economy are key conditions for firms to increase investment and production and hire additional workers. A propitious climate for new business start-ups also encourages the creation of new jobs.[36] Nonetheless, as has been stressed repeatedly, the enterprise creation process is often hindered by inefficient bureaucratic mechanisms requiring lengthy and complex procedures.[37] Without denying the importance of the authorities' enforcing environmental, urban, hygiene and other standards, the corresponding permits need to be processed efficiently and rapidly. Moreover, new firms' needs in terms of credit and information support require activities to be coordinated between the public and private domains.

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33 Enrique de la Garza Toledo and Alfonso Bouzas, *La flexibilidad del trabajo en México: una visión actualizada,* "Right versus efficiency", *Paper series*, No. 4, New York, Institute of Latin American and Iberian Studies, Columbia University, September 1998.

34 It should be recalled that the international context has also become more relevant to the debate on labour standards. Whereas initiatives introduced by industrialized countries are often viewed as protectionism in a new guise, it has been argued that Latin America could benefit from the establishment of certain minimum standards, given the competition posed by the low wages paid in Asia. See Patrick Belser, "Do low Asian labour standards hurt Latin American workers?", document prepared for a seminar entitled Mercado de trabajo: entre la solidaridad y la lealtad (Montevideo, 19 and 20 May), 1998.

35 In "El mercado laboral en Perú: problemas y propuestas", Economic Commission for Latin America and the Caribbean (ECLAC) (unpublished), Norberto García claims that the attempt to encourage enterprises to join the formal sector, by reducing nonwage labour costs, initially had very limited effects, but subsequently factors unrelated to the labour market accelerated the process. Tokman (2001) gives a detailed analysis of modernization policies in the informal sector, such as labour and tax legislation, the function of municipalities, promotion regimes and institutional development, along with microentrepreneur organization.

36 Gerhard Reinecke and Simon White, *Policies for Small Enterprises. Creating the Right Environment for Good Jobs,* Geneva, International Labour Organization (ILO), 2004.

37 World Bank, *Doing Business in 2004. Understanding Regulation,* Washington, D.C., 2004.

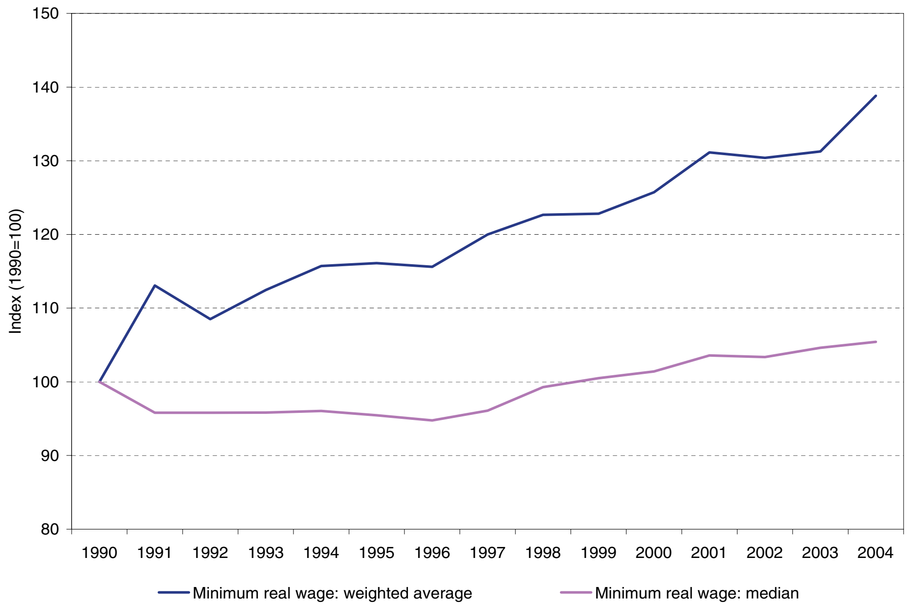
In terms of policies more closely related to the labour market, two areas require particular attention: (i) labour costs, wage and non-wage alike; and (ii) transaction costs and the efficiency of labour-market institutions.

As noted in the first section, average real wages in the formal sector have risen little in the last few years, reflecting the weak growth of labour productivity. Real labour incomes as a whole display an even more negative trend, with no increase at all recorded between 1990 and roughly 2002.[38] Average unit labour costs can thus be said to have held steady or fallen slightly, depending on the calculation method used.

This is partly explained by the conservative nature of the wage policy applied in most countries, although the weighted average and median average real wage followed divergent trends in the 1990s. After falling sharply in the 1980s (by roughly 35% regionwide), the minimum real wage recovered in the 1990s in some countries, particularly Brazil and, in 2004 and 2005, in Argentina. Accordingly, the weighted average real minimum wage for the region rose by 39% between 1990 and 2004. Nonetheless, in most countries, increases in the minimum wage only compensated for inflation, so the regional median remained virtually flat, rising by no more than 5% (see figure V.5.)

Figure V.5

LATIN AMERICA AND THE CARIBBEAN (18 COUNTRIES): MINIMUM REAL WAGE



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

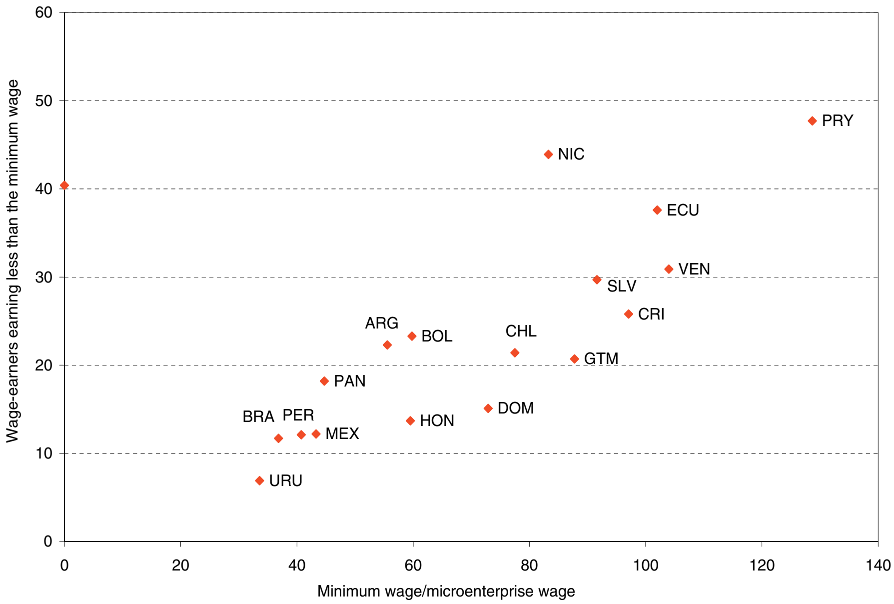
Increases in minimum wages are often blamed for undermining employment in specific labour groups, especially the least skilled and young people. According to this argument, a rise in the minimum wage would result in fewer people being hired from these groups, because their wages would outweigh their productivity. Thus, the favourable impact of higher minimum wages on the standard of living of individuals receiving an income at or slightly above the minimum would be offset by a rise in unemployment among these groups. Clearly, increases in minimum wages that are not in line with general labour-market trends can have a negative effect on hiring practices, although the impact is likely to depend greatly on the level of the minimum relative to other wages. An

38 ECLAC calculations based on household surveys in the various countries, show that average labour income held steady at a level equivalent to 3.9 times the poverty line, when measured as a simple average of 18 countries. As a median of those countries, incomes fell from 4.1 to 3.5 times the poverty line.

excessively high level (in relation to the labour-market situation of the country rather than in terms of ethical justification) would elicit not only higher unemployment but also, in the context of weak supervision systems, increased non-compliance. Figure V.6 shows, first, a clear relation between the level of the minimum wage (as a percentage of the average wage paid in microenterprises in the respective country) and the degree of non-compliance, calculated on the basis of the proportion of wage earners being paid less than the minimum wage.[39]

Figure V.6

LATIN AMERICA: RELATIVE MINIMUM WAGE AND NON-COMPLIANCE, 2002



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

Second, figure V.6 shows that non-compliance remains below 25% when the minimum wage does not exceed 80% of the average paid by microenterprises. At higher relative levels, non-compliance rises to 30% and more, reflecting the fact that firms with lower productivity levels are unable to pay higher rates.[40]

In conclusion, when contemplating increases in the minimum wage, its relative level needs to be taken into account, along with the overall performance of the economy, particularly productivity trends. If the minimum wage is below the indicated level (80%), there is room for increases whose positive effects on the incomes of poor households will probably outweigh the potential negative effects in terms of non-compliance (i.e., informality, with the concomitant reduction in social security coverage, among other factors). On the other hand, if the relative level is higher, additional increases could have a more negative impact.

Another issue affecting wage costs is their flexibility. It has been claimed that, with the reduction of inflation in the countries of the region, an important mechanism for adjusting real wages at times of economic turbulence has been lost. Indeed, the response or variation of wages in relation to trends in the rate of economic growth does seem to have declined as inflation rates have come down.[41] One way of compensating for this loss of real-wage flexibility, which may make unemployment more likely to rise during an adjustment to economic turbulence, is to link wages partially to firms' results.[42] Thus, when a firm is in difficulties, it may reduce costs without having to lay off workers; and the negative effects of the adjustment

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39 This exercise replicates a similar one undertaken by the International Labour Organization using 1995 data, International Labour Organization (ILO), *Panorama Laboral 1997*, Lima, 1997.

40 Some countries try to deal with this situation by establishing minimum wages differentiated by firm size, activity branch or region.

41 José Antonio González Anaya, "Labor market flexibility in thirteen Latin American countries and the United States. Revisiting and expanding Okun coefficients", *Working Paper*, World Bank, 1999.

42 David Bravo, Osvaldo Larrañaga and Joseph Ramos, "Una nueva agenda de políticas de empleo", *Economía & Administración*, No. 142, December 2001.

would be distributed more widely. Obviously, a number of considerations need to be taken into account, such as the amount of risk that can reasonably be shifted onto workers, and transparency in calculating firms' results.[43]

A relatively new policy in the region to encourage hiring is wage subsidies, variants of which are being applied in Argentina and Chile, and are soon to be introduced in Colombia. The system risks being ineffective at times of low expectations (because in this situation it is hard to stimulate additional hiring), and is not likely to be very efficient in boom periods (because some of the subsidized hiring would probably have occurred anyway). Nonetheless, compared to other policies —such as emergency employment programmes— it has the potential advantage of encouraging more lasting incorporation into the labour market.[44]

Lastly, a high proportion of labour costs in many countries consist of non-wage expenses,[45] mostly payments relating to future benefits (such as health services, pensions and training). Many countries have taken steps to reduce these costs, in some cases by reforming social-security systems, elsewhere by introducing special contracts that exclude certain benefits.[46] As such payments represent a real benefit for workers, a sizeable reduction is not really feasible. Nonetheless, it is worth studying the potential for making other factors bear part of the corresponding costs. In addition, if social protection systems were to be made more efficient, this would have a positive impact on the related costs.[47] In any event, the repercussions of such measures on the level of employment would probably be limited, since at least part of the increases and reductions in contributions borne by firms tend to have an opposite effect on wages. On the other hand, non-wage costs not linked to the employment contract should be identified and eliminated, or else financed from other sources.[48]

Labour-market interactions are often non-transparent. For example, a large proportion of firms hire new workers on the basis of recommendations made by third parties. In a market characterized by incomplete information on workers' characteristics, skills, experience and attitudes, this might be the best solution for firms, provided it does not reflect links unrelated to their needs, for example friendship and political affiliations. At best, however, this mechanism deepens tendencies towards exclusion and discrimination against workers who, while possessing the necessary human capital, do not have the social capital that facilitates access to selection processes.

Accordingly, greater efficiency and transparency in labour intermediation could not only help to reduce transaction costs and improve the efficiency of hiring, but also contribute to greater equity. Recently, intermediation has been reappraised as a potentially effective and low-cost instrument. Major efforts have been made to expand its coverage, with new technologies being introduced; and different modalities of public-private cooperation have been established. To realize the full potential of intermediation, the idea is to combine it more effectively with other labour-market policies, both active and passive.[49] The establishment of a skills certification system would help to significantly improve transparency in the labour market. The documentation of skills and knowledge would address one of the main information failings typical in this market, and would thus reduce transaction costs and improve labour mobility.[50] For these goals to be fulfilled, the certification system needs to be developed in a tripartite social process.

Another domain in which efficiency can be substantially enhanced through lower transaction costs is labour justice. In many countries, resolving disputes through the courts is costly in terms of time and uncertainty; streamlining these processes could help reduce such costs.

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43 Víctor E. Tokman, "Las dimensiones laborales de la transformación productiva con equidad", *Financiamiento del desarrollo series,* No. 150 (LC/L.2187-P), Santiago, Chile, Economic Commission for Latin America and the Caribbean (ECLAC), October 2004. United Nations publication, Sales No. S.04.II.G.115.

44 Emergency programmes are justified at times of profound economic crisis which cause a sharp drop in labour demand. To be efficient, it is important that the institutions responsible, especially municipalities, have a portfolio of projects available to implement through programmes of this type. A further point is that these programmes tend to be self-perpetuating. As they do not help their participants to become integrated into the labour market, and may even act as an obstacle by having a stigmatizing effect, it is important to develop alternatives such as well-designed wage subsidies.

45 In Latin America, these range from 30% of the wage in El Salvador to 78% in Honduras. See Norberto García, "El mercado laboral en Perú: problemas y propuestas", Economic Commission for Latin America and the Caribbean (ECLAC), unpublished.

46 María Luz Vega Ruiz (ed.), *La reforma laboral en América Latina. Un análisis comparado*, Lima, International Labour Organization (ILO), 2001.

47 A complete overhaul of social-security systems, delinking them from the formal employment contract, could have very significant effects. Nonetheless, a reform of this type would pose huge financing, efficiency and equity challenges.

48 For example, Peru's special solidarity tax was abolished in 2004.

49 Jacqueline Mazza, "Labour intermediation services: lessons for Latin America and the Caribbean", *CEPAL Review*, No. 80 (LC/G.2204-P), Santiago, Chile, Economic Commission for Latin America and the Caribbean (ECLAC), August 2003.

50 Mariana Schkolnik, "Incremento de la productividad y empleabilidad de los trabajadores y certificación por competencias como parte del sistema de protección social: La experiencia de países desarrollados y lineamientos para América Latina", Economic Commission for Latin America and the Caribbean (ECLAC), unpublished.

4. Labour protection in the new economic setting

The highly volatile nature of the region's economic growth in recent years has had significant labour-market consequences. Changes in the socio-economic fabric mean that firms need greater adjustment capacity. This stems partly from more variable labour demand, which is likely to be incompatible with hiring regimes that are overly rigid in terms of the number and distribution of working hours and in terms of hiring and firing practices. There is a belief that institutional factors in Latin American and Caribbean labour markets cause rigidity, thus reducing staff turnover. In this scenario, low levels of mobility would lead to a loss of efficiency, by slowing down the process of matching workers to jobs and obstructing progress from lower- to higher-productivity jobs. Nonetheless, recent studies seem to suggest that levels of job creation and destruction and worker mobility are quite high.[51]

Many countries have reformed their labour legislation to facilitate adjustment capacity at the firm level. In particular, they have introduced hiring modalities that allow for greater flexibility in terminating an employment contract and, to a lesser extent, in the distribution of working hours and the cost of overtime.

The lifting of all restrictions on flexibility is not recommended for various reasons. For example, where labour markets display a bias against certain groups, such as older workers, a degree of employment protection may be justified.[52]

In addition, greater job instability —whether real or perceived— has been identified as a factor of growing discontent at work.[53] This is not only contrary to the goal of ongoing improvement in the population's well-being, but also tends to have negative effects on worker performance.

Lastly, excessive staff turnover hinders the generation of specific human capital —in particular, instability in labour relations increases firms' investment risk in relation to training, with the result that they frequently sacrifice the training of specialized staff. Consequently, during economic booms, the shortage of skilled workers then often acts as a bottleneck, making it impossible to take advantage of particular opportunities. Maximization of labour turnover should not be a labour-policy goal, because of its economic as well as its social consequences.

It is therefore worth asking what may be achieved through labour policy. First, it needs to be realized that the speed of adjustment has increased in all markets, the labour market included. The magnitude of the increased turnover and shortening of labour contracts has yet to be clearly determined empirically, however.[54] Be that as it may, the situation in Latin American and Caribbean labour markets does not offer prospects of job stability.[55]

Second, as occurs in other domains, measures aimed at making jobs more permanent need to be undertaken cautiously, because they can have undesired consequences. For example, it has been argued that certain protectionist regulations could prompt firms to prevent workers from accumulating rights through years of service, thus encouraging an excessively high turnover.[56]

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51 Angel Calderón-Madrid, "Job stability and labor mobility in urban Mexico: a study based on duration models and transition analysis", *Research Network Working paper*, No. R-419, Inter-American Development Bank (IDB), Washington, D.C., 2000, and Victoria Castillo and others, "Dinámica del empleo y rotación de empresas: La experiencia en el sector industrial de Argentina desde mediados de los años noventa", *Estudios y perspectivas series*, No. 9 (LC/L.1765-P), Economic Commission for Latin America and the Caribbean (ECLAC), ECLAC office in Buenos Aires, 1999. United Nations publication, Sales No. S.02.II.G.79.

52 In some industrialized countries, this protection may not exist in law but often operates for a high percentage of workers on the basis of collective agreements.

53 International Labour Organization (ILO), *Economic Security for a Better World*, Geneva, 2004.

54 The results of studies on member countries of the Organisation for Economic Co-operation and Development (OECD) can be summarized as showing that there has been no significant reduction in long-term employment contracts. Nonetheless, new labour contracts have a much higher proportion of temporary jobs, which is probably more a reflection of future trends than a recomposition of the contractual situation of the labour force as a whole. See Peter Auer and Sandrine Cazes, "Introduction", *Employment Stability in an Age of Flexibility. Evidence from Industrialized Countries,* Peter Auer and Sandrine Cazes (eds.), International Labour Organization (ILO), Geneva, 2002; René Morissette and Anick Johnson, "Are good jobs disappearing in Canada?", *Analytical Studies Branch research paper series*, No. 239, Ottawa, Statistics Canada, 2005.

55 This can be inferred from a study of focus groups with young people and young adults in five Latin American countries, as part of the ECLAC/GTZ project entitled "Inserción laboral de jóvenes".

56 For the case of Brazil, see the argument put forward by José Márcio Camargo and Marcelo Neri, "Emprego e productividade no Brasil na década de noventa", *Reformas económicas series*, No. 30 (LC/L.1219), Economic Commission for Latin America and the Caribbean (ECLAC), 1999; Carlos Alberto Ramos, "Las políticas del mercado de trabajo y su evaluación en Brasil", *Macroeconomía del desarrollo series*, Nº 16 (LC/L.1814-P), Economic Commission for Latin America and the Caribbean (ECLAC), Santiago, Chile, December 2002. United Nations publication, Sales No. S.02.II.G.128.

There are two approaches to tackling this problem. Hitherto, the increased labour market volatility has resulted mainly in the introduction of short-term contracts and lower layoff costs. In contrast, systems that seek to offset the decrease in labour demand by allowing greater flexibility in hours worked and wages paid have been relatively less explored. Mechanisms that help to "concentrate" the adjustment on these variables could help to stabilize employment. This would be beneficial not only for workers' well-being but also for the prospects of the firm, which would not lose human capital at times of crisis and therefore would save on new training expenses when the economy rebounds.

As mentioned above, some discrepancy has been observed between a discourse aspiring to maximum contractual flexibility and the actual practices of firms, which tend to seek a balance between flexibility and stability, since they do need a minimum degree of stability in their labour force. The effort to develop mechanisms by which such a balance may be established is clearly an issue that calls for a bargaining process between stakeholders rather than legal imposition.

Increased job insecurity needs to be compensated for with the redesign of social-security systems to loosen the link between job stability and social benefits. This would mean that shorter-term contracts could be used to adapt better to more volatile circumstances, but these should not cut labour costs by eliminating the benefits associated with permanent contracts. In other words, shorter-term contracts should include the same social security "guarantees" as "standard" ones.

In this regard, the system of income protection needs to be developed in keeping with the conditions prevailing in the region. In Latin America and the Caribbean, passive policies involving different modalities for transferring incomes to unemployed workers have traditionally been weak. One of these is the complex system in place in Brazil —which combines three payment mechanisms for cases of dismissal without just cause— and another is the innovative Chilean model. In general, however, there is a growing recognition that, in the new economic, social and labour-market climate, the traditional aspiration to job stability is tending to give way to the design of unemployment insurance systems.[57]

5. Labour-market participation by groups with specific problems

A number of groups face specific problems in joining in the labour market, which require special measures. These include women, young people, ethnic minorities and migrants. In all of these groups, the individuals who suffer most are those with little schooling from low-income families.

On the supply side, the accent needs to be placed on improving equity in education systems to help compensate for opportunity disadvantages caused by social inequality and gender and ethnic discrimination. As mentioned above, in recent years training initiatives have been developed with programmes targeting needy groups, especially those with low and medium levels of education.

Other measures to improve the employability of members of the aforementioned groups involve assistance in defining personal employment strategies. These include the early establishment of contacts and familiarity with the labour-market domain, along with better information on the labour market generally. In a recent trend, and in view of the weakness of labour demand, there have been initiatives to draw the attention of members of these groups to the development of their own business initiatives. This is an interesting prospect, providing people with tools to expand their range of work alternatives as well as to foster personal development and citizenship-building. It would be unrealistic to expect significant growth of new sustainable enterprises, however, given the high rates of microenterprise failure worldwide.

On the demand side, over the last few years many countries have introduced special contracts containing reduced labour rights (in terms of wages, social coverage and layoff conditions). This has been intended to encourage hiring from among specific groups, especially young people. In this case, it is essential that such contracts include verifiable training measures, so that it is not merely a matter of replacing older workers with lower paid youth.

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57 Jacqueline Mazza, "Unemployment insurance: case studies and lessons for Latin America and the Caribbean", *Working Paper,* No. 411, Inter-American Development Bank (IDB), March 2000, and Mario D. Velásquez Pinto, "Seguros de desempleo, objetivos, características y situación en América Latina", *Financiamiento del desarrollo series*, No. 133 (LC/L.1917-P), Santiago, Chile, Economic Commission for Latin America and the Caribbean (ECLAC), July 2003. United Nations publication, Sales No. S.03.II.G.73.

Women's labour market participation could be encouraged by the introduction of part-time contracts with the corresponding social benefits. Account also needs to be taken of the gender perspective in vocational training, both to improve the quality of programmes in occupations to which women have traditionally had access, and to expand their access to other types of job.[58] There is also a need to improve daycare alternatives for small children.

Lastly, anti-discrimination legislation needs to be enforced, and awareness-raising campaigns should be undertaken in coordination with chambers of commerce and organizations involved in corporate social responsibility, among other institutions. Measures to make intermediation more transparent, such as those outlined above, could help reduce the bias towards the exclusion of such groups.

D. Conclusions

The global setting is not propitious for the creation of stable employment, and many steps have been taken in the region to address the resulting challenges. Although significant progress has been achieved, much remains to be done, as shown by the region's unsatisfactory employment performance.

Insufficient job creation over the last few years is largely due to low levels of economic growth. While the region is clearly not in a phase of jobless growth, the growth that has occurred has not led to more intensive use of labour, contrary to expectations aroused by the economic reforms.

Accordingly, policies aimed at encouraging high and sustained economic growth, along with productive development based on higher productivity and continuous innovation, are essential to productive job creation. Nonetheless, given the high and increasing heterogeneity of productive and occupational structures, economic growth cannot solve labour problems by itself. Labour and labour-market policies need to support these efforts to meet four challenges, namely: (i) to improve labour productivity; (ii) to generate productive employment; (iii) to develop protection mechanisms that are consistent with the new economic context; and (iv) to encourage labour-market participation by groups that face specific problems in finding productive employment.

This chapter has studied some of the policies available for tackling these challenges. Labour-market policies need to address the following.

First, at the more formal end of the labour market, the focus needs to be on requirements for modernization in both the private and public sectors. Among other measures, this involves rising to the challenges posed by more open economies through vocational training in the private sector, and modernization of the State in the public domain —for example through greater cooperation between the two sectors on vocational training and intermediation.

Second, at the other extreme of the labour market, it is very important for labour-market policies to be integrated with social policies. Marginalized groups need to be targeted through special training programmes, support for microentrepreneurs, male and female alike, and subsidies.

Third, the functioning of the labour market needs to be improved in terms of employability, efficiency of intermediation, integration of active and passive instruments, and skills certification, among other things.

Economic conditions need to be taken into account in implementing these policies, since a massive vocational training programme, no matter how well designed, will not be effective if it is implemented in a context of low labour demand.

Labour policies, in contrast, address the need to adjust labour-market regulations to take account of changes in the economic environment, without disregarding the dual challenge of fostering an efficiently functioning market while protecting the legitimate interests its participants, especially the typically weaker parties, i.e., workers.

Lastly, as mentioned above, the characteristics of the labour market mean that the best solution for specific problems is often not obvious and may vary from country to country.[59] Accordingly, all policies and programmes need to be monitored and evaluated, which will require data on results and, possibly, on correction needs, as well as a clear distinction between problems caused by policy design and those arising from implementation.

58 Caroline S. Fawcett and Sarah Howden, "Gender issues in technical training and vocational education programs", No. WID-103, Washington, D.C., Inter-American Development Bank (IDB), October 1998.

59 Structural reform processes have brought many surprises in the labour domain, both for the governments implementing the reforms and for their critics —surprises that dealt lessons of caution and humility to all stakeholders. Inter-American Development Bank (IDB), *Good jobs wanted*, Washington, D.C., 2003.

Second part

Countries

South America

Argentina

1. General trends

Economic expansion continued apace in 2004 with GDP growth of 9%, and in the first half of 2005 the level of activity appears to have matched the highs recorded some seven years ago. Although the strong recovery was associated with a significant jump in consumption, the ratio of domestic saving to GDP also rose to well above the last decade's figures. In 2004 fixed investment expanded by nearly 35%, thereby enabling a recovery of capital formation, which climbed to 17.7% (19% in the third quarter).

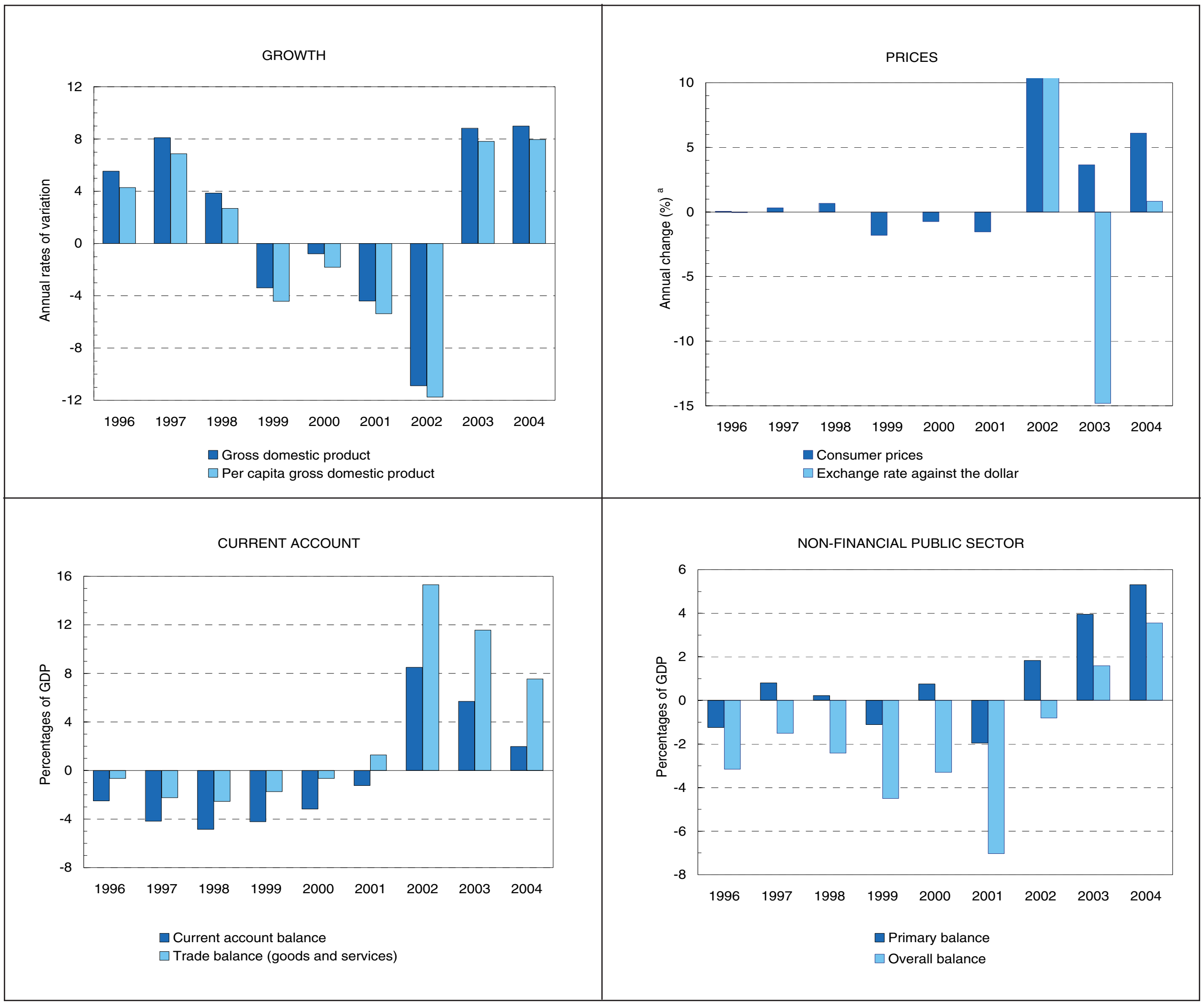
The expansion in economic activity again brought a considerable amount of job creation, although much of this new employment was in the informal sector. Even allowing for the possible effects of a new methodology and the inclusion of beneficiaries of State programmes, the employment rate rose well above past figures. There was also a further drop in the rate of unemployment, which nevertheless remains high. Higher demand for labour and government-approved pay increases contributed to an upturn in real wages. In combination, these trends helped to lower rates of poverty and indigence, which even so continue to represent a serious social problem.

Prices continued to climb only slowly until well into 2004, but the rate then picked up at the end of the year and into the early months of 2005; in fact, between November 2004 and April 2005 the consumer price index rose by a monthly average of well over 1%. This was probably due to a combination of intermittent effects (such as seasonal price rises and external prices) and price rises fuelled by strongly expanding domestic demand. Be that as it may, keeping inflation within the planned limits (around 10% or below) became a key economy policy issue.

Goods imports responded in a highly elastic fashion to domestic demand, surging by over 60%. This tended to narrow the trade surplus, which nevertheless exceeded US$ 13 billion, or around 9% of GDP. The current-account balance decreased but came in positive again, at almost 2% of GDP, counting interest accrued on defaulted debt. Capital movements in the non-financial private sector were slightly positive, contrasting with the three preceding years. Throughout the reporting period there was a persistent oversupply of foreign exchange which, given the authorities' wish to keep the real exchange rate high, fed into a build-up of reserves.

Receipts from national taxes again rose considerably to reach an all-time high of 22% of GDP. This higher income provided manoeuvring room for fiscal management and helped to build up a national public-sector primary surplus of over 5% of GDP, the largest for several decades. The provinces also returned highly positive —and historically exceptional— fiscal balances, with a primary surplus of 1.4% of GDP. Although the fiscal targets agreed upon with the International Monetary Fund (IMF) were easily met, the respective programme was abandoned over differences with the Fund, particularly as regards structural measures and the restructuring of past-due public debt. This led to the suspension of scheduled disbursements, which translated into net repayment of US$ 2 billion in Fund loans. The government devised a debt swap offer based on a flow of debt servicing commitments compatible with government primary surpluses of around 3% of GDP. This proposal did not involve the multilateral agencies in write-downs of principal or interest. The offer was taken up by bondholders representing a considerable proportion (76%) of the eligible bonds.

Figure 1
ARGENTINA: MAIN ECONOMIC INDICATORS



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

As economic activity bounced back strongly, strengthened by large primary surpluses in the public sector and a positive external trade balance, the last vestiges of the crisis in the contracts system gradually dissipated. In this regard, the debt swap represented an important step towards regaining a normal economic footing. One major outstanding contractual issue is the reworking of the operating frameworks of utilities run by privatized companies, given the need to respond to probable increases in demand in such areas as energy supply, where difficulties arose in 2004. In more general terms, the authorities were trying to steer the economy onto a path that would continue the recovery in the long term. With this in mind, it was evidently important to extend decision horizons and strengthen processes of saving and investment, and to identify opportunities for productive growth with a medium-term perspective. The distributive implications of social and labour policies and wage setting were also prominent issues.

2. Economic policy

Two prominent traits of macroeconomic management were the considerable volume of the public sector primary surplus, national and provincial alike, despite an increase in government spending, and the maintenance of the real exchange rate (with a slight appreciation against the dollar), in a context of voluminous sales of foreign exchange by the private sector. Aside from this, the period was marked by complex discussions and negotiations over debt restructuring which, as well as the national authorities, involved developed country governments, IMF, courts of justice in several countries (especially the United States) and a broad array of private creditors. Tensions flared on several occasions,[1] and the parties decided to suspend implementation of the agreement, which meant that commitments were not refinanced as they fell due and were paid by the government. IMF declared that it would not participate in the government's proposed debt swap. After the offer closed, the Fund and the Argentine government resumed discussions on a new accord, with one of the items on the table being how to deal with debt owed to creditors who did not enter the debt swap.

(a) Fiscal policy

National tax receipts rose by around 36% in 2004, which was well above the rate of nominal output, considerably boosting the tax ratio again. The largest variations in returns were recorded in VAT (48%) and in the range of taxes on income and assets (43%). These broad-base taxes represent 58% of all tax receipts. Aside from the effect of certain price rises on tax liabilities (since balances were not adjusted for inflation, nor was any nominal change made to tax exemption limits), there was a trend towards higher compliance. Social security payments and contributions also rose significantly (31%), reflecting a higher proportion of formal-sector wages. Less steep increases were recorded in revenues from external trade taxes (20%, with the largest impetus coming from import taxes) and from the tax on financial transactions (30%), whose share in fiscal revenues dropped to 20%.

Higher public revenues had a direct impact on tax transfers to the provinces, which expanded by more than one GDP percentage point. This increase, together with larger capital outlays on infrastructure projects, drove the primary spending of the national public sector up to 19.6% of GDP (as against 18.3% in 2003). Staff expenditures rose 8.8%, which was above the rate of inflation, but lower than growth in GDP. The government raised the minimum pension and, at the end of the year, awarded a fixed sum to pensioners in the form of a special, one-off bonus. Spending on social security rose 18%, in line with nominal GDP. Overall, net primary expenditure on transfers rose slightly as a proportion of GDP, but remained lower in net terms than the levels posted prior to devaluation. The volume and quality of spending, especially on social concerns, were heavily debated topics.

Government debt in the form of performing bonds and loans from international agencies decreased in 2004, and was serviced out of the surplus and by central bank credits. The exchange of defaulted bonds, the window for which closed in March 2005, was accepted by holders of eligible debt amounting to US$ 82 billion (see box II.3).

(b) Monetary policy

The expansion of the monetary base (13%, compared with 59% the previous year, when quasi-money in circulation was redeemed) came close to the ceiling established in the monetary programme. Cash in circulation expanded more rapidly than commercial bank deposits in the central bank, although the commercial banks did place funds in the central bank through swap operations known as "pases", while maintaining a comfortable liquidity position. The expansion of the monetary base was the result of intervention in the foreign-exchange market, only partially sterilized by the paying off of rediscounts and the issue of bills. The central bank gradually shifted the focus of monetary regulation towards interest rates and away from quantitative monetary targets. The effects of monetary expansion on money demand eased in the first few months of 2005, as the authorities increased interest rates. A scheme was also created to encourage ahead-of-schedule payment of rediscounts.

1 Differences arose between the government and IMF towards mid-2004, during negotiations over the implementation of a new tranche of the Fund programme. The government was seeking to focus conditionality on fiscal targets, defined in relation to the debt swap offered to private creditors. The Fund, on the other hand, broadened its requirements to encompass such matters as tariff adjustments and fresh consultations with bondholders' groups.

Table 1

ARGENTINA: MAIN ECONOMIC INDICATORS

	1996	1997	1998	1999	2000	2001	2002	2003	2004 [a]
				Annual growth rates [b]					
Gross domestic product	5.5	8.1	3.9	-3.4	-0.8	-4.4	-10.9	8.8	9.0
Per capita gross domestic product	4.3	6.9	2.7	-4.4	-1.8	-5.4	-11.7	7.8	8.0
Gross domestic product, by sector									
Agriculture, livestock, hunting, forestry and fishing	-1.2	0.5	8.7	2.5	-1.8	1.1	-2.3	6.9	-1.5
Mining	4.5	0.7	-3.8	-3.3	6.7	4.7	-3.7	3.7	-0.4
Manufacturing	6.5	9.2	1.9	-7.9	-3.8	-7.4	-11.0	16.0	11.9
Electricity, gas and water	4.1	8.2	7.6	3.6	6.6	1.1	-3.0	6.9	6.5
Construction	8.4	16.6	8.7	-7.9	-9.3	-11.6	-33.4	34.4	29.4
Wholesale and retail commerce, restaurants and hotels	7.9	10.9	3.4	-6.9	-2.4	-7.8	-16.8	11.7	12.4
Transport, storage and communications	6.9	11.2	8.9	-1.3	1.7	-4.6	-7.9	8.2	13.4
Financial institutions, insurance, real estate and business services	6.1	7.3	7.0	-0.5	1.3	-4.4	-9.6	-1.1	2.2
Community, social and personal services	2.3	4.0	1.5	1.9	1.7	-0.1	-3.3	2.8	4.3
Gross domestic product, by type of expenditure									
Consumption	5.0	8.1	3.5	-1.3	-0.5	-5.2	-12.8	7.0	8.3
General government	2.2	3.2	3.4	2.6	0.6	-2.1	-5.1	1.5	2.7
Private	5.5	9.0	3.5	-2.0	-0.7	-5.7	-14.4	8.2	9.4
Gross domestic investment	8.9	17.7	6.5	-12.6	-6.8	-15.7	-36.4	38.2	34.5
Exports (goods and services)	7.6	12.2	10.6	-1.3	2.7	2.7	3.1	6.0	8.2
Imports (goods and services)	17.5	26.9	8.4	-11.3	-0.2	-13.9	-50.1	37.6	39.8
				Percentages of GDP					
Investment and saving [c]									
Gross domestic investment	19.6	20.9	21.0	17.9	17.5	15.6	11.0	14.6	18.9
National saving	17.1	16.7	16.1	13.7	14.3	14.4	19.5	20.3	20.8
External saving	2.5	4.2	4.9	4.2	3.2	1.2	-8.5	-5.7	-2.0
				Millions of dollars					
Balance of payments									
Current account balance	-6 822	-12 219	-14 510	-11 948	-9 015	-3 336	8 682	7 370	3 029
Merchandise trade balance	1 760	-2 123	-3 097	-795	2 452	7 385	17 178	16 448	13 267
Exports, f.o.b.	24 043	26 431	26 434	23 309	26 341	26 543	25 651	29 566	34 453
Imports, f.o.b.	22 283	28 554	29 531	24 103	23 889	19 158	8 473	13 118	21 185
Services trade balance	-3 527	-4 408	-4 490	-4 151	-4 323	-3 911	-1 561	-1 448	-1 733
Income balance	-5 503	-6 203	-7 387	-7 456	-7 548	-7 237	-7 487	-8 208	-9 210
Net current transfers	448	515	465	454	403	427	552	578	705
Capital and financial balance [d]	10 080	15 549	18 600	13 960	7 798	-18 123	-22 067	-16 407	-10 184
Net foreign direct investment	5 348	5 507	4 965	22 257	9 517	2 005	2 776	1 113	3 934
Financial capital [e]	4 732	10 042	13 635	-8 297	-1 720	-20 128	-24 843	-17 521	-14 118
Overall balance	3 258	3 331	4 090	2 013	-1 218	-21 459	-13 385	-9 037	-7 154
Variation in reserve assets [f]	-3 875	-3 293	-3 436	-1 186	439	12 083	4 516	-3 581	-5 320
Other financing [g]	617	-38	-654	-826	778	9 376	8 869	12 618	12 474
Other external-sector indicators									
Real effective exchange rate (index: 2000=100) [h]	115.0	112.7	108.8	99.6	100.0	95.6	221.9	204.5	214.8
Terms of trade for goods (index: 2000=100)	103.5	102.2	96.6	90.9	100.0	99.3	98.7	107.2	109.2
Net resource transfer (percentage of GDP)	1.9	3.2	3.5	2.0	0.4	-5.9	-20.3	-9.3	-4.5
Total gross external debt (billions of dollars)	114.4	130.0	147.6	152.6	155.0	166.3	156.7	165.0	172.8
Total gross external debt (percentage of GDP)	42.0	44.4	49.4	53.8	54.5	61.9	153.6	127.4	112.9
Net profits and interest (percentage of exports) [i]	7.3	8.8	8.9	7.5	7.9	2.5	0.4	3.8	7.4
				Average annual rates					
Employment									
Labour force participation rate [j]	41.5	42.2	42.2	42.6	42.6	42.5	42.4	45.7	45.9
Open unemployment rate [k]	17.2	14.9	12.9	14.3	15.1	17.4	19.7	17.3	13.6
Visible underemployment rate [k]	13.2	13.2	13.5	14.3	14.6	15.6	19.3	17.1	15.1

Table 1 (concluded)

	1996	1997	1998	1999	2000	2001	2002	2003	2004 [a]
					Annual percentages				
Prices									
Variation in consumer prices (December-December)	0.1	0.3	0.7	-1.8	-0.7	-1.5	41.0	3.7	6.1
Variation in wholesale prices (December-December)	2.1	-0.9	-6.3	1.2	2.4	-3.4	113.7	2.0	7.9
Variation in nominal exchange rate (December-December)	-0.1	0.0	0.0	0.0	0.0	0.0	243.7	-14.8	0.8
Variation in average real wage	0.6	0.3	0.0	2.9	2.3	-0.8	-13.9	-1.9	10.0
Nominal deposit rate [l]	...	7.0	7.6	8.3	8.5	16.3	39.3	10.5	2.7
Nominal lending rate [m]	...	9.2	10.6	11.0	11.1	26.5	53.0	19.1	6.8
					Percentages of GDP				
Non-financial public sector [n]									
Current income	21.7	22.6	22.9	23.5	24.6	23.3	23.6	26.5	16.5
Current expenditure	23.1	22.7	23.4	26.2	26.7	29.2	23.6	23.7	13.2
Current balance	-1.4	-0.1	-0.5	-2.7	-2.1	-5.9	-0.1	2.9	3.3
Net capital expenditure	1.6	1.4	1.9	1.9	1.2	1.1	0.7	1.3	1.5
Primary balance	-1.2	0.8	0.2	-1.1	0.8	-2.0	1.8	4.0	3.3
Overall balance	-3.2	-1.5	-2.4	-4.5	-3.3	-7.0	-0.8	1.6	2.0
National government public debt	35.7	34.5	37.6	43.0	45.0	53.7	145.9	138.2	126.5
Domestic	8.9	9.6	10.4	13.9	16.4	22.3	52.1	58.2	54.5
External	26.8	24.9	27.1	29.1	28.6	31.5	93.7	80.0	72.1
Interest payments of NFPS (percentage of current income)	8.8	10.2	11.5	14.4	16.5	21.8	11.3	8.9	...
Money and credit [o]									
Domestic credit [p]	24.6	25.6	28.7	32.2	32.8	32.9	41.5	34.5	29.1
To the public sector	5.4	5.5	5.9	7.2	8.5	9.9	24.8	23.0	19.6
To the private sector	19.2	20.1	22.7	25.0	24.2	23.0	16.7	11.5	9.6
Liquidity (M3)	24.5	27.5	31.3	34.9	35.7	35.4	32.3	31.6	34.2
Currency in circulation and local-currency deposits (M2)	14.8	16.8	18.4	19.1	18.6	16.6	28.4	30.3	32.0
Foreign-currency deposits	9.7	10.8	12.9	15.9	17.1	18.7	3.9	1.3	2.2

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.
[a] Preliminary figures. [b] Based on figures in local currency at constant 1993 prices. [c] Based on figures in local currency expressed in dollars at current prices. Gross domestic investment does not include changes in stocks. [d] Includes errors and omissions. [e] Refers to the capital and financial balance (including errors and omissions), minus net foreign direct investment. [f] A minus sign (-) denotes an increase in reserves. [g] Includes the use of IMF credit and loans and exceptional financing. [h] Annual average, weighted by the value of merchandise exports and imports. [i] Refers to net investment income as a percentage of exports of goods and services as shown on the balance of payments. [j] Economically active population as a percentage of the total population in urban areas. [k] Unemployment and underemployment rates as percentages of the economically active population, urban areas. [l] Fixed-term deposits, all maturities. [m] 30-day loans to leading firms. [n] Accrual basis. The figures for 2004 refer to central government. [o] The monetary figures are annual averages. [p] Refers to net credit extended to the public and private sectors by commercial banks and other financial and banking institutions.

M3 monetary aggregates increased by 15% in the course of 2004, similarly to the monetary base. Money demand shifted from less quickly accessible liquid assets towards cash and sight deposits, in a context of low interest rates. Narrow money (M1) therefore increased considerably (26.6%), with a similar variation in cash in circulation and current-account deposits.

Bank credit to the private sector, which had contracted sharply during the financial crisis of 2001-2002, increased by 26% in 2004 (well in excess of inflation), but still fell short of 10% of GDP. The slow recovery in financing was combined with a rather weak demand for credit and took place against a backdrop of interest rates that declined up to the end of 2004. At the end of the year, nominal annual yields on short-term deposits were around 3%, while average rates on advances and discounts varied between 10% and 15%. The early months of 2005 brought incipient signs of interest rate rises.

The securities markets continued to stage a gradual recovery from the devastating effects of the crisis. In fact, the prices of government bonds issued after the default rose in 2004, thereby reducing the implicit interest rate premium; notably, the spread between bonds maturing in 2012 and similar United States instruments was around 6% in December. Share prices also rose by 28%, partly reflecting both local and international conditions. The rise in long-term interest rates in the United States impacted on the prices of government paper, which dropped after rising strongly in the first two months of 2005.

Table 2
ARGENTINA: MAIN QUARTERLY INDICATORS

	2003				2004 [a]				2005 [a]	
	I	II	III	IV	I	II	III	IV	I	II
Gross domestic product (variation from same quarter of preceding year) [b]	5.4	7.8	10.2	11.7	11.3	7.1	8.7	9.3	8.0	...
Merchandise exports, f.o.b. (millions of dollars)	6 556	8 125	7 550	7 336	7 353	6 314	8 911	8 842	8 367	...
Merchandise imports, c.i.f. (millions of dollars)	2 502	3 336	3 712	4 283	4 662	3 832	6 027	6 274	5 953	...
International reserves (millions of dollars)	10 517	12 183	13 406	14 119	15 003	17 442	18 223	19 645	20 338	23 052
Real effective exchange rate (index: 2000=100) [c]	208.4	198.5	202.4	209.0	215.4	208.2	215.4	220.5	217.2	214.7 [d]
Unemployment rate	20.4	17.8	16.3	14.5	14.4	14.8	13.2	12.1	13.0	...
Consumer prices (12-month percentage variation)	31.7	10.2	3.5	3.7	3.1	4.9	5.9	6.1	9.1	9.0
Average nominal exchange rate (pesos per dollar)	3.12	2.80	2.83	2.86	2.89	2.89	2.98	2.94	2.93	2.89
Average real wage (variation from same quarter of preceding year)	-19.5	0.0	5.3	9.2	16.0	13.7	7.8	3.9	2.0	...
Nominal interest rates (annualized percentages)										
Deposit rate [e]	18.8	14.2	4.8	4.1	2.5	2.4	2.8	3.1	2.9	3.8
Lending rate [f]	27.6	24.3	13.9	10.8	9.1	6.3	5.9	5.8	5.5	6.0
Interbank interest rate [g]	6.0	5.6	2.5	1.6	1.4	2.3	2.5	2.4	2.3	3.4
Sovereign bond spread (basis points)	6 165	4 554	5 484	5 632	4 873	5 188	5 440	4 703	5 393	462
Stock price index (in dollars, December 2000=100)	43.9	57.2	60.3	79.4	87.3	69.7	88.1	97.4	107.8	114.6
Domestic credit (variation from same quarter of preceding year) [h]	6.1	-12.3	-13.6	-7.5	-1.0	1.0	3.5	7.8	11.8	12.8 [i]
Non-performing loans as a percentage of total credit [j]	14.0	13.8	15.0	14.1	11.8	10.6	9.5	8.3	7.2	6.7 [d]

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.
[a] Preliminary figures. [b] Based on figures in local currency at constant 1993 prices. [c] Quarterly average, weighted by the value of merchandise exports and imports. [d] Data to May. [e] Fixed-term deposits. [f] 30-day loans to leading firms. [g] Buenos Aires interbank offered rate (BAIBOR). [h] Refers to net credit extended to the public and private sectors by commercial banks and other financial and banking institutions. [i] Data for April. [j] Refers to total credit extended by the banking system.

3. The main variables

(a) Economic activity

Economic activity took a steady upward course in 2004, levelling off in the second quarter and picking up strongly again in the last semester, thanks to an increase in export volumes and in private consumption. The domestic savings ratio remained relatively high, at 21.5%, compared to 19.65% at the peak of the cycle in 1998 and 18.5% in 2001. The contrast is sharper when observed in current values, since capital goods have become relatively more expensive since devaluation, with domestic saving in 2004 (27% of GDP) 8 points higher than in 1998 and 9 points above the 2001 figure. Nevertheless, the trend in saving was partly due to the fact that investment was financed, in aggregate terms, out of domestic resources.

Capital formation surged in construction (25.5%), with the strongest component being machinery and equipment (52.5%). Investment in production for the domestic market was driven by the upturn in demand, while the maintenance of the real exchange rate provided room for investment in the production of tradable goods.

Overall, the goods-producing sectors expanded more quickly than services. Output was up in construction (29% on average over the year), due to a faster rate of both private building and public works. Manufacturing increased by almost 12%, whereas mining was practically flat and agriculture contracted slightly.

Despite an increase in the area under crops, grain production slipped marginally to 69.3 million tons in the 2003-2004 growing season, down from 70.8 million tons the previous year. Oilseeds accounted for much of the decline, since there was an expansion in the cereal harvest, especially wheat. External demand for beef livestock was up, partly thanks to the absence of fresh outbreaks of foot-and-mouth disease, and this was reflected in higher exports. Domestic demand also rose.

Crude petroleum production dropped again in 2004, this time by 6%. By contrast, production of natural gas rose, though this did not prevent supply constraints. In the first part of the year there was a surge in demand for gas both for industrial use and for electricity generation and transport (in the form of compressed natural gas). In addition to the expansion in economy activity, other contributing factors were a rate scheme that encouraged the use of gas and a shift in energy supply towards thermal sources, since climatic factors meant that less water was available for hydroelectric generation. Signs of excess demand generated a variety of reactions, among other things because of the cutting back of the gas supply to Chile. The problems that ensued clearly signalled the need for a system of incentives and an investment plan to serve as a frame of reference for energy suppliers and users alike. Negotiations did take place in 2004 on the definition of regulatory and contractual frameworks to govern the sector's activities, but specific agreements remained on the agenda for 2005.

Manufacturing activity grew strongly throughout 2004, despite a dip in the second quarter that may have been partly attributable to energy supply problems, as well as the effects of demand. Be that as it may, the uptrend still had plenty of momentum in the second half of the year and the early months of 2005, and pushed March's industrial production index above the previous high recorded in 1998.

(b) Prices, wages and employment

The consumer price index rose 6.1% in 2004. This figure was higher than the preceding year's rate, but exhibited no sharp variations until the end of the year. Prices rose more quickly between December 2004 and March 2005, however, accumulating an increase of 4.9% and turning the public spotlight on inflation. In general, the rise over this period was attributable to the sharpening of traits that were already decipherable in 2004. In any case, the inflation rate dipped considerably in April, to 0.5%. The price trends in the coming months will show whether the surge was simply the sum of a number of isolated adjustments or part of a persistent uptrend with broader macroeconomic implications.

The items in the wholesale price index basket fluctuated strongly, reflecting a number of factors influencing prices, some domestic and others generated by the international markets. Whereas the overall index rose by 7.9% over the year, the prices of agricultural goods dropped by 10.4% on average, with cereals, oilseeds and vegetables slumping as much as 20% in price. At the other extreme, the wholesale price of electricity rose 39%, and there were also sharp rises in the prices of petroleum and natural gas.

Economic policy focused on limiting variation in the real exchange rate and keeping it relatively high. The price of the dollar fluctuated throughout 2004 without building up any appreciable variation, which meant a slight appreciation in real terms. Given international currency trends, the Argentine peso lost value with respect to the country's main trading partners, including the economies of the region.

The government decreed large rises in the minimum wage and fixed sum pay increases for private-sector workers. The effects of higher demand for labour also began to kick in, with an upturn in real wages that carried over into the early months of 2005. Although formal workers in the private sector have built up the largest wage increases during the recovery, informal workers and civil servants have also benefited.

Formal employment rose steeply once again, by approximately 7% in the course of 2004, notwithstanding the still very high degree of informality in the labour market. The increase took place across the board, encompassing manufacturing, construction and services.

This expansionary trend was also evident in the higher employment ratio as recorded in household surveys, in which it reached historical levels. This translated into a visible reduction in unemployment, even though the labour force participation rate varied at higher levels than at the end of 2003. In the fourth quarter of 2004, unemployment stood at around 12%, which was 2.5 points lower than a year earlier. This rate, however, rises to 14.5% when people working mainly in the framework of State programmes and actively seeking other employment are included. This figure, in turn, represents a drop of just over 3 percentage points in relation to the equivalent rate at the end of 2003.

(c) The external sector

The current-account balance decreased in 2004, but was still high and positive, at US$ 3 billion. This figure was calculated with accrued interest on unpaid debt figuring as debits, not counting reductions and write-downs. The goods trade balance returned a substantial surplus. Within services, tourism-related income and expenditures both increased, as the activity of the sector expanded and demand from residents rose. The profits and dividends of foreign firms operating in Argentina also climbed by a significant US$ 1.6 billion.

After three years of a large, albeit decreasing, deficit, the combined capital movements of the non-financial private sector resulted in a small surplus. This was in addition to an upturn in foreign direct investment which, however, at about US$ 4 billion, still fell clearly short of the figures seen before the crisis of 2001-2002. The non-financial private sector received net credit from suppliers for its imports and made payments on bonds and bank loans in excess of the resources received. The banks, too, reduced their external liabilities. True to the pattern that has continued since 2002, net financing from international agencies was negative, this time by US$ 2.4 billion. Amortizations to the World Bank and the Interamerican Development Bank exceeded disbursements, but the bulk of net payments (some US$ 2 billion) went to IMF.

The increase in exports in 2004 (by 17%, to US$ 34.5 billion) was due partly to price rises (11%), led by agricultural manufactures and fuels. Prices edged back down in the course of the year, however, so that towards the end of the period they were lower in aggregate terms than a year earlier. In any case, there was also a considerable expansion in the volumes exported: the year-on-year rate in the fourth quarter (18%) more than compensated for the drop in prices, with the value exported up 13%.

The increased value of exports in 2004 was thanks mainly to manufactures, of agricultural and industrial origin alike (19% and 24%, respectively). Of particular note among agricultural exports was the rise in meat sales, which appeared to reflect an uptrend associated with the opening of new markets. In general, the prices of non-traditional manufactures also rose, particularly in the case of automotive vehicles and chemicals. Exports of primary goods recorded a smaller increase of 6%; the expansion in this category was led by cereals and copper, which stood at about US$ 650 million, and was partially offset by smaller sales of oilseeds. The MERCOSUR countries went some way to regaining their share in total exports, at 19.6% compared to 19.1% in 2003. The proportion exported to the rest of Latin America and NAFTA also increased, while exports to China increased more than the average, although they represented only 8% of the total.

Imports soared again in 2004, by 61%. The steepest rises were seen in imports of capital goods (114%) and fuels, accounted for mainly by increased volumes. Significant price movements were seen in imports of intermediate goods, which rose by 15%, and volumes grew by an amount that exceeded GDP growth in net terms. Generally speaking, the MERCOSUR countries retained their share of Argentina's imports, which stands at around 37%, whereas the share of the European Union dropped to below 19%.

Bolivarian Republic of Venezuela

1. General trends

The economic expansion that started in the third quarter of 2003 continued in 2004. Growth of 17.9% over the year brought activity close to the levels recorded prior to the general strike at the end of 2002. The recovery took place across practically all the sectors and was stronger than original estimates had suggested. The political turmoil in the country continued during much of 2004. The result of the recall referendum held on 15 August confirmed the President's continuation in office until the end of his mandate at the beginning of 2007. According to data available for the first quarter of 2005, the economy grew by 7.9%, led by the non-petroleum sector, in particular the subsectors of construction, commerce, transport and finance. A growth rate of 7% is forecast for 2005 as a whole.

Several factors contributed to the expansion recorded in 2004. In the first place, the first quarter of 2003 represents a low basis for comparison.[1] In fact, activity was up by 35% year-on-year in the first quarter of 2004. Second, the economic policies adopted by the authorities provided a stimulus. The third factor is statistical in nature, since the base year used by the Central Bank of Venezuela (BCV) to prepare the national accounts was changed from 1984 to 1997. One significant result of this change in the country's accounting system has been a decline in the proportion of the economy accounted for by the oil sector, from around 25% of GDP to approximately 18%. Since the most buoyant branches of activity in 2004 corresponded precisely to the non-oil sector, the change in the structure of the economy magnified their good performance and downplayed the petroleum sector's lower productivity in GDP terms.

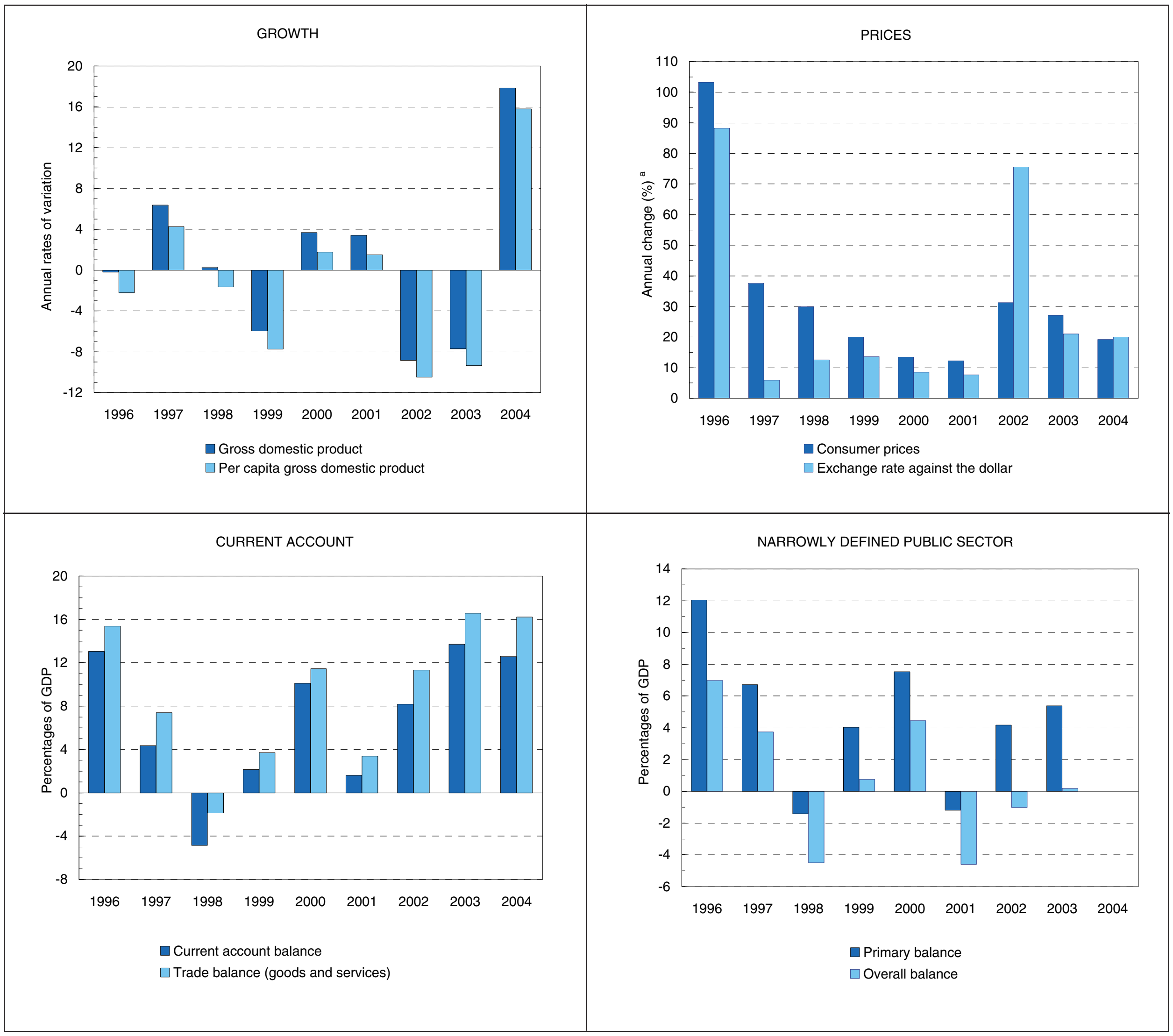
In the labour markets, the robust economic recovery translated into a decrease in unemployment and, to a lesser extent, in informality; it also triggered an improvement in real wages, especially in the public sector. In spite of a considerable increase in imports, the current-account surplus was higher in 2004 than in 2003, thanks primarily to the high price of oil on international markets.

Fiscal and monetary policies remained openly expansionary and the authorities continued to apply the foreign exchange control system adopted in 2003.

1 In the first quarter of 2003, economic activity declined sharply as a result of the work stoppage called by the opposition and business groupings, which lasted from December 2002 until early February 2003.

Figure 1

BOLIVARIAN REPUBLIC OF VENEZUELA: MAIN ECONOMIC INDICATORS



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

2. Economic policy

(a) Fiscal policy

The fiscal policy deployed in 2004 kept up the expansionary trend in current expenditure. During the year, central government expenditure increased by approximately 50% in nominal terms. Fiscal revenue was up by close to 60%, also in nominal terms. Nevertheless, the central government financial balance recorded a deficit of close to 2% of GDP, considerably less than the 2003 figure of 4.3%.

The substantial increase in current revenue was due mainly to higher tax receipts, in particular to the proceeds of income tax, value-added tax (VAT) and duties on ordinary imports, with the rise in these tax items reflecting, in turn, the upturn in economic activity and in imports. This was in addition to efforts to reduce tax evasion and a generalized rise in the prices of goods and services subject to consumption taxes. The fastest-growing category among non-tax revenues was petroleum royalties, thanks to the high price of the Venezuelan basket in international markets.[2]

In the light of these developments, the government lowered the VAT rate from 16% to 15%, with effect from 1 September 2004. The tax on corporate assets was eliminated on the same date. The resulting decline in revenue was offset by an increase in the proceeds from oil sales and other domestic taxes, particularly the tax on bank debits, and profits on foreign exchange transactions turned over to the government by the central bank.

In 2004, the government carried on the process of refinancing and restructuring the national public debt. The executive continued its policy of issuing new debt instruments in order to buy back and swap older treasury bills and thereby restructure its portfolio on more favourable conditions as regards terms and interest rates. The public debt continued to increase in 2004, albeit at a slower rate than in 2003, and showed an improvement in terms of GDP. In 2004, the public debt/GDP ratio was close to 40%, down from 45.9% in 2003, but significantly higher than the figure of 30.4% recorded in 2001. Debt servicing represented 5.2% of GDP, the lowest level since 1998. This was due to a reduction in domestic debt servicing payments from 4.8% of GDP in 2003 (a similar percentage to that of 2002 and the highest on record since 1996) to 2% in 2004, which was equivalent to pre-2000 levels.

In the first quarter of 2005, the authorities kept fiscal policy expansionary. According to information published by the central bank, in this period, central government operating expenditure increased by 44% over the first quarter of 2004. The increase in spending was, however, offset by a significant rise in current revenues (67%), in particular from taxes (84%).

In 2004 and the months of 2005 included in the reporting period, the authorities continued their social welfare programmes or "missions", several of which target low-income groups. In general, they are directed towards providing health services, education and food at subsidized prices, with food distribution centres set up by the government under the Mercal programme. These programmes are funded through special mechanisms set up by the authorities, in particular a fund for economic and social development (FONDESPA) funded from the proceeds of oil sales by Petróleos de Venezuela S.A. (PDVSA).[3]

Following the referendum of August 2004, a number of laws that had been adopted in 2001 came into effect. A land and agrarian development act —which is directed towards identifying large nonproductive estates and which has been the subject of much controversy— took effect late in 2004. The beginning of 2005 saw the entry into force of a new hydrocarbons law, which modified the taxes and royalties to be paid under operating agreements in the oil sector. Royalties were raised from 1% to 16.66% of drilled oil, while the income tax rate was increased from 35% to 50%.

(b) Monetary and exchange-rate policy

In 2004, nominal interest rates continued the downward trend begun in 2003. Private lending by the banking system soared by 60% in nominal terms between December 2003 and December 2004, coming to account for 41% of the banking system's total assets, as compared with 30% in January 2004. Investments in both government and central bank securities decreased from 39% of banking assets in January 2004 to 29% in December 2004. Up to May 2005, credit to the private sector dropped to 38.4% of assets, while investments in public securities remained at around 29%. The authorities determined minimum allocations of the banks' credit portfolios for specific activities: 16% for agriculture, 3% for micro-credits and 10% for mortgages.

Monetary aggregates continued to expand in 2004, though at much slower rates than in 2003. From December 2003 to December 2004, currency in circulation (M1) grew by 46.3% in nominal terms and broad money (M2), by 50.4%, compared with 87.7% and 63.1%, respectively, in 2003. Deposits in the banking system increased at a similar rate to 2003, except for time deposits, which were up by 71% in the period. The expansion in monetary aggregates slowed in the first five months of 2005: M1 increased by 2.1% over the level of December 2004 and M2, by 5.9%.

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2 In 2004, the average price of the basket of Venezuelan crude was US$ 32.61 per barrel, 26.6% higher than the average of US$ 25.76 per barrel recorded in 2003.

3 The Fund for the Economic and Social Development (FONDESPA) is denominated in dollars. It is funded by contributions from Petróleos de Venezuela S.A. and used for social spending. It may accumulate up to US$ 2 billion and its income is channelled directly from the country's sales of crude petroleum, not from international reserves. The fund is authorized by the Central Bank of Venezuela.

Table 1

BOLIVARIAN REPUBLIC OF VENEZUELA: MAIN ECONOMIC INDICATORS

	1996	1997	1998	1999	2000	2001	2002	2003	2004 [a]
	Annual growth rates [b]								
Gross domestic product	-0.2	6.4	0.3	-6.0	3.7	3.4	-8.9	-7.7	17.9
Per capita gross domestic product	-2.2	4.3	-1.6	-7.8	1.8	1.5	-10.5	-9.3	15.8
Gross domestic product, by sector									
Agriculture, livestock, hunting, forestry and fishing	2.0	2.4	3.5	1.9	6.5	2.0	-0.8	-1.8	...
Mining	8.2	9.8	0.6	-6.4	2.4	2.6	-12.9	-0.5	11.6
Manufacturing	-3.0	5.1	-1.7	-7.3	4.8	0.3	-13.7	-7.6	7.1
Electricity, gas and water	1.2	4.7	0.5	-2.2	4.7	4.8	2.1	-0.5	6.9
Construction	1.1	17.2	1.4	-17.4	4.0	13.5	-8.4	-39.5	32.1
Wholesale and retail commerce, restaurants and hotels	-7.2	4.1	-1.3	-5.3	4.8	4.2	-12.4	-9.6	11.0 [c]
Transport, storage and communications	1.7	9.0	-0.1	-7.5	7.7	2.8	-4.4	-6.5	18.3
Financial institutions, insurance, real estate and business services	-3.3	3.0	0.6	-6.8	0.5	3.4	-3.1	-4.6	12.5
Community, social and personal services	-1.5	-0.5	-0.4	-3.9	2.2	2.4	-0.2	3.4	14.8
Gross domestic product, by type of expenditure									
Consumption	-4.9	5.0	0.8	-2.9	4.6	6.2	-6.2	-2.5	16.0
General government	-7.6	4.2	-3.1	-7.5	4.2	6.9	-2.5	5.7	13.9
Private	-4.4	5.1	1.8	-1.7	4.7	6.0	-7.1	-4.6	16.6
Gross domestic investment	-11.0	34.0	4.4	-10.6	6.7	13.6	-34.0	-34.0	89.8
Exports (goods and services)	7.8	9.4	3.5	-11.0	5.8	-3.6	-4.0	-9.9	11.8
Imports (goods and services)	-11.2	33.9	11.3	-9.3	12.4	14.1	-25.2	-19.6	60.0
	Percentages of GDP								
Investment and saving [d]									
Gross domestic investment	22.8	27.7	30.7	26.5	24.2	27.5	21.2	15.6	21.5
National saving	35.8	32.0	25.8	28.7	34.3	29.1	29.3	29.3	34.1
External saving	-13.1	-4.3	4.9	-2.2	-10.1	-1.6	-8.2	-13.7	-12.6
	Millions of dollars								
Balance of payments									
Current account balance	8 914	3 732	-4 432	2 112	11 853	1 987	7 599	11 448	13 830
Merchandise trade balance	13 770	8 954	952	6 471	16 664	7 460	13 421	16 483	21 430
Exports, f.o.b.	23 707	23 871	17 707	20 963	33 529	26 667	26 781	27 170	38 748
Imports, f.o.b.	9 937	14 917	16 755	14 492	16 865	19 207	13 360	10 687	17 318
Services trade balance	-3 269	-2 608	-2 649	-2 839	-3 253	-3 305	-2 909	-2 644	-3 626
Income balance	-1 725	-2 517	-2 534	-1 453	-1 388	-2 020	-2 756	-2 411	-3 885
Net current transfers	138	-97	-201	-67	-170	-148	-157	20	-89
Capital and financial balance [e]	-2 676	-638	1 027	-1 054	-5 895	-3 818	-12 026	-6 005	-11 932
Net foreign direct investment	1 676	5 645	3 942	2 018	4 180	3 479	-244	1 341	1 866
Financial capital [f]	-4 352	-6 283	-2 915	-3 072	-10 075	-7 297	-11 782	-7 346	-13 798
Overall balance	6 238	3 094	-3 405	1 058	5 958	-1 831	-4 427	5 443	1 898
Variation in reserve assets [g]	-6 271	-2 643	3 853	-608	-5 449	2 028	4 427	-5 454	-2 153
Other financing [h]	33	-452	-448	-450	-508	-197	0	11	255
Other external-sector indicators									
Real effective exchange rate (index: 2000=100) [i]	177.3	141.4	116.5	102.6	100.0	95.2	123.7	136.8	143.2
Terms of trade for goods (index: 2000=100)	67.1	70.1	51.2	66.1	100.0	82.2	87.6	98.7	118.1
Net resource transfer (percentage of GDP)	-6.4	-4.2	-2.1	-3.0	-6.7	-4.9	-15.9	-10.1	-14.2
Total gross external debt (millions of dollars)	34 117	37 242	35 087	37 016	36 437	35 398	35 460	39 672	44 546
Total gross external debt (percentage of GDP)	50.0	43.4	38.4	37.8	31.1	28.8	38.2	47.5	40.6
Net profits and interest (percentage of exports) [j]	1.7	6.6	11.4	3.9	4.1	6.7	7.0	6.7	8.2
	Average annual rates								
Employment									
Labour force participation rate [k]	62.2	63.8	65.1	66.3	64.6	66.5	68.7	69.2	68.5
Open unemployment rate [l]	11.8	11.4	11.3	15.0	13.9	13.3	15.8	18.0	15.3
Informal sector [m]	48.7	47.7	49.8	52.4	53.0	50.3	51.0	52.6	49.8

Table 1 (concluded)

	1996	1997	1998	1999	2000	2001	2002	2003	2004 [a]
			Annual percentages						
Prices									
Variation in consumer prices (December-December)	103.2	37.6	29.9	20.0	13.4	12.3	31.2	27.1	19.2
Variation in wholesale prices (December-December)	105.8	17.3	23.3	13.6	15.8	10.2	49.4	48.4	23.1
Variation in nominal exchange rate (December-December)	88.3	5.9	12.6	13.6	8.5	7.7	75.6	21.0	20.0
Variation in average real wage	-23.3	25.6	5.4	-4.6	1.5	2.4	-10.1	-16.7	-3.9
Nominal deposit rate [n]	...	14.5	36.2	20.6	14.9	14.7	28.8	17.2	12.9
Nominal lending rate [o]	...	22.0	45.3	31.3	24.5	24.8	38.4	25.7	17.1
			Percentages of GDP						
Public sector, narrowly defined [p]									
Current income	35.0	30.0	24.1	26.8	32.7	27.3	29.4	32.3	...
Current expenditure	16.8	18.1	18.2	18.1	19.7	20.9	20.7	22.1	...
Current balance	18.2	12.0	5.9	8.7	13.0	6.4	8.7	10.2	...
Net capital expenditure	10.5	7.2	10.0	7.5	7.5	9.5	8.3	8.8	...
Primary balance	12.0	6.7	-1.4	4.0	7.5	-1.2	4.2	5.4	...
Overall balance	7.0	3.7	-4.5	0.7	4.5	-4.6	-1.0	0.2	...
Debt of the non-financial public sector	46.8	31.7	29.1	29.0	26.7	30.0	41.9	45.8	39.0
Domestic	7.8	5.1	4.6	5.9	8.8	12.1	14.8	17.7	14.3
External	39.0	26.6	24.5	23.0	17.9	17.9	27.1	28.1	24.6
Interest payments (percentage of current income)	14.5	9.9	12.8	12.3	9.4	12.5	17.7	16.1	...
Money and credit [q]									
Domestic credit [r]	10.0	10.5	13.8	12.8	11.8	12.6	11.5	10.0	10.5
To the public sector	2.9	0.6	0.4	0.6	0.8	1.6	2.2	2.5	2.7
To the private sector	7.1	9.9	13.4	12.3	11.0	11.0	9.3	7.5	7.8
Liquidity (M3)	...	15.8	18.3	18.2	16.8	17.4	15.1	17.1	17.2

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.
[a] Preliminary figures. [b] Based on figures in local currency at constant 1997 prices. [c] The figure for 2004 does not include restaurant and hotel activities, which are only considered in total GDP. [d] Based on figures in local currency expressed in dollars at current prices. [e] Includes errors and omissions. [f] Refers to the capital and financial balance (including errors and omissions), minus net foreign direct investment. [g] A minus sign (-) denotes an increase in reserves. [h] Includes the use of IMF credit and loans and exceptional financing. [i] Annual average, weighted by the value of merchandise exports and imports. [j] Refers to net investment income as a percentage of exports of goods and services as shown on the balance of payments. [k] Economically active population as a percentage of the working-age population, nationwide total. [l] Unemployment rate as a percentage of the economically active population, nationwide total. [m] Population employed in the informal sector as a percentage of the employed population. [n] 90-day deposits. [o] Average lending rate of the counntry's six major commercial and universal banks. [p] The narrowly-defined public sector is composed of the budgetary central government, Petróleos de Venezuela, S.A. (PDVSA), a set of non-financial public enterprises, the Venezuelan Social Insurance Institute (IVSS), the Deposits and Bank Protection Guarantee Fund (FOGADE) and the Venezuelan Investment Fund (FIV). [q] The monetary figures are annual averages. [r] Refers to net credit extended to the public and private sectors by commercial banks and other financial and banking institutions.

The central bank's board of directors set a minimum rate for deposits and a cap on lending rates, which came into effect on 1 May 2005. Restrictions were imposed on bank commissions as well. The maximum annual interest rate on lending operations, including credit card transactions, was set at 28%, while minimum interest rates on savings and time deposits were fixed at 6.56% and 10%, respectively.

With regard to exchange-rate policy, the government devalued the bolívar by 20% in nominal terms in February 2004, to a rate of 1,920 bolívares to the dollar. Exchange-rate controls remained in place but were loosened slightly.[4] This was reflected in the parallel exchange market, in which the local currency has tended to appreciate.[5] In March 2005, the authorities devalued the bolívar by 12%, bringing the new rate of exchange against the United States dollar to 2,150 bolívares.

4 Foreign exchange became easier to obtain in the controlled market because the list of legal import products was extended and the travel quota was increased. The quota for remittances abroad was also raised. In addition, the Foreign Exchange Board (CADIVI) has significantly increased the amount of foreign currency released daily.

5 The bolívar-dollar exchange rate in the parallel market moved from 3,240 in February 2004 to 2,500 in May 2005.

Table 2

BOLIVARIAN REPUBLIC OF VENEZUELA: MAIN QUARTERLY INDICATORS

	2003				2004 [a]				2005 [a]	
	I	II	III	IV	I	II	III	IV	I	II
Gross domestic product (variation from same quarter of preceding year) [b]	-24.9	-5.0	-7.1	6.6	35.0	14.3	14.2	12.1	7.9	...
Merchandise exports, f.o.b. (millions of dollars)	4 262	7 159	7 737	7 703	8 556	6 555	10 496	10 848	11 333	...
Merchandise imports, f.o.b. (millions of dollars)	2 189	2 082	2 774	3 296	3 187	2 557	4 857	5 431	4 969	...
International reserves (millions of dollars)	15 142	17 959	19 184	21 366	23 262	23 226	21 841	24 208	25 646	...
Real effective exchange rate (index: 2000=100) [c]	135.4	143.1	136.8	132.2	143.5	146.4	142.0	141.0	137.5	150.2 [d]
Unemployment rate	19.7	18.9	17.9	15.6	17.3	16.1	15.0	12.5	14.3	12.2
Consumer prices (12-month percentage variation)	34.1	34.2	26.6	27.1	23.1	22.3	20.8	19.2	15.8	15.9
Average nominal exchange rate (bolívares per dollar)	1 634	1 598	1 598	1 598	1 811	1 918	1 918	1 918	1 918	2 147
Average real wage (variation from same quarter of preceding year)	-19.5	-20.1	-15.7	-10.8	-5.7	-3.4	-3.1	-3.2	0.0	...
Nominal interest rates (annualized percentages)										
Deposit rate [e]	23.1	16.1	15.6	14.1	12.4	12.7	13.0	13.2	12.4	11.8
Lending rate [f]	34.1	25.9	22.6	20.1	18.8	18.2	17.8	17.3	17.3	16.7
Interbank interest rate [g]	28.3	9.7	9.0	5.5	3.7	4.0	3.6	6.2	1.1	3.5
Sovereign bond spread (basis points)	1 412	1 002	828	593	667	647	490	411	459	466
Stock price index (in dollars, December 2000=100)	43.3	72.3	86.9	59.2	67.7	75.4	91.2	88.9	77.2	68.5
Domestic credit (variation from same quarter of preceding year) [h]	16.1	-1.8	2.4	6.8	36.2	79.3	85.7	93.4	58.6	59.9 [i]
Non-performing loans as a percentage of total credit [j]	7.9	7.1	5.8	3.7	3.4	2.5	2.2	1.5	1.6	1.5 [d]

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

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

3. The main variables

(a) Economic activity

In 2004, economic activity expanded substantially in the oil and non-oil sectors alike (11.6% and 17.8%, respectively) and import duties were up by 34.3%. Although the strong upturn during the year brought economic activity overall back up to 2001 levels, not all sectors recovered their previous performance. The oil sector and, to a lesser extent, construction are at lower levels than in 2001.[6]

The most buoyant sectors were construction (32.1%), commerce and repair services (25.5%), transport and storage (26.4%) and financial institutions (26.6%). Oil production over the year varied little from the end of 2003, suggesting

[6] Levels of activity in the oil and construction sectors are actually lower than in 1997.

that the expansion recorded is due to the low basis for comparison represented by the first quarter of 2003.

The increase in central government spending was reflected in a significant expansion in public consumption (13.9%). Private consumption grew by 16.6% and gross domestic investment, by 90% (including a 43% rise in gross fixed investment). Thus, domestic demand increased by 29% during the year, as reflected in a significant real expansion in imports of goods and services (60%). The increase in exports (12%) was attributable to the performance of the oil sector and, like it, reflects the low basis for comparison of the first quarter of 2003.

Boosted by non-oil activity (9.3%), GDP grew by 7.9% in the first quarter of 2005, compared with the same period in 2004. Petroleum-related activity was up by 1%. The fastest-growing sectors were commerce and repair services (17.8%), construction (15.4%) and transport (14.7%). With respect to spending, domestic demand increased by 20.3%, with rises in private consumption (12.2%), public consumption (8.5%) and gross fixed investment (38.8%). The expansion in public consumption is attributable to the increase in government expenditure on health and education, while the rise in private consumption reflects falling unemployment and rising credit. The expansion in gross domestic investment was accounted for by a substantial increase in the construction sector and in imports of machinery and equipment.

(b) Prices, wages and employment

In 2004, inflation, measured by the consumer price index, stood at 19.2%, much lower than the 2003 figure of 27.1%. This was attributable to the real appreciation of the bolívar, exchange-rate policy measures, the maintenance of price controls and the wider availability of goods. This last factor resulted from an increase in imports made possible, in turn, by the release of larger amounts of foreign exchange. The core inflation index rose by 21.1% in 2004. The slower rate of increase in consumer prices was partly due to the food subsidies extended by the government. Price controls have been effective in containing, but have not eliminated, price rises for some products, since the price index for controlled products rose by the same percentage as the general consumer price index (CPI).

In the first half of 2005, the CPI showed a variation of 8.0%, lower than that recorded in the year-earlier period (11.0%). The core inflation index rose by 9.5% between December 2004 and June 2005, compared with 13.6% for December 2003 to June 2004.

The wholesale price index was up by 22.4% in 2004. The price indexes for domestic products and imports showed similar rises. Between December 2004 and June 2005, the wholesale index rose by 10.9% (11.4% and 9.4% for domestic products and imports, respectively). The increases recorded in 2005 were due to higher prices for capital and intermediate goods.

Wages improved in nominal terms in 2004, with the general wage index published by the central bank showing an average increase of 22% over the year, although they remained constant in real terms. Private sector wages rose by 17% on average during the year, while public-sector wages were up by 37.7%. The government raised the minimum wage by 26% with effect from 1 May 2005. The increase in economic activity led to a decline in the unemployment rate, from 16.8% in the second half of 2003 to close to 12.5% in the fourth quarter of 2004. The rate of informal employment, which exceeded 50% at the end of 2003, declined to 47% on average at the end of 2004. In May 2005, the unemployment rate stood at 12.6%.

(c) The external sector

Exports climbed strongly (43%) in 2004. Oil exports were up by 45% and non-oil exports, by 33%. The increase in oil exports was due to the steep rise in the international price of the Venezuelan oil basket in international markets and to the increase in exports of oil derivatives, including orimulsion.[7] Among non-oil exports, iron products and iron ore performed well (up 82% and 94.6%, respectively). Imports expanded by 81.9% during the year. While all products recorded significant growth, the most dynamic were consumer goods (durables and non-durables) and capital goods, in particular machinery and equipment.

Despite the surge in imports, the high price of oil drove an increase in the trade surplus from US$ 16.483 billion in 2003 to US$ 21.430 billion in 2004. The wider deficits on the services and income balances prevented a larger jump in the current-account surplus, however, which moved from US$ 11.448 billion in 2003 to US$ 13.830 billion in 2004.

In the first quarter of 2005, merchandise exports maintained their upward trend, expanding by 35.4% in relation to the same period of 2004; oil and non-oil exports posted increases of 39.3% and 16.5%, respectively. Imports recorded a 56% increase in the same period.

International reserves swelled throughout 2004. In December 2004, they stood at US$ 23.498 billion, up from US$ 20.666 billion in December 2003. In May 2005, they amounted to US$ 27.293 billion.

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7 Orimulsion is an emulsion of bitumen (extra heavy crude) with water.

Bolivia

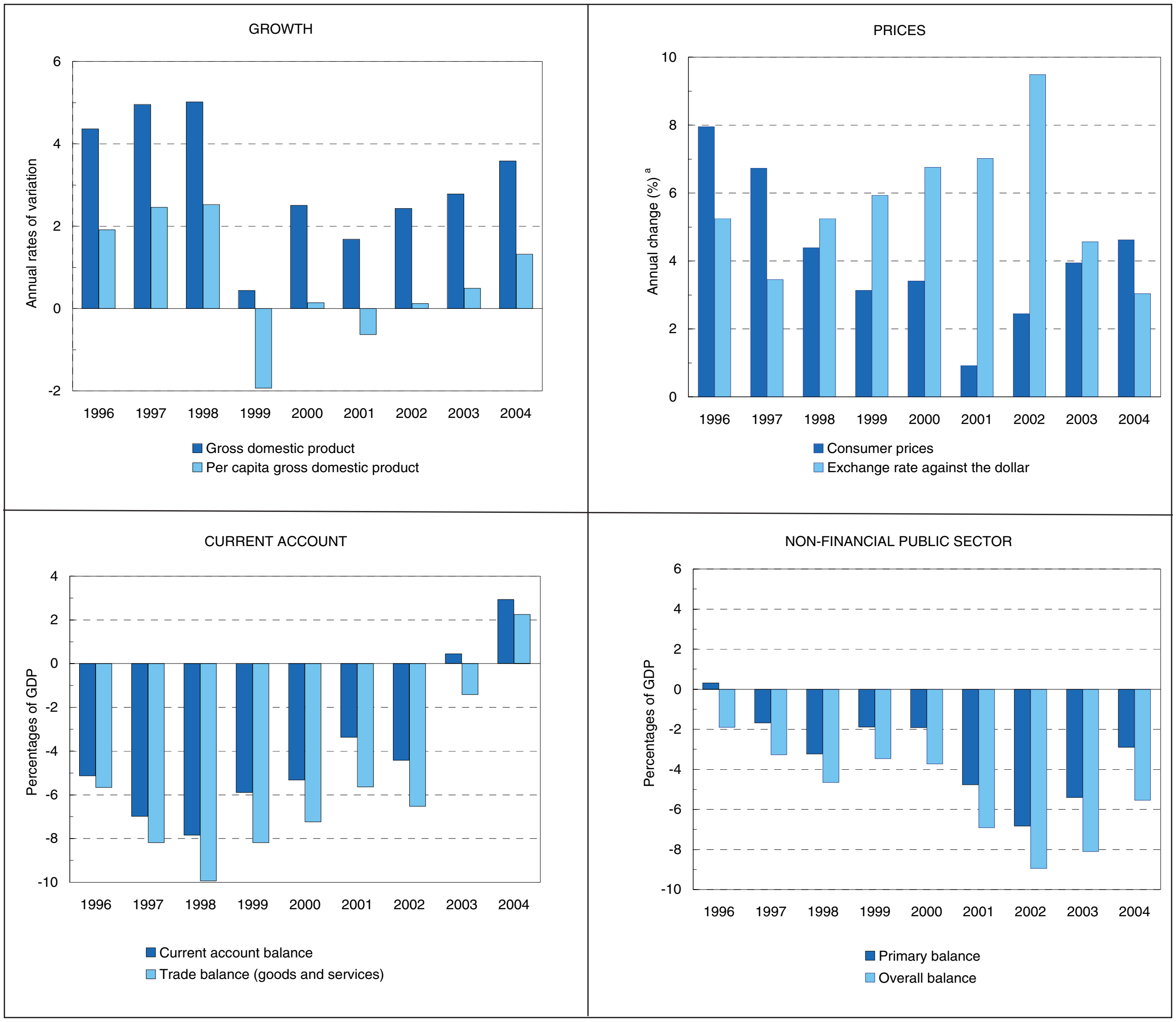
1. General trends

Bolivia's economy turned in a good performance in 2004, on the strength of favourable external conditions and a degree, albeit tenuous, of political and social stability. In 2005, however, although external conditions remained favourable, a grave political crisis culminated in the resignation of the President in early June and his replacement by a transition government, whose main objective is to hold general elections before the year is out. The mobilizations in May and June took their toll on economic activity, inflation and tax receipts. The situation had begun to deteriorate in January, when demands for autonomy by the department of Santa Cruz were heightened after the government raised fuel prices. Later, the debate surrounding the hydrocarbons act escalated with some movements pressing for the nationalization of the industry, leading, ultimately, to the resignation of the President. In May Congress passed hydrocarbons legislation providing for a direct tax of 32% on the value of production (in addition to the existing royalty of 18%) and afforded the State a larger role and increased regulatory capacity in the sector. There are some signs that this, together with the possibility of nationalization, could deter future investments in the industry. Bolivia is now engaged in a debate on the political reorganization of the State which, among other things, would involve changes in the degree of departmental autonomy.

Despite the complicated panorama, some of the economic indicators for the first part of 2005 are good and look consistent with external conditions that have remained favourable since 2003, perhaps signalling that economic agents have become somewhat accustomed to political instability. In April 2005, the International Monetary Fund (IMF) approved the fifth review of the standby agreement signed a year earlier and extended it for another year, which will afford Bolivia US$ 64.5 million in resources. The agreement includes commitments on the fiscal deficit and international reserves and is directed towards a gradual flexibilization of exchange-rate policy, a strengthening of the financial system, improved public-debt management and the adoption of legislation on hydrocarbons to broaden tax revenues and encourage investment.

In 2004, GDP expanded at a rate of 3.6% (compared to 2.8% in 2003), nudging per capita GDP up above its 2003 level, though this still fell short of the 1998 figure, patently illustrating the deeply negative effects of the low growth period that began in 1999. The non-financial public sector (NFPS) deficit came down substantially to 5.5% of GDP in 2004 (which was one percentage point lower than mid-year projections suggested) compared with 7.9% in 2003. Not including the heavy

Figure 1
BOLIVIA: MAIN ECONOMIC INDICATORS



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

burden of pension payments, the deficit was 3.1% of GDP in 2003 and 0.9% in 2004. The impetus from exports meant that the balance-of-payments position was also comfortable in 2004, with a second year of current-account surplus which, in fact, reached a record level. A number of monetary and financial variables improved slightly, while inflation remained within reasonable limits throughout the year. Data from the first semester of 2004 show a decline in real wages in both public and private sectors, while the rate of unemployment remained high, although it may have dipped with respect to 2003.

2. Economic policy

The tight fiscal and monetary restraints on Bolivia's economy eased somewhat in 2004, especially in the second part of the year, and exchange rate trends were also favourable.

(a) Fiscal policy

The NFPS fiscal deficit narrowed by 2.3 GDP percentage points, from 4.88 billion bolivianos in 2003 to 3.86 billion in 2004, with 84% of this sum corresponding to outlays on pensions. Income-side contributors to the narrower deficit were the success of the tax regularization schemes, a levy on financial transactions and increased revenues from hydrocarbons exports. Higher fiscal revenues from the first two factors accounted for 73% of growth in total income, which increased by 23.3% over the year. Grants represented 2.5% of GDP (1.744 billion bolivianos), which was lower than the 2.9% recorded in 2003, but higher than the average of 2.0% in 1998-2002. On the expenditures side, the aggregate total expanded by 12.7%, with capital spending being the fastest-growing component (26.6%) and current spending rising relatively little. In fact, spending on goods and services actually shrank by 8%, reflecting the austerity programmes implemented to ease the critical fiscal situation carried over from 2003. Higher-than-expected revenues and complementary external financing allowed an expansion in public investment, which went chiefly to infrastructure and social investment.

External loans covered 73.2% of the deficit, and domestic credit the remaining 26.8%. Domestic credit fell into two categories: securities sold to pension fund companies and treasury bond purchases by the financial system. According to central bank figures, at the end of December 2004 the public debt stood at US$ 6,925,500,000, which represented 78.9% of GDP.[1] Of the balance owed, US$ 4,950,600,000 was external debt, with a grant component of 39.3%, reflecting the highly concessional[2] profile of Bolivia's external public borrowing. In 2004 the outstanding balance dropped by 1.8% thanks to debt forgiveness from Japan and Brazil, which condoned US$ 506.2 million and US$ 21.9 million, respectively, and 92% of external debt now corresponds to loans from multilateral agencies. Domestic debt rose 15.4% (14.3% in 2003), to stand at the equivalent of US$ 1,974,900,000, of which only 30% is denominated in bolivianos, although this component has increased significantly in the last few years. The treasury resorted to liquidity credits from the central bank in order to ease cash flow difficulties, particularly in the first semester. Although by the end of the year 612.9 million bolivianos had been extended in net financing (with a total balance of 1,937,900,000 bolivianos), this amount was within the limits stipulated in the respective Memorandum of Understanding between the central bank and the Ministry of Finance, and is expected to be lowered in 2005. Public-sector borrowing has remained constant, representing almost half of the monetary base since the end of 2002.

Although Congress did not approve the budget for 2005, since the projected revenues included income that was subject to approval of the hydrocarbons act, it legally came into effect. At the end of December, the government decreed an increase in hydrocarbons prices in order to lessen the distortion in relative prices, which was causing shortages of some products and encouraging exports to neighbouring countries, and to contain the growth in the subsidies used to keep the domestic price below the international level. The authorities then established a fiscal target of 5.2% of GDP for 2005, with an increase of 10.5% in income and 7.8% in expenditures. Almost 70% of the extra income is to come from new levies on the hydrocarbons sector, since preliminary estimates of the income effect of the hydrocarbons act place the associated revenues at about US$ 200 million, slightly more than the amount envisaged in the budget. Returns from the financial transactions tax and the last remaining effects

[1] Economic Commission for Latin America and the Caribbean (ECLAC) *Preliminary Overview of the Economies of Latin America and the Caribbean, 2004* (LC/G.2265-P), Santiago, Chile, December 2004, p. 81 indicates that "total public debt […] amounted to US$ 8.032 billion". This information came from the newspaper "La Razón" of 16 November 2004 and had apparently been released by the Ministry of Finance, whose authorities, however, did not confirm this. In this connection, it is worth noting that the estimate of the central bank is based on net domestic public debt, whereas some of the statistics prepared by the Ministry of Finance include debts owed by the treasury to the central bank.

[2] The grant component of debt incurred is calculated as a percentage, using the ratio (1 - present net value/nominal value) multiplied by 100; when this figure is over 35% IMF categorizes the debt as "concessional".

Table 1
BOLIVIA: MAIN ECONOMIC INDICATORS

	1996	1997	1998	1999	2000	2001	2002	2003	2004 [a]
	Annual growth rates [b]								
Gross domestic product	4.4	5.0	5.0	0.4	2.5	1.7	2.4	2.8	3.6
Per capita gross domestic product	1.9	2.5	2.5	-1.9	0.1	-0.6	0.1	0.5	1.3
Gross domestic product, by sector									
Agriculture, livestock, hunting, forestry and fishing	6.7	4.5	-4.4	2.6	3.4	3.5	0.5	8.1	0.3
Mining	-2.0	6.1	5.5	-4.6	6.4	-1.5	2.6	4.2	9.0
Manufacturing	4.9	2.0	2.5	2.9	1.8	2.7	0.7	3.6	5.1
Electricity, gas and water	3.4	4.7	2.4	4.6	1.9	0.7	2.2	3.0	2.2
Construction	9.0	4.9	35.7	-16.9	-4.1	-7.0	17.0	-23.2	1.2
Wholesale and retail commerce, restaurants and hotels	5.1	4.1	2.0	0.8	3.6	1.1	2.1	2.1	3.4
Transport, storage and communications	6.9	9.2	7.1	-0.8	2.4	3.0	4.4	3.9	3.0
Financial institutions, insurance, real estate and business services	8.5	12.6	12.5	13.3	-0.6	0.2	-2.9	-2.2	-1.8
Community, social and personal services	2.5	4.9	3.6	2.9	2.4	2.6	3.1	3.0	2.0
Gross domestic product, by type of expenditure									
Consumption	3.2	5.1	5.1	2.8	2.3	1.5	2.3	2.1	2.2
General government	2.6	3.4	3.8	3.2	2.1	2.9	3.5	3.6	-0.7
Private	3.3	5.4	5.2	2.8	2.3	1.3	2.1	1.9	2.6
Gross domestic investment	18.8	30.2	28.5	-18.8	-7.4	-17.5	18.8	-12.8	-10.1
Exports (goods and services)	4.1	-2.1	6.5	-12.8	15.0	8.4	4.3	12.3	16.1
Imports (goods and services)	7.9	13.5	22.3	-17.1	4.7	-5.0	12.7	0.6	5.4
	Percentages of GDP								
Investment and saving [c]									
Gross domestic investment	16.2	19.6	23.6	18.8	18.1	14.3	16.6	13.4	12.4
National saving	11.1	12.6	15.8	12.9	12.8	10.9	12.2	13.8	15.3
External saving	5.1	7.0	7.8	5.9	5.3	3.4	4.4	-0.4	-2.9
	Millions of dollars								
Balance of payments									
Current account balance	-380	-554	-666	-488	-446	-274	-350	36	257
Merchandise trade balance	-236	-477	-656	-488	-364	-423	-476	-36	266
Exports, f.o.b.	1 132	1 167	1 104	1 051	1 246	1 285	1 299	1 573	2 129
Imports, f.o.b.	1 368	1 644	1 760	1 539	1 610	1 708	1 775	1 610	1 863
Services trade balance	-182	-172	-189	-190	-244	-36	-41	-78	-69
Income balance	-208	-197	-162	-196	-225	-211	-205	-302	-369
Net current transfers	247	292	341	386	387	396	371	452	429
Capital and financial balance [d]	648	654	791	515	407	237	57	41	-131
Net foreign direct investment	472	728	947	1 008	734	703	674	195	114
Financial capital [e]	176	-74	-156	-493	-327	-467	-617	-154	-245
Overall balance	268	101	125	27	-39	-37	-293	77	126
Variation in reserve assets [f]	-310	-90	-133	-32	39	28	275	-93	-139
Other financing [g]	42	-11	8	5	1	9	17	16	13
Other external-sector indicators									
Real effective exchange rate (index: 2000=100) [h]	105.3	103.9	98.5	98.6	100.0	101.0	95.4	104.1	111.7
Terms of trade for goods (index: 2000=100)	108.0	107.9	102.0	97.1	100.0	95.8	96.2	98.5	104.1
Net resource transfer (percentage of GDP)	6.5	5.6	7.5	3.9	2.2	0.4	-1.6	-3.0	-5.6
Gross external public debt (millions of dollars)	4 366	4 234	4 655	4 574	4 461	4 412	4 300	5 042	4 951
Gross external public debt (percentage of GDP)	59.0	53.4	54.8	55.2	53.1	54.2	54.3	62.3	56.4
Net profits and interest (percentage of exports) [i]	3.0	5.7	6.0	10.9	10.1	...	...	...	...
	Average annual rates								
Employment									
Labour force participation rate [j]	56.5	52.5	49.5	55.9	56.1	60.6	58.0	60.4	...
Open unemployment rate [k]	3.8	4.4	6.1	7.2	7.5	8.5	8.7	9.2	8.5

Table 1 (concluded)

	1996	1997	1998	1999	2000	2001	2002	2003	2004 [a]
			Annual percentages						
Prices									
Variation in consumer prices (December-December)	7.9	6.7	4.4	3.1	3.4	0.9	2.4	3.9	4.6
Variation in nominal exchange rate (December-December)	5.3	3.5	5.3	5.9	6.8	7.0	9.5	4.6	3.0
Variation in real minimum wage	-3.3	2.0	16.1	7.6	2.9	10.8	4.7	0.8	-4.2
Nominal deposit rate [l]	...	...	...	...	...	...	2.7	1.8	2.0
Nominal lending rate [l]	...	...	...	...	...	...	10.9	9.1	8.2
			Percentages of GDP						
Non-financial public sector									
Current income	28.1	28.1	29.9	30.8	31.5	28.5	25.8	26.8	25.0
Current expenditure (includes pensions)	24.2	23.3	25.3	25.2	26.2	24.9	23.9	25.0	19.6
Current balance	3.9	2.5	1.0	1.8	1.1	-0.9	-2.7	-2.8	1.1
Net capital expenditure	5.8	5.8	5.6	5.3	4.9	6.0	6.3	5.3	6.6
Primary balance	0.3	-1.7	-3.2	-1.9	-1.9	-4.8	-6.8	-5.4	-2.9
Overall balance	-1.9	-3.3	-4.7	-3.5	-3.7	-6.9	-9.0	-8.1	-5.5
Debt of non-financial public sector	67.0	61.7	61.2	65.0	66.3	74.9	79.3	93.3	85.0
Domestic	14.1	13.6	13.8	16.7	19.4	26.4	29.1	31.6	31.5
External	52.9	48.1	47.4	48.3	46.9	48.5	50.2	61.7	53.5
Interest payments (percentage of current income)	7.9	5.7	4.7	5.1	5.7	7.5	8.2	10.1	10.6
Money and credit [m]									
Domestic credit [n]	46.7	53.3	58.9	65.2	61.3	58.6	55.1	52.6	45.4
To the public sector	2.7	1.1	1.6	2.2	1.7	2.9	3.7	4.5	3.5
To the private sector	44.0	52.2	57.3	63.1	59.6	55.7	51.3	48.1	41.9
Liquidity (M3)	40.4	47.9	50.0	52.3	50.3	52.7	48.9	47.4	40.8
Currency in circulation and local-currency deposits (M2)	6.2	7.1	7.0	6.5	6.0	6.3	6.3	6.7	7.0
Foreign-currency deposits [o]	34.2	40.9	43.0	45.8	44.3	46.4	42.7	40.7	33.8

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.
[a] Preliminary figures. [b] Based on figures in local currency at constant 1990 prices. [c] Based on figures in local currency expressed in dollars at current prices. [d] Includes errors and omissions. [e] Refers to the capital and financial balance (including errors and omissions), minus net foreign direct investment. [f] A minus sign (-) denotes an increase in reserves. [g] Includes the use of IMF credit and loans and exceptional financing. [h] Annual average, weighted by the value of merchandise exports and imports. [i] Refers to net investment income as a percentage of exports of goods and services as shown on the balance of payments. [j] Economically active population as a percentage of the working-age population, urban total; up to 1998, departmental capital cities. [k] Unemployment rate as a percentage of the economically active population, urban total; up to 1998, departmental capital cities. [l] Bank operations (61-90 days), in dollars. [m] The monetary figures are annual averages. [n] Refers to net credit extended to the public and private sectors by commercial banks and other financial and banking institutions. [o] Refers to demand and time deposits, savings banks and other obligations of the banking sector with the private sector.

of the tax regularization programmes will also represent an important contribution. In the first quarter, the total income of NFPS rose by 12.7% and its expenditure, by 3.7%. Of the increase in income, 34% is attributable to the correction of domestic hydrocarbons prices and 60% to the increase in tax revenues from that sector.

(b) Monetary policy

The country's monetary policy is aimed at keeping the inflation rate low and stable, with the central bank setting intermediate targets for both domestic assets (with a cap on net domestic credit) and external assets (a minimum level of net international reserves). In the mid-1980s there was a clear link between the expansion of net domestic credit and inflation, because the central bank financed a large portion of the fiscal deficit, but this relationship is not so clear-cut today. The international reserves target is essential to the stability of the payments system in Bolivia's highly dollarized economy. Open-market operations comprise the main instrument of monetary regulation. Several runs on deposits have occurred since 2002 in the context of a process of financial disintermediation generated by sluggish economic growth since 1999.

In 2004, the announcement of a financial transactions tax and the referendum on hydrocarbons policy triggered a run on deposits that peaked in June, after which deposits began a gradual recovery that continued into the early months of 2005, despite political instability. In April rumours of false dollars in circulation led to an increase of

Table 2
BOLIVIA: MAIN QUARTERLY INDCIATORS

	2003				2004 [a]				2005 [a]	
	I	II	III	IV	I	II	III	IV	I	II
Gross domestic product (variation from same quarter of preceding year) [b]	3.7	4.8	2.4	0.3	3.1	1.3	4.9	5.1	3.9	...
Merchandise exports, f.o.b. (millions of dollars)	350	412	446	437	469	402	619	583	552	...
Merchandise imports, c.i. f. (millions of dollars)	379	381	404	451	395	308	467	559	495	...
International reserves (millions of dollars)	729	868	902	976	889	805	951	1 123	1 035	1 163
Real effective exchange rate (index: 2000=100) [c]	97.2	105.4	106.1	108.2	110.5	109.8	111.1	115.5	117.8	120.4 [d]
Consumer prices (12-month percentage variation)	2.8	3.2	3.6	3.9	3.9	4.9	4.3	4.6	5.7	6.4
Average nominal exchange rate (bolivianos per dollar)	7.55	7.61	7.70	7.77	7.86	7.91	7.96	8.02	8.06	8.09
Nominal interest rates (annualized percentages)										
Deposit rate [e]	2.3	1.8	1.6	1.6	1.6	2.1	2.5	1.8	1.7	1.6
Lending rate [e]	9.6	9.7	9.7	7.5	7.4	7.9	8.8	8.8	8.5	7.6
Repurchase rate [f]	6.4	6.7	6.7	7.2	6.4	8.1	9.8	7.8	...	...
Domestic credit (variation from same quarter of preceding year) [g]	1.9	2.7	4.6	3.0	2.0	-1.4	-2.6	0.5	0.6	3.6 [d]
Non-performing loans as a percentage of total credit [h]	20.1	19.7	18.6	17.1	18.7	18.1	17.4	14.5	16.8	...

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

almost US$ 92 million in deposits, as private individuals sought to ensure the security of their holdings. At the end of May bank deposits stood at US$ 2.653 billion, which was 2.2% lower than the balance recorded at the end of 2003 but 10.7% higher than the figure at the end of June 2004. In response to withdrawals in the early part of 2004, the central bank injected liquidity into the financial system in the form of repo operations, credits secured against the liquid assets fund (RAL) and the purchase of securities, as interest rates rose. The upturn in deposits brought down the respective rates of interest, but lending rates remained high into 2005. The average dollar lending rate rose from 8.3% in March 2004 to an average of 10.4% in the first five months of 2005. Rising international interest rates, the perceived high risk of lending and measures to absorb liquidity in the second part of the year go some way to explaining this pattern. The recapturing of deposits has not been accompanied by an increase in the banking portfolio, except for a few isolated cases. In May 2005 lending was down by 5.5% with respect to December 2003 and by 2.2% compared with June 2004. The expansion in deposits has therefore swelled bank liquidity, especially short-term investments abroad, which at the end of May represented some US$ 360 million, corresponding to 31.2% of total liquidity and 13.5% of deposits, in a trend that clearly reflects the prevailing uncertainty. In May 2005 the non-performing portfolio represented 16.8% of the total.

Annual growth of the monetary base was 10.1% at the end of 2004 and occurred in the second half of the year when net international reserves increased. Credit to the financial system and to the government was neutral in terms of primary liquidity creation. In the first quarter of 2005, the drop in net international reserves caused the monetary base to contract by 17.1%. The boliviano-denominated proportion of monetary aggregates increased as a result of the mid-2004 introduction of the financial transactions tax, from which local-currency savings funds are exempt. On average, in 2003 bolivianos accounted for 44.9% of M1, but this figure rose to 53.4% in the first quarter of 2005; the equivalent figures for M3 were 14.8% and 20.5%. In May 2005 the central bank raised from 10%

to 12% the portion of the required dollar legal reserve that banks are permitted to keep in authorized securities (the liquid assets fund), in order to boost the liquidity of financial entities in the dollarized environment, fuel demand for bolivianos and strengthen the central bank's performance as a lender of last resort. As regards non-bank intermediation (which represents 25% of credit), in 2004 deposit-taking and lending by private financial funds increased to 29.0% and 32.6%, respectively, on the back of increasing financial formalization of microenterprises and small firms.

(c) Exchange-rate policy

Bolivia operates a crawling-peg exchange rate regime (with non-previously-announced depreciations of the boliviano against the dollar) which is intended to sustain external competitiveness. This is subordinate to the inflation target, however, and requires particular care to avoid currency mismatches in a highly dollarized system. In 2004, nominal depreciation was 2.8%, which was lower than the figure of 4.5% recorded in 2003, although the real effective exchange rate depreciated by 7.1%, mainly because the currencies of Bolivia's main trading partners rose in value against the dollar. Real depreciation against the dollar amounted to 1.4%. The boliviano has attained record levels of competitiveness, thereby fuelling exports. In the first four months of 2005, the real effective exchange rate was standing 15.1% above its level of 1990-1999. Demand for dollars in the central bank's "bolsín", an indicator used for exchange-rate management, dropped by 50% in relation to 2003, reflecting an inflow of foreign exchange linked to the country's balance-of-payments position. At the end of May 2005, nominal depreciation was a mere 0.5%, while the real effective exchange rate remained practically unchanged.

3. The main variables

(a) Economic activity

The economy expanded by 3.6% in 2004, with the most dynamic component being exports (16.1%), especially hydrocarbons (23.8%), on the strength of increased gas exports to Brazil and the resumption of shipments to Argentina. By contrast, domestic demand virtually stagnated, with an increase of just 0.4%, although this reversed the contraction of 0.3% seen in 2003. Gross fixed capital formation declined again, this time by 4.8%, which was not as sharp a drop as the preceding year, when it was down 10.9%. This variable has declined by 39% since 1998 and now accounts for only 12.5% of GDP. Imports were up by 5.4% at constant prices, which mainly reflected a recovery from the low level of 2003. The industrial sector expanded by 5.1%, led by activities linked to the export of textiles and leather, which was facilitated by the Andean Trade Promotion and Drug Eradication Act (ATPDEA), and construction posted a slight upturn after contracting sharply in 2003. Mining outturn dropped as a number of gold deposits were depleted, but good international prices and the start-up of investments in new projects augur an increase in production in 2005. Meanwhile, agriculture was hit by weather problems.

Economic activity trended upwards in 2004, with a surge in the second semester in particular, followed by an expansion of 3.9% in the first quarter of 2005. First-quarter indicators were good in agriculture, construction and gas production, which rose 37%. At the start of the year, the government had estimated the year's growth at 4.5%, but the complex political situation that developed in mid-2005 is likely to shear about half a percentage point off this figure.

(b) Prices, wages and employment

Inflation from December 2003 through to December 2004 came in at 4.6%, thereby overshooting the central bank's target of 3.5%, although core inflation was 3.2%. Domestic fuel price hikes and diesel shortages had a heavy impact on inflation in 2004, through both direct and indirect channels, especially transport costs and the prices of certain foods. The correction of fuel prices in January 2005 had a strong effect on inflation that month (1.37%), though this tapered off in the months that followed. In May and June shortages in a number of cities rebounded on the price index, which recorded a cumulative variation of 2.22% in those two months. In June, cumulative inflation for the year was 3.45%, compared with a 3.8% target for 2005 overall.

No detailed information on wage developments is available for 2004, although it is known that public-sector pay slipped by 6.4% in real terms over the year. In the first semester, real wages in the private sector declined (5.6%) and, although they may have stabilized in the second part of the year, their level will nevertheless be similar to that of mid-2002. The only available figure for urban unemployment in 2004 is a projection that places it at 8.5%, which represents a drop with respect to the 9.2% posted at the end of 2003.

(c) The external sector

Exports attained an all-time high of US$ 2.19 billion in 2004, reflecting a growth rate of 37.3%. The expansion occurred across a large variety of products, but was strongest in hydrocarbons, which accounted for 58% of the increase, of which 39% corresponded to gas alone. Minerals and soya were also robust contributors, thanks to price rises. Imports were up 11.6%, which represented a strong comeback after the dip of 7.6% in 2003. Imports of intermediate goods for industry, construction and agriculture accounted for much of the increase. Exports expanded in the first quarter of 2005, although at a lower rate (15.2%) than in 2004, while the import momentum that had been incipient in the fourth quarter of 2004 gathered strength. In 2004 the goods balance posted a surplus of close to US$ 270 million, which was the main contributing factor in a large current account surplus of 2.9% of GDP, or US$ 257 million. Also playing a role in this surplus were official transfers, which represented 2.8% of GDP, not including resources received under the Heavily Indebted Poor Countries (HIPC) initiative. Net foreign direct investment was only US$ 114 million, as against US$ 195 million in 2003. A voluminous flight of capital and loss of reserves occurred in the first semester of 2004, but these built back up in the second semester and the year closed with growth of US$ 139 million. In the first quarter of 2005, the racking up of imports together with slackening exports resulted in a current-account deficit of US$ 15 million. This was in addition to capital outflows of US$ 69 million, mainly in the form of short-term external assets. The deficit on the overall balance was financed out of reserves, which dropped by US$ 84 million.

Brazil

1. General trends

In 2004, the Brazilian economy recorded its strongest expansion in 10 years, with growth in GDP attaining 4.9%. This performance took place against the backdrop of a favourable balance-of-payments position attributable to an unprecedented surplus on both the trade and current-account balances, which led, in turn, to an improvement in external borrowing indicators. On the domestic front, the fiscal primary surplus increased and the nominal deficit on the public accounts shrank to its lowest level in decades, thus helping to reduce public-sector debt. On the strength of this economic upturn, as reflected in the behaviour of its principal indicators, Brazil decided not to renew its agreement with the International Monetary Fund (IMF), following six years of Fund programmes.

These buoyant conditions generated a significant expansion in employment: 1.5 million new jobs were created in the formal market and, for the first time in seven years, the real average wage improved. The average unemployment rate fell to 11.5% in 2004, down from 12.3% in 2003.

The monetary authorities sought to contain inflationary pressures generated by the rate of economic expansion. According to the broad consumer price index, inflation stood at 7.6% in 2004, thereby remaining within the allowable deviation from the target of 5.5%. Nevertheless, in view of steeper price rises and in order to achieve the inflation target of 5.1% set for 2005, in September 2004 the central bank started to raise the benchmark interest rate (Special System of Clearance and Custody, SELIC),[1] which rose to 19.75% in May 2005, thus matching the level recorded in September 2003.

The rise in interest rates has had repercussions for the progress of economic activity. Indeed, the growth rate slowed in the last quarter of 2004 (0.4%) and in the first quarter of 2005 (0.3%).[2] Gross fixed capital formation declined by 3.9% in the fourth quarter of 2004 and 3.0% in the first quarter of 2005. In view of these developments, growth projections for 2005 have been adjusted to 3%.

2. Economic policy

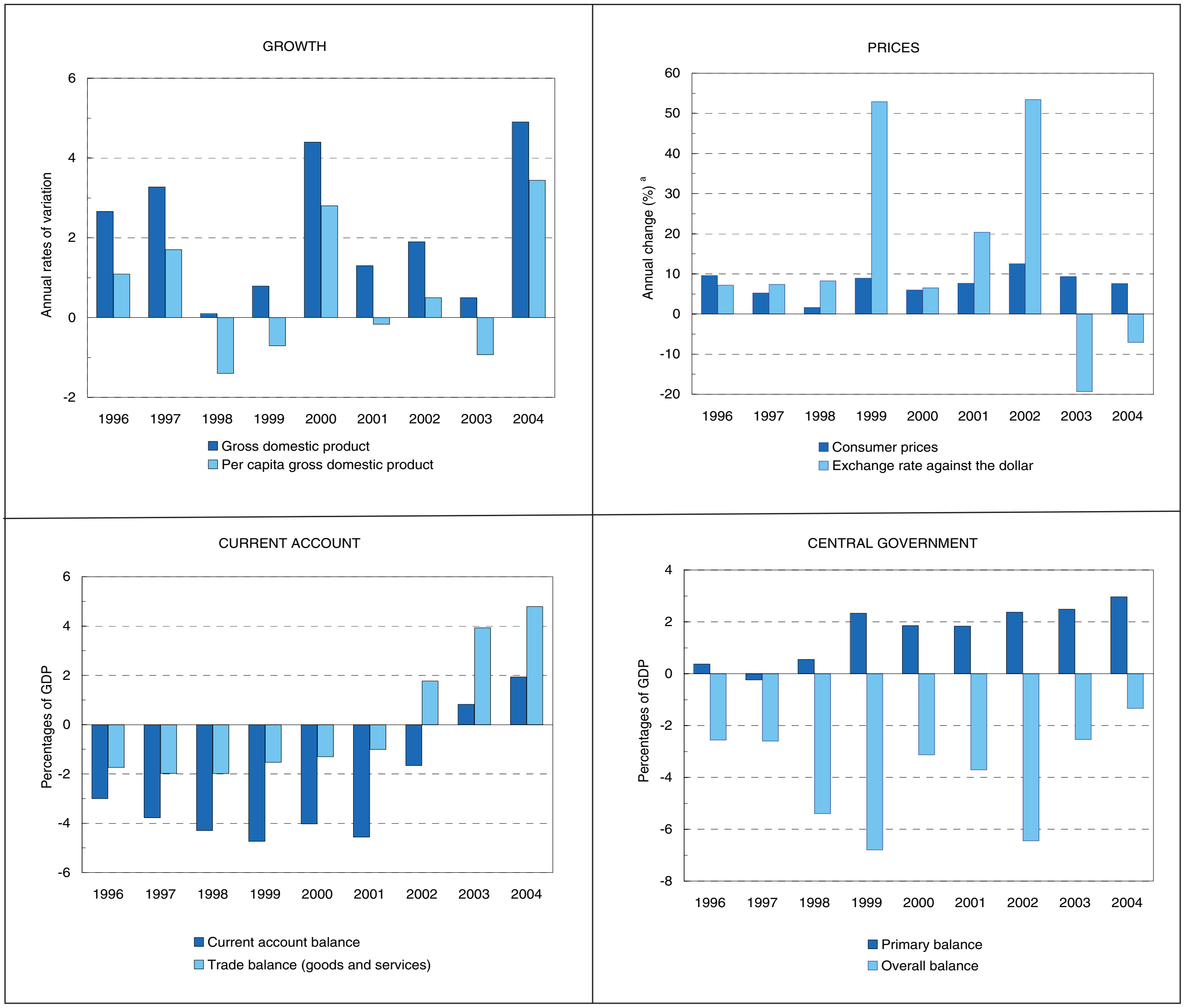
(a) Fiscal policy

The public sector recorded a positive outturn for the sixth consecutive year with a primary surplus equivalent to 4.6% of GDP in 2004. The nominal deficit narrowed to less than 3% of GDP, its lowest level in the past two decades. Thus, net public-sector debt fell from 57.2% of GDP in 2003 to 51.6% in 2004, with the nominal

1 The central bank decreed nine consecutive rises in the SELIC rate between September 2004 and May 2005.
2 Both rates refer to the seasonally adjusted variation in GDP in relation to the preceding quarter.

Figure 1

BRAZIL: MAIN ECONOMIC INDICATORS



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

appreciation of the real also helping to lower external public indebtedness.

The primary surplus was mainly a reflection of a 10.7% real increase in federal government revenue in 2004. Increased income from production and income taxes was attributable to the higher level of economic activity. Receipts from the tax on industrial goods were up —by 20% in real terms in the case of automobiles— while payroll withholding taxes rose 11.7%. Social security contributions reflected the impact of the change in rates, as well as collections of the levy on imports as from May 2004. For example, the proceeds of the Contribution to the Financing of Social Security (COFINS) tax showed a 21% rise in real terms in 2004 and represented a total of 4.4% of GDP. These increases in federal taxes and similar expansions in state and municipal taxes are expected to bring Brazil's tax burden to over 36% of GDP.

The higher revenues were sufficient to sustain a 10% real increase in federal spending in 2004. Current expenditure was the main contributor to the increase in spending, with real variations of 24.4% in social welfare payments and 5.2% in government payroll in 2004. Federal government investments grew by over 70% in real terms, but were still modest in absolute terms, accounting for just 0.2% of GDP, compared with federal primary expenditures, which were equivalent to 17% of GDP. The deficit on the social security system's accounts widened to 1.8% of GDP, compared with 1.3% in 2003. Real increases in the minimum wage and a higher number of beneficiaries contributed to an expansion of over 10% in the system's expenditure in 2004, as against a 9% real increase in revenues, whose growth was due to the high rate of formal job creation generated by the economic upturn.

Notwithstanding the pressure exerted by these higher expenditures, the federal government increased its primary surplus, including the social security accounts, from 2.5% of GDP in 2003 to 3.0% in 2004. This boosted the public-sector surplus from 4.25% of GDP in 2003 to 4.6% in 2004, thus meeting commitments made in the framework of the agreement with IMF. The state and municipal governments, which generated a primary surplus of close to 1% of GDP in 2004, also contributed to these results. In 2004, the states compensated for a drop (from 0.12% of GDP in 2003 to 0.08% of GDP in 2004) in the primary surplus posted by the municipalities, whose finances were pressured by local elections.

A decrease in interest payments by the public sector, from 9.3% of GDP in 2003 to 7.3% in 2004, also contributed to the narrowing of the nominal deficit (from 5.0% of GDP in 2003 to 2.7% in 2004). Public debt-servicing payments are expected to increase in 2005 as a result of rising interest rates. Although fixed-rate securities are accounting for a higher proportion of total debt (21.2% in May 2005, compared with 11.6% of total in December 2003), close to 55% of all public securities are still indexed to the SELIC rate.

Up to April 2005, the balances on the public accounts reflected the government's sustained efforts to achieve a primary surplus of 4.25% of GDP and help to lower public debt. Thanks to steadily expanding revenue and tighter current spending controls, the public-sector primary surplus for the 12 months to April stood at 5.0% of GDP. Net public debt diminished to 50.1% of GDP at the end of April, continuing the pattern observed in 2004.

Following lengthy negotiations, a pilot investment plan is being put in place to increase public investment, especially in infrastructure. It includes a series of projects, whose expenditure will not affect the calculation of the fiscal balance, under certain conditions agreed upon with IMF. This expenditure should amount to something over US$ 3 billion over a three-year period. In addition, the Public-Private Corporations Act (legislation governing public-private investment partnerships) was approved by Congress at the end of 2004 and came into force in early 2005. The respective projects are expected to be launched towards the end of the year.

(b) Monetary policy

Throughout 2004, the authorities applied a prudent monetary policy as regards the movements of the benchmark interest rate (SELIC). The downtrend initiated in June 2003, in which the SELIC rate fell from 26.5% to 16.5%, was halted in January, before further reductions in March and April brought it down to 16%. In September, the central bank announced the start of a series of interest rate hikes in order to counter inflationary pressures and create expectations of lower inflation in 2005. In recognition that inflation expectations were higher than the authorities would have wished, the reference rate of the inflation-targeting system was revised from 4.5% to 5.1% in 2005. Interest rate hikes continued until May 2005, when the rate reached 19.75%.

A credit expansion that started in the second half of 2003 contributed to economic growth in 2004, by financing household consumption in particular. Total credit grew by more than 10% in real terms following a flat performance in 2003; personal loans expanded by a real 19% and business loans, by 8% in real terms following a real contraction of almost 9% in 2003. Loans extended for housing and agriculture and credits provided by the National Bank for Economic and Social Development (BNDES) increased by only 2.7% in real terms.

Among personal loan instruments, there was a sharp rise in loans directly secured by wages and deducted from the payroll. Such operations, which were introduced in 2003, accounted for one third of personal lending by April 2005, following a nominal expansion of 110.9% in the preceding 12 months. Even with the rise in interest rates, credit for the purchase of consumer durables, especially automobiles, continued to expand and recorded a nominal expansion of 28% up to April 2005. Households have taken advantage of the broader credit facilities and lower interest rates to take out loans not only for consumption purposes, but also to pay off former credit obligations incurred under less favourable circumstances, which has kept the level of lending arrears stable.

The resources for this lending boom were provided by an expansion in the money supply. After recording a 1.7% nominal rise in 2003, M1 increased by 16.7% in 2004, owing to a policy of purchasing public securities in open-market operations. The main purpose of this policy was to bring the proportion of exchange-rate-linked securities to less than 10% of the total in December 2004

Table 1

BRAZIL: MAIN ECONOMIC INDICATORS

	1996	1997	1998	1999	2000	2001	2002	2003	2004 [a]
	Annual growth rates [b]								
Gross domestic product	2.7	3.3	0.1	0.8	4.4	1.3	1.9	0.5	4.9
Per capita gross domestic product	1.1	1.7	-1.4	-0.7	2.8	-0.2	0.5	-0.9	3.4
Gross domestic product, by sector									
Agriculture, livestock, hunting, forestry and fishing	3.1	-0.8	1.3	8.3	2.2	5.8	5.5	4.5	5.3
Mining	7.5	5.5	8.6	5.9	10.5	3.2	6.2	3.3	-0.7
Manufacturing	2.1	2.9	-3.5	-2.5	5.1	0.4	3.2	0.6	7.7
Electricity, gas and water	6.0	5.9	5.2	1.4	4.2	-5.6	3.0	2.7	4.6
Construction	5.2	7.6	1.5	-3.7	2.6	-2.7	-1.8	-5.2	5.7
Wholesale and retail commerce, restaurants and hotels	1.8	3.0	-4.7	-0.6	4.5	0.5	-0.2	-1.8	7.9
Transport, storage and communications	5.5	4.3	0.9	4.0	8.6	5.8	6.5	1.6	3.5
Financial institutions, insurance, real estate and business services	2.8	3.1	1.9	1.9	4.3	1.9	1.7	0.8	3.5
Community, social and personal services	1.3	1.0	2.1	2.1	1.8	0.9	0.2	1.2	5.6
Gross domestic product, by type of expenditure									
Consumption	3.1	2.9	-0.0	0.3	3.2	0.6	-2.5	-0.8	3.0
General government	1.4	2.1	2.4	2.4	1.3	1.0	1.4	1.3	0.1
Private	3.7	3.1	-0.8	-0.4	3.8	0.5	-0.4	-1.5	4.1
Gross domestic investment	2.8	8.3	-0.6	-7.6	10.0	-1.1	5.3	-2.4	10.9 [c]
Exports (goods and services)	0.6	11.1	3.7	9.2	10.6	11.2	7.9	9.0	18.0
Imports (goods and services)	5.4	17.8	-0.3	-15.5	11.6	1.2	-12.3	-1.7	14.3
	Percentages of GDP								
Investment and saving [d]									
Gross domestic investment	20.9	21.5	21.1	20.2	21.5	21.2	19.8	19.8	21.3
National saving	17.9	17.7	16.8	15.4	17.5	16.6	18.1	20.6	23.2
External saving	3.0	3.8	4.3	4.7	4.0	4.6	1.7	-0.8	-1.9
	Millions of dollars								
Balance of payments									
Current account balance	-23 248	-30 491	-33 829	-25 400	-24 225	-23 215	-7 637	4 177	11 669
Merchandise trade balance	-5 453	-6 652	-6 603	-1 261	-698	2 650	13 121	24 794	33 693
Exports, f.o.b.	47 851	53 189	51 136	48 011	55 086	58 223	60 362	73 084	96 475
Imports, f.o.b.	53 304	59 841	57 739	49 272	55 783	55 572	47 240	48 290	62 782
Services trade balance	-8 059	-9 309	-9 045	-6 983	-7 162	-7 759	-4 957	-4 931	-4 773
Income balance	-12 177	-16 344	-19 617	-18 844	-17 886	-19 743	-18 191	-18 552	-20 520
Net current transfers	2 441	1 814	1 436	1 688	1 521	1 638	2 390	2 867	3 268
Capital and financial balance [e]	31 930	22 240	17 527	8 635	32 206	19 764	-3 542	-451	-5 062
Net foreign direct investment	11 667	18 608	29 192	26 886	30 498	24 715	14 108	9 894	8 695
Financial capital [f]	20 263	3 632	-11 665	-18 251	1 708	-4 951	-17 650	-10 345	-13 757
Overall balance	8 682	-8 251	-16 302	-16 765	7 981	-3 450	-11 178	3 726	6 607
Variation in reserve assets [g]	-8 326	8 284	6 990	7 783	2 260	-3 307	-302	-8 496	-2 244
Other financing [h]	-356	-33	9 312	8 983	-10 242	6 757	11 480	4 769	-4 363
Other external-sector indicators									
Real effective exchange rate (index: 2000=100) [i]	71.2	69.9	72.3	108.0	100.0	119.7	130.5	130.6	124.6
Terms of trade for goods (index: 2000=100)	107.1	113.6	111.9	97.0	100.0	99.6	98.4	97.0	97.9
Net resource transfer (percentage of GDP)	2.5	0.7	0.9	-0.2	0.7	1.3	-2.2	-2.8	-5.0
Total gross external debt (billions of dollars)	180	200	224	226	217	210	211	215	201
Total gross external debt (percentage of GDP)	23.2	24.8	28.4	42.0	36.1	41.3	45.7	42.5	33.3
Net profits and interest (percentage of exports) [j]	7.6	10.3	11.0	9.3	6.6	7.4	8.5	7.2	6.3
	Average annual rates								
Employment									
Labour force participation rate [k]	59.6	58.5	58.2	57.1	58.0	56.4	56.7	57.1	57.2
Open unemployment rate [l]	5.4	5.7	7.6	7.6	7.1	6.2	11.7	12.3	11.5
Visible underemployment rate [l]	...	...	...	...	...	...	3.6	4.4	4.1

Table 1 (concluded)

	1996	1997	1998	1999	2000	2001	2002	2003	2004 [a]
	Annual percentages								
Prices									
Variation in consumer prices (December-December)	9.6	5.2	1.7	8.9	6.0	7.7	12.5	9.3	7.6
Variation in wholesale prices (IPA-DI) (December-December) [m]	8.1	7.8	1.5	28.9	12.1	11.9	35.4	6.3	14.7
Variation in nominal exchange rate (December-December)	7.2	7.4	8.2	52.9	6.5	20.4	53.4	-19.3	-7.1
Variation in average real wage	7.9	2.7	0.1	-4.5	-1.1	-4.9	-2.1	-8.8	0.7
Nominal deposit rate [n]	...	24.9	29.3	25.8	17.5	17.4	19.0	23.3	16.2
Nominal lending rate [o]	...	63.2	68.3	64.8	41.9	41.1	44.4	49.8	41.1
	Percentages of GDP								
Central government [p]									
Total income [q]	...	15.5	17.1	18.1	17.8	18.9	19.8	19.2	20.1
Total expenditure [r]	...	17.6	22.2	25.1	20.9	22.6	26.2	21.7	21.6
Primary balance [s]	0.4	-0.2	0.6	2.3	1.9	1.8	2.4	2.5	3.0
Overall balance [t]	-2.6	-2.6	-5.4	-6.8	-3.1	-3.7	-6.4	-2.5	-1.3
Central government debt	16.5	19.3	25.3	32.5	32.1	34.4	41.7	37.2	34.0
Domestic	14.9	17.3	21.1	23.9	24.3	25.7	27.0	26.9	26.9
External	1.6	2.0	4.2	8.5	7.8	8.6	14.7	10.3	7.1
Money and credit [u]									
Domestic credit [v]	42.4	43.7	45.6	62.0	65.5	66.4	64.7	64.4	67.0
To the public sector	10.0	13.0	12.5	28.5	32.7	32.1	31.1	31.7	34.5
To the private sector	32.4	30.7	33.1	33.5	32.8	34.3	33.6	32.7	32.5
Liquidity (M3)	24.7	25.5	28.5	25.5	23.2	23.4	24.9	24.0	23.6
Currency in circulation and local-currency deposits (M2)	22.7	23.8	26.9	26.7	24.2	24.2	25.9	25.1	24.7
Foreign-currency deposits	2.0	1.7	1.6	-1.2	-0.9	-0.8	-1.0	-1.1	-1.2

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.
[a] Preliminary figures. [b] Index based on the previous year's prices. [c] The figure for 2004 refers to gross fixed capital formation. [d] Based on figures in local currency expressed in dollars at current prices. [e] Includes errors and omissions. [f] Refers to the capital and financial balance (including errors and omissions), minus net foreign direct investment. [g] A minus sign (-) denotes an increase in reserves. [h] Includes the use of IMF credit and loans and exceptional financing. [i] Annual average, weighted by the value of merchandise exports and imports. [j] Refers to net investment income as a percentage of exports of goods and services as shown on the balance of payments. [k] Economically active population as a percentage of the working-age population; six metropoplitan areas. [l] Unemployment and underemployment rates as percentages of the economically active population; six metropolitan areas. [m] IPA-DI: wholesale price index (acronym in Portuguese). [n] Certificates of deposit. [o] Pre-set corporate rate. [p] Includes federal government and the central bank. [q] Refers to total income net of transfers to local governments. [r] Includes nominal interest payments. [s] Balance calculated "below the line". Figures from the Central Bank of Brazil. [t] Nominal. [u] The monetary figures are annual averages. [v] Refers to net credit extended to the public and private sectors by commercial banks and other financial and banking institutions.

and to 4.4% in April 2005 (such securities had accounted for more than a third of the total at the end of 2002).

(c) Exchange-rate policy

The real exchange rate continued to strengthen against the United States dollar in 2004 and the first few months of 2005, with a cumulative nominal appreciation of 12% between December 2003 and April 2005. This translated into a significant real appreciation in relation to Brazil's main trading partners: by April 2005, the real effective exchange rate calculated by ECLAC was 12% lower than the average for 2004.

Although the free float of the currency is one of the pillars of Brazil's macroeconomic policy, exchange-rate appreciation has generated reactions and expectations in terms of the impact on external trade and on the behaviour of investment. This prompted the central bank to intervene in the market in certain circumstances by buying foreign exchange. In effect, the bank purchased US$ 4 billion in January 2004, US$ 2.8 billion in December 2004 and US$ 9 billion in the first quarter of 2005. Gross international reserves thus swelled by some US$ 3.6 billion in 2004, to stand at US$ 52.9 billion in December. In May 2005, reserves stood at US$ 60.709 billion.

Table 2
BRAZIL: MAIN QUARTERLY INDICATORS

	2003				2004 [a]				2005 [a]	
	I	II	III	IV	I	II	III	IV	I	II
Gross domestic product (variation from same quarter of preceding year) [b]	1.5	0.0	-0.2	0.9	4.0	5.1	5.9	4.7	2.9	...
Merchandise exports, f.o.b. (millions of dollars)	15 045	17 957	19 788	20 294	19 448	17 269	26 972	26 197	24 451	29 226
Merchandise imports, f.o.b. (millions of dollars)	11 239	11 364	12 393	13 263	13 315	10 357	16 898	17 605	16 133	17 877
International reserves (millions of dollars)	42 335	47 956	52 675	49 296	51 612	49 796	49 503	52 937	61 960	59 885
Real effective exchange rate (index: 2000=100) [c]	148.0	127.2	124.3	124.4	125.2	129.6	125.0	118.8	113.8	106.4 [d]
Urban unemployment rate [e]	11.6	12.7	12.9	12.0	12.2	12.3	11.2	10.2	10.5	10.1
Consumer prices (12-month percentage variation)	16.6	16.6	15.1	9.3	5.3	6.1	6.7	7.6	7.5	7.3
Average nominal exchange rate (reais per dollar)	3.49	2.99	2.93	2.90	2.90	3.04	2.98	2.78	2.67	2.48
Average real wage (variation from same quarter of preceding year)	-7.1	-12.8	-11.3	-6.0	-1.8	1.5	0.8	2.2	-1.5	...
Nominal interest rates (annualized percentages)										
Deposit rate [f]	25.6	26.1	23.2	18.2	16.2	15.8	15.8	16.9	18.4	19.5
Lending rate [g]	52.5	53.0	49.6	44.1	42.2	41.2	40.3	40.7	43.0	44.4 [d]
Interbank interest rate [h]	25.7	26.2	23.3	18.3	16.3	15.8	15.9	17.0	18.5	19.5
Sovereign bond spread (basis points)	1 048	801	698	463	559	650	469	382	458	414
Stock price index (in dollars, December 2000=100)	53.9	66.6	78.3	105.9	104.5	92.6	116	142	147	155
Domestic credit (variation from same quarter of preceding year) [i]	13.2	15.1	16.6	23.0	20.4	19.0	16.0	15.0	17.9	19.0 [j]
Non-performing loans as a percentage of total credit [k]	4.3	4.5	4.7	4.2	4.1	3.8	3.6	3.6	3.7	3.6 [d]

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.
[a] Preliminary figures. [b] Index based on the previous year's prices. [c] Quarterly average, weighted by the value of merchandise exports and imports. [d] Data to May. [e] New methodology used as of the first quarter of 2002. Data not comparable to previous figures. [f] Cumulative monthly rate on certificates of deposit. [g] Pre-set corporate rate. [h] SELIC (Special System for Settlement and Custory) rate. [i] Refers to net credit extended to the public and private sectors by commercial banks and other financial and banking institutions. [j] Data for April. [k] Refers to total credit extended by the banking system.

3. The main variables

(a) Economic activity

Gross domestic product grew by 4.9%, led by commerce (7.9%), manufacturing (7.7%) and construction (5.7%). Agricultural activity continued to expand (5.3%), as in the last seven years. Communications, however, which has been one of the most dynamic sectors in recent years, recorded a fall in value added for the first time in two decades (-1.4%). The mining sector showed flat growth (0.7%), owing to difficulties in bringing new areas of oil production into operation.

The leading components of demand in 2004 were investment and household consumption, which expanded by 10.9% and 4.5%, respectively, together with a sharp increase in export volumes (18%). The two first aggregates had declined in recent years: in the category of investment, gross fixed capital formation fell by 8.1% in the period 2000-2003, while household consumption fell by 1.8% between 2001 and 2003.

In 2005, first-quarter growth of 0.3% with respect to the last quarter of 2004 has generated expectations of slower expansion for the year overall. Adverse weather conditions, especially the drought in the south of the country, will hurt agriculture, while higher interest rates will have a negative impact on manufacturing.

Investment indicators have become a source of concern. In the early months of 2005, the business confidence index published by the National Confederation of Industry showed levels below those of the last quarter of 2004. In addition, data supplied by the National Bank for Economic and Social Development (BNDES) reflected a more cautious stance on investment decisions, with a nominal expansion of 9% in financing in the first five months of 2005 with respect to the year-earlier period.

(b) Prices, wages and employment

In 2004, inflation stood at 7.6% (IPCA), which was close to the ceiling of the 2.5 percentage-point allowable deviation from the target of 5.5%. In 2003, the annual rate of inflation had reached 9.3% and in 2002, 12.5%, exceeding the original targets in each case.

The absence of a more substantial drop in inflation may be attributed, on the one hand, to the persistence of forms of indexation that have generated greater pressure on price adjustment contracts for regulated services, such as electricity and telephones, and, on the other, to higher prices for industrial products, whose wholesale prices increased by 19.5% in 2004, compared with a 6.9% variation in 2003. Agricultural prices helped to counteract these pressures: wholesale agricultural prices over the year showed a variation of around -2.7%.

In the first few months of 2005, inflation tended to converge with the targets set by the government (5.1%, with a deviation of 2.5% in either direction). In May, the 12-month IPCA showed a variation of 8.1%. Exchange-rate appreciation and the slowdown in economic activity, however, may help to lower inflation over the rest of the year. In May, the wholesale indexes showed a monthly deflation that encompassed the general index (almost 1.0%), agricultural prices (2.8%) and, especially, industrial prices (0.4%).

The favourable trend in economic activity has boosted labour markets. In 2004, the rate of unemployment in the main metropolitan regions was 11.5% on average, down from 12.3% in 2003. Employment rose in the formal market (6.6%), with more than 1.5 million jobs created, especially in the manufacturing industry, which accounted for more than 500,000 of these new posts (a 9.4% expansion). Much of the overall increase in formal employment was observed outside the metropolitan areas, where 546,000 new jobs were created. Indicators for 2005 continue to confirm the rise in employment, with a net generation of 558,000 new posts up to April.

The minimum wage increased in real terms by 3.8% as an annual average, maintaining the gains made in its purchasing power, which has accumulated a real variation of 50% since 1995. In May 2005, the authorities raised the minimum wage by a nominal 15%. Real average income in metropolitan areas improved for the first time since 1997, by 2%.[3]

(c) The external sector

As in the last two years, the external accounts continued to show a favourable balance. In the first four months of 2005, the value of exports amounted to US$ 33 billion, while imports totalled US$ 21 billion. In the 12 months to April, exports exceeded US$ 104 billion, while imports posted a value of over US$ 66 billion. The resulting surplus, of US$ 38 billion, is the highest among all the emerging economies in this period.

Exports expanded by 29% in the first four months of 2005, with respect to the same period of 2004, while imports were up by 20% in this period. The expansion in exports has not only outstripped growth in imports, but has coincided with a higher level of activity and a real appreciation of the local currency. The increase in the value of exports was driven mainly by a sharp expansion in volumes (17% in the first four months of 2005 compared with the year-earlier period). Industrial manufactures were strong contributors to this trend, with manufactures and semi-manufactures up 21.7%and 11.7%, respectively, in volume and 1.3% and 20.5%, respectively, in price.

In 2004, sharp increases were recorded in both exports and imports (30.1%) of goods. Merchandise exports jumped by 32%, reflecting a rise in prices (18.3% for commodities and 14.5% for semi-manufactures) and volumes (19.2%), particularly in the case of manufactures (26.1%). The rate of expansion of exports is expected to slow, however, given the continued appreciation of the real, the slower pace of world economic growth, weaker international prices for a number of agricultural commodities and the indicators available for some categories of manufacturing.

Import figures reflect the impact of the higher cost of petroleum imports, which soared by 19% in the first four months of 2005. Imports of capital and intermediate goods imports were also up (20.9% and 18.2%, respectively). Currency appreciation may encourage an increase in imports, especially of consumer goods, which in 2004

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[3] Refers to the real average income regularly received by employees in six metropolitan areas.

grew by 17% in value, accounting for close to 8.4% of total imports. From January to April 2005, the import value of consumer goods increased by 24.4% compared with the same period of 2004.

The current-account balance totalled US$ 3.45 billion (1.5% of GDP) in the first four months of 2005. The figure for the 12 months to April 2005 is the highest since 1947 (2.2% of GDP) and reflects mainly the large trade surplus (US$ 12 billion), which offset a deficit of US$ 9 billion on the services and income accounts.

In 2004, the balance-of-payments capital and financial accounts yielded a negative balance of US$ 7.4 billion, owing in part to a reduction in private-sector liabilities abroad, and just over 50% of the private bonds that matured during the year were renewed. Approximately 60% of private bonds maturing in the first four months of 2005 were renewed. Net foreign direct investment stood at US$ 8.7 billion in 2004, reflecting an exceptional outflow of Brazilian investments, including inter-company loans to the tune of US$ 9.5 billion, in the wake of mergers in a variety of sectors, particularly food and beverages.

The capital and financial balance showed a net inflow of US$ 5.7 billion in the first four months of 2005. For the first time since January 2004, direct investments, portfolio investments and other foreign investments recorded a positive net balance. This was due largely to interest arbitrage transactions, the procurement of credit lines for forward exchange transactions and the establishment of interbank credit lines with banks outside the country, also associated with arbitrage transactions. Portfolio investments performed well, moving from a net deficit of US$ 2.2 billion between January and April 2004 to a positive balance of US$ 2.6 billion in the same period of 2005. After recording an overall surplus of US$ 2.2 billion in 2004, the balance of payments stood at US$ 9.9 billion in the first four months of 2005.

Brazil's total external debt diminished by 6.3% in 2004, to stand at US$ 201.7 billion at the end of December. This drop, together with the external sector results, boosted Brazil's net borrowing indicators; bearing in mind the level of international reserves, the ratio of net debt to exports fell to 1.54, which compares with 3.94 at the end of 1999.

Chile

1. General trends

Chile's economy expanded by 6.1% in real terms in 2004, amply outstripping the rates of 2.2% and 3.7% posted in 2002 and 2003, respectively. This performance was mainly thanks to the buoyancy of exports, which surged by 48.8%, and gross domestic investment, which posted the highest growth rate seen in nine years (16.1%). GDP is expected to grow around 6% in 2005.

The upswing in exports in 2004 came about in a context of international economic expansion and an upturn in the prices of raw materials, including copper. For the first time in five years, the balance-of-payments current account closed with a surplus, amounting to 1.5% of GDP.

The central government's overall balance posted a surplus of 2.2% of GDP while its external debt eased down from 13.1% of GDP in 2003 to 10.8% in 2004. Inflation came in at 2.4%, within the limits of the central bank's target band.

Hourly wages went up by 1.8% on average last year. The revival of economic activity pushed the labour force participation rate up 0.3 percentage points in 2004, while unemployment edged up from 8.5% to 8.8%.

2. Economic policy

In 2004, economic policy continued to be geared to maintaining price stability and fiscal equilibrium, improving the fiscal accounts in the medium term and consolidating Chile's position in the international markets.

The central bank continued to use its inflation-targeting scheme to maintain price stability. The fiscal authorities maintained the self-imposed requirement of an overall surplus equivalent to 1% of GDP on the central government's accounts. The international context of low interest rates, combined with low country risk, provided some leeway which the government used to restructure the external public debt and the burden thereof, thus steepening the downward trend of this debt item.

The government hopes that the signature of trade accords in the last two years with the United States, the European Union and the Republic of Korea will boost the potential of Chile's export sector.

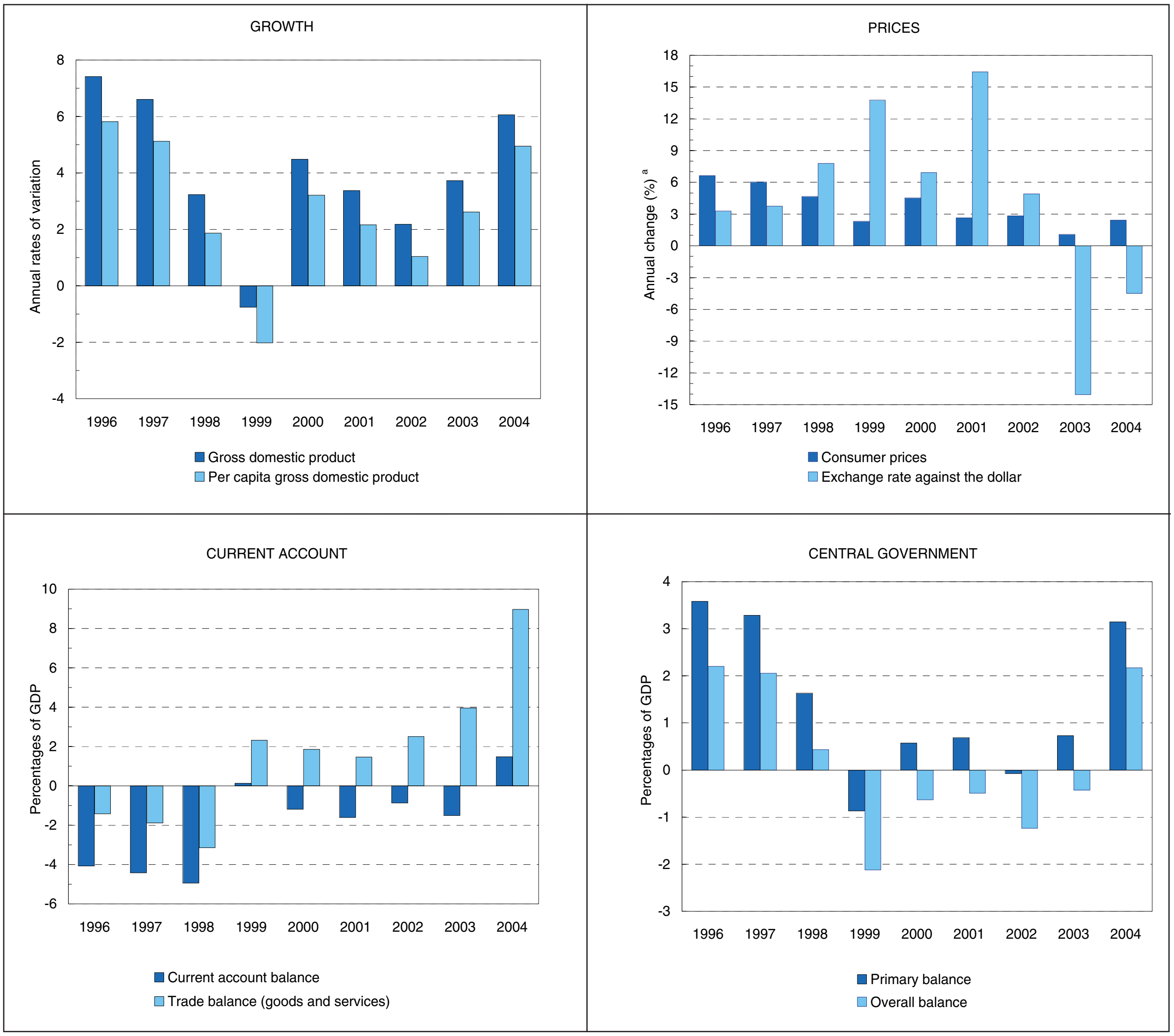
The thrust of economic policy is expected to remain unchanged in 2005. It appears that the fiscal rule will be maintained: although parliamentary and presidential elections are due this year, the leading presidential candidates have declared that they would retain this policy if elected.

(a) Fiscal policy

The public sector deployed its financial strategy on two fronts in the reporting period: one short-term, focused on budget design and implementation, and another medium-term, involving the restructuring of external public debt.

With regard to the budget, for the fifth consecutive year the government enforced its rule requiring a structural surplus of 1% of GDP per year. The central government's overall surplus (calculated on an accrual basis, as established in 2003) was 2.2% of GDP in 2004, compared to a deficit of 0.4% the previous year. Current spending by the central government decreased from 18.1% in 2003 to 17.0% in 2004, while capital spending again dropped slightly, from 3.3% to 3.1% of GDP.

Figure 1
CHILE: MAIN ECONOMIC INDICATORS



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

The government took advantage of propitious external conditions, including low interest rates and relatively low country risk, to improve the structure of the external public debt burden. In January 2004, a new sovereign bond was issued for US$ 600 million, with a spread of 43 basis points over the LIBOR rate, and the proceeds went to pre-pay older debts incurred at higher rates of interest. The outcome of these strategies, combined with scheduled payments, was a drop from 5.6% to 4.8% of GDP in the central government's external debt, in a trend which appears likely to continue in 2005.

The budget law for 2005 proposes to reduce public indebtedness by means of US$ 1.567 billion in scheduled amortizations. Indeed, the central government's gross financial debt declined to 10.9% of GDP in December 2004. The consolidated figure for this debt together with the central bank's liabilities represents 29.2% of GDP, which is lower than the 33.7% of GDP recorded in 2003.

In 2004 Chile's budget was prepared for the first time on an accrual basis, meaning that any economic operation carried out by the government is recorded at the time a payment obligation is incurred (i.e., when a good is delivered, a service is provided or work is performed). In addition, the budget includes income and expenditure under the copper reserve law and the provisions of the petroleum stabilization fund. Up until this system came into operation, the government's practice had been to record operations at the time when it made the relevant payments (cash basis).

(b) Monetary and exchange-rate policy

Prices rose by 2.4% in 2004, well within the inflation target range of 2% to 4% set by the central bank. In 2003 the rate of inflation had been 1.1%, beneath the floor level of the band, and the trend in the early months of 2005 suggests that it will come in at between 2% and 3% at the end of the year.

Low inflation and the enforcement of the fiscal rule have afforded more room for manoeuvre to the central bank, which was thus in a position to lower the monetary policy interest rate during the low-growth years up to and including 2003, and raise it again from September 2004 onward. One factor constraining the central bank's strategy on interest rate rises was the sluggish performance of employment, which has lagged behind the main economic variables. Wage employment figures began to take a turn for the better from the third quarter on, however.

The central bank's rate-cutting policy began in January 2002, starting from a nominal annual rate of 6.5%, and entailed a series of reductions that brought the rate to 3% in August 2002. The absence of inflationary pressures made it possible to lower the interest rate steadily in the course of 2003, from 3.0% in December 2002 to 1.75% in February 2004, and to keep it at that level in the subsequent months. The reversal of this trend began in September 2004, when the interest rate rose to 2.0%, and continued with further hikes approximately every two months, bringing the rate to 3.25% in May 2005.

In real terms, the monetary policy rate established by the central bank, which was barely positive at the end of 2003 and turned negative in 2004, became slightly positive again in 2005.

The higher demand for real monetary balances continued to be evident in 2004. The year-on-year variation in the private money supply (M1A) between December 2003 and December 2004 was 19.8% in real terms, which was higher than the variation of 15.1% recorded in 2003, when inflation was 1.1%. Notes and coins in circulation rose by 12.5% in real terms in 2004, compared to only 4.1% the previous year, and the rate of one- to three-year deposits reached a nominal annual rate of just 3.16%.

The average interest rate on local-currency loans (with terms of between 90 days and a year) fell from 13.0% in December 2003 to 10.8% in December 2004, then rose to 13.6% in April 2005.

Bank credit increased by 13% in December 2003, then by 6.3% up to April 2005. The banking system reduced the level of non-performing loans from 1.6% in December 2003 to 1.2% in December 2004, where it remained until March 2005.

A combination of factors were implicated in the appreciation of the Chilean peso in 2004: an improvement of the situation in Argentina, good expectations in Brazil and, at the end of the year, a larger inflow of dollars on the back of higher copper prices, increased profits from exports and inflows of financial capital attracted by a boom in the stock market. In parallel to all this, foreign direct investment has continued to climb steadily.

The drop in the nominal exchange rate hurt exporters, and the central bank was obliged to account for its decision not to intervene in the currency market while the peso was strong, but to reserve its intervention options for times of exchange-rate surges (such episodes had occurred in response to expectations of a crisis in Argentina in 2001 and uncertainty over the Brazilian real in 2002).

In the second half of 2004 and the early months of 2005 the exchange rate remained at appreciated levels, with parities of less than 600 pesos to the dollar, since exports continued to generate foreign currency and international conditions remained favourable.

The average real effective exchange rate index dipped 6.67% in 2004 with respect to 2003, which is attributable to the fact that the peso has appreciated against the United States dollar and against other currencies that behaved in a similar fashion (including the yuan), but has not risen in value relative to the euro.

(c) Trade policy

The signature of trade agreements with the United States, the European Union and the Republic of Korea raised expectations of more stable trade with those countries and areas. Chile now faces new challenges in realizing the potential of those accords, as well as the free trade agreements with India and China that the government hopes to sign shortly. Such challenges include proper training, the implementation of quality standards in national production, the achievement of more efficient production and the adoption of effective marketing mechanisms. These agreements are therefore particularly significant for the Chilean economy, in which exports account for a third of GDP, making growth prospects highly dependent on world economic trends and on domestic policies that affect the profitability of external sales.

Table 1

CHILE: MAIN ECONOMIC INDICATORS

	1996	1997	1998	1999	2000	2001	2002	2003	2004 [a]
				Annual growth rates [b]					
Gross domestic product	7.4	6.6	3.2	-0.8	4.5	3.4	2.2	3.7	6.1
Per capita gross domestic product	5.8	5.1	1.9	-2.0	3.2	2.2	1.0	2.6	4.9
Gross domestic product, by sector									
Agriculture, livestock, hunting, forestry and fishing	2.8	3.4	2.3	0.8	6.6	7.5	6.8	0.7	10.3
Mining	15.8	11.3	8.3	10.6	3.2	5.7	-4.2	5.0	6.9
Manufacturing	3.2	4.7	-2.3	-0.5	4.9	0.6	1.9	3.1	6.9
Electricity, gas and water	-3.8	8.3	4.4	-4.7	9.5	1.5	3.3	3.8	3.8
Construction	8.6	6.3	1.9	-9.9	-0.7	4.1	2.5	4.5	5.0
Wholesale and retail commerce, restaurants and hotels	9.5	7.6	3.5	-4.4	4.4	2.6	0.9	4.8	6.8
Transport, storage and communications	10.2	10.9	6.6	0.8	8.6	7.4	5.3	5.1	4.6
Financial institutions, insurance, real estate and business services	6.1	5.9	5.0	0.5	4.0	3.0	2.8	2.8	4.6
Community, social and personal services	4.6	4.8	2.7	1.8	3.0	2.8	2.5	3.0	3.6
Gross domestic product, by type of expenditure									
Consumption	8.8	6.5	4.3	-0.4	3.6	2.9	2.5	3.9	5.2
General government	4.0	5.8	2.3	2.7	3.0	2.9	3.1	2.4	3.0
Private	9.4	6.6	4.7	-1.0	3.7	2.9	2.4	4.1	5.6
Gross domestic investment	5.9	9.4	2.2	-20.1	14.0	0.8	2.2	7.8	16.1
Exports (goods and services)	11.8	11.2	5.2	7.3	5.1	7.2	1.6	5.9	12.8
Imports (goods and services)	11.8	13.2	6.7	-9.5	10.1	4.1	2.3	9.5	18.6
				Percentages of GDP					
Investment and saving [c]									
Gross domestic investment	27.4	27.7	26.9	20.9	21.9	22.1	21.7	22.0	21.7
National saving	23.3	23.3	22.0	21.0	20.7	20.5	20.8	20.5	23.2
External saving	4.1	4.4	4.9	-0.1	1.2	1.6	0.9	1.5	-1.5
				Millions of dollars					
Balance of payments									
Current account balance	-3 083	-3 660	-3 918	99	-898	-1 100	-580	-1 102	1 390
Merchandise trade balance	-1 072	-1 428	-2 040	2 427	2 119	1 844	2 386	3 522	9 019
Exports, f.o.b.	16 627	17 870	16 323	17 162	19 210	18 272	18 180	21 524	32 025
Imports, f.o.b.	17 699	19 298	18 363	14 735	17 091	16 428	15 794	18 002	23 006
Services trade balance	-1	-136	-452	-737	-719	-844	-701	-617	-580
Income balance	-2 518	-2 617	-1 889	-2 233	-2 856	-2 526	-2 847	-4 606	-8 101
Net current transfers	508	520	462	643	558	427	583	599	1 051
Capital and financial balance [d]	5 677	6 979	1 727	-846	1 234	504	779	737	-1 580
Net foreign direct investment	3 681	3 809	3 144	6 203	873	2 590	2 207	2 501	6 660
Financial capital [e]	1 995	3 170	-1 417	-7 049	361	-2 086	-1 428	-1 765	-8 240
Overall balance	2 594	3 318	-2 191	-747	337	-596	199	-366	-191
Variation in reserve assets [f]	-1 119	-3 318	2 191	747	-337	596	-199	366	191
Other financing [g]	-1 475	0	0	0	0	0	0	0	0
Other external-sector indicators									
Real effective exchange rate (index: 2000=100) [h]	97.1	90.8	92.5	98.2	100.0	111.2	109.1	114.5	106.9
Terms of trade for goods (index: 2000=100)	89.4	94.5	91.0	94.2	100.0	93.3	97.2	102.8	124.9
Net resource transfer (percentage of GDP)	2.2	5.3	-0.2	-4.2	-2.2	-2.9	-3.1	-5.3	-10.3
Total gross external debt (millions of dollars)	26 272	29 034	32 591	34 758	37 177	38 538	40 675	43 396	43 764
Total gross external debt (percentage of GDP)	34.7	35.1	41.1	47.6	49.4	56.2	60.5	59.1	46.5
Net profits and interest (percentage of exports) [i]	9.4	10.0	6.9	7.0	10.9	10.0	10.8	17.4	21.2
				Average annual rates					
Employment									
Labour force participation rate [j]	54.2	54.2	54.4	54.4	53.7	52.9	52.5	52.9	53.2
Open unemployment rate [k]	6.4	6.1	6.4	9.8	9.2	9.1	9.0	8.5	8.8
Visible underemployment rate [k]	3.8	5.2	4.0	4.9	5.4	6.4	5.6	5.9	7.6

Table 1 (concluded)

	1996	1997	1998	1999	2000	2001	2002	2003	2004 [a]
	Annual percentages								
Prices									
Variation in consumer prices (December-December)	6.6	6.0	4.7	2.3	4.5	2.6	2.8	1.1	2.4
Variation in wholesale prices (December-December)	3.1	1.9	0.3	13.5	7.9	3.1	10.4	-1.0	7.8
Variation in nominal exchange rate (December-December)	3.3	3.8	7.8	13.8	6.9	16.4	4.9	-14.1	-4.5
Variation in average real wage	4.1	2.4	2.7	2.4	1.4	1.7	2.0	0.9	1.8
Nominal deposit rate [l]	...	12.7	16.3	8.9	8.7	6.5	4.1	3.2	2.4
Nominal lending rate [l]	...	20.2	27.4	17.6	18.7	16.7	14.4	13.0	11.0
	Percentages of GDP								
Central government [m]									
Current income	21.8	21.6	21.1	20.4	21.6	21.8	21.1	20.9	22.3
Current expenditure	16.4	16.4	17.3	18.9	19.1	18.9	18.9	18.1	17.0
Gross operating balance	5.4	5.2	3.8	1.5	2.5	2.8	2.2	2.8	5.3
Net acquisition of non-financial assets	3.2	3.2	3.4	3.6	3.2	3.3	3.4	3.3	3.1
Primary balance	3.6	3.3	1.6	-0.9	0.6	0.7	-0.1	0.7	3.1
Overall balance	2.2	2.1	0.4	-2.1	-0.6	-0.5	-1.2	-0.4	2.2
Public debt	15.1	13.2	12.5	13.8	13.7	15.0	15.7	13.1	10.9
Domestic	10.9	10.0	9.3	9.8	10.0	10.4	10.0	7.6	6.0
External	4.2	3.2	3.2	4.0	3.6	4.5	5.7	5.6	4.8
Interest payments of NFPS (percentage of income)	6.4	5.7	5.7	6.2	5.6	5.4	5.5	5.5	4.4
Money and credit [n]									
Domestic credit [o]	60.4	63.6	64.0	67.2	66.6	68.9	70.8	72.2	72.4
To the public sector	-0.6	0.4	0.1	0.6	0.7	1.0	1.7	1.8	2.4
To the private sector	61.1	63.2	63.9	66.6	65.9	67.8	69.1	70.5	70.0
Liquidity (M3)	37.8	40.3	45.4	50.1	49.9	51.6	52.6	49.8	47.1
Currency in circulation and local-currency deposits (M2)	35.9	38.7	43.2	46.1	45.5	46.3	46.7	44.2	41.9
Foreign-currency deposits	1.9	1.6	2.3	4.0	4.4	5.3	5.9	5.6	5.1

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.
[a] Preliminary figures. [b] Based on figures in local currency at constant 1996 prices. [c] Based on figures in local currency expressed in dollars at current prices. [d] Includes errors and omissions. [e] Refers to the capital and financial balance (including errors and omissions), minus net foreign direct investment. [f] A minus sign (-) denotes an increase in reserves. [g] Includes the use of IMF credit and loans and exceptional financing. [h] Annual average, weighted by the value of merchandise exports and imports. [i] Refers to net investment income as a percentage of exports of goods and services as shown on the balance of payments. [j] Economically active population as a percentage of the working-age population; nationwide total. [k] Unemployment and underemployment rates as percentages of the economically active population; nationwide total. [l] Non-adjustable 90-360 day operations. [m] Reflects the new accounting methodology set out in the 2001 IMF manual. [n] The monetary figures are annual averages. [o] Refers to net credit extended to the public and private sectors by commercial banks and other financial and banking institutions.

3. The main variables

(a) Economic activity

Chile's GDP grew by 6.1% in real terms in 2004, driven by a 12.8% rise in exports and by domestic demand. This last item expanded by a substantial 7.9%, which was well above the rate of 4.8% posted in 2003 and represented a real leap relative to the growth rates in overall demand seen since 1999, which have all been closer to the 2003 figure. Within domestic demand, investment performed particularly well, with growth of 16.1%.

In 2004 profits from export activities began a pronounced upward trend, which carried over into 2005, thanks to an expansion in the volumes shipped and higher prices for copper and other export products. Terms of trade rose by 21.5% in the course of 2004.

The increased buoyancy of the export sector helped to push up domestic demand. In 2004 consumption by the private sector and central government rose 5.6% and 3.0%, respectively. The increase in investment, as noted earlier, was also a major contributing factor.

Table 2
CHILE: MAIN QUARTERLY INDICATORS

	2003				2004 [a]				2005 [a]	
	I	II	III	IV	I	II	III	IV	I	II
Gross domestic product (variation from same quarter of preceding year) [b]	3.9	4.1	4.1	2.8	4.7	5.3	7.0	7.3	5.7	6.1
Merchandise exports, f.o.b. (millions of dollars)	5 282	5 283	5 153	5 805	7 484	5 168	7 933	8 681	9 203	...
Merchandise imports, c.i. f. (millions of dollars)	4 556	4 847	4 901	5 078	5 404	3 849	6 624	7 113	7 298	5 260
International reserves (millions of dollars)	16 499	15 490	15 655	15 851	15 965	15 853	15 843	16 016	15 380	17 253
Real effective exchange rate (index: 2000=100) [c]	117.8	118.0	115.5	107.1	103.3	109.1	109.0	106.4	106.7	106.3 [d]
Unemployment rate	8.2	9.1	9.4	7.4	8.1	9.6	9.7	7.8	7.9	...
Consumer prices (12-month percentage variation)	4.5	3.6	2.2	1.1	-0.7	1.1	1.4	2.4	2.4	2.7
Average nominal exchange rate (pesos per dollar)	737	710	693	625	587	629	628	593	579	581
Average real wage (variation from same quarter of preceding year)	0.2	0.0	1.0	2.4	3.1	2.5	1.3	0.4	1.2	1.8
Nominal interest rates (annualized percentages)										
Deposit rate [e]	3.1	3.2	3.4	3.2	2.2	2.2	2.3	2.9	3.6	4.5
Lending rate [e]	13.3	12.5	13.0	13.0	11.0	10.6	11.2	11.1	12.2	13.8
Interbank interest rate	2.7	2.7	2.7	2.7	1.8	1.7	1.8	2.2	2.7	3.2
Sovereign bond spread (basis points)	195	162	133	121	127	118	97	...	...	...
Stock price index (in dollars, December 2000=100)	80.7	100.8	126.3	145.9	142.3	138.2	154.8	176.9	177.2	184.2
Domestic credit (variation from same quarter of preceding year) [f]	8.4	13.9	11.9	11.7	11.0	10.9	16.9	17.8	19.3	...
Non-performing loans as a percentage of total credit [g]	1.9	1.9	1.8	1.6	1.6	1.5	1.4	1.2	1.2	1.2 [h]

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.
[a] Preliminary figures. [b] Based on figures in local currency at constant 1996 prices. [c] Quarterly average, weighted by the value of merchandise exports and imports. [d] Data to May. [e] Non-readjustable 90-360 day operations. [f] Refers to net credit extended to the public and private sectors by commercial banks and other financial and banking institutions. [g] Refers to total credit extended by the banking system. [h] Data for April.

Two sectors to perform particularly well in 2004 were agriculture, with growth of 10.3%, and manufacturing, both of which posted the highest rates of expansion for the last nine years. In another prominent development, the construction sector expanded by 5% —the highest rate since 1997— fuelled by infrastructure investment programmes and an upturn in the real estate segment. Manufacturing was up 6.9% in 2004, compared to 3.1% in 2003. The industrial production index was 10.2% higher than in 2003, and the supermarket sales index displayed a real variation of 7.6% in 2004 in relation to the previous year.

If the current international conditions continue and no major turnarounds occur, the Chilean economy should grow by around 6% in 2005. The main external source of difficulties could, potentially, be a correction of the disequilibria in the United States economy, which would devalue the currency, push up interest rates and trigger fresh hikes in petroleum prices.

(b) Prices, wages and employment

Inflation came in at 2.4% in 2004, which was within the limits of the central bank's target range of 2% to 4%. Underlying inflation amounted to an average of 0.9%, and the wholesale price index showed an average increase of 2.5% in the 12 months up to December 2004, while the consumer price index rose by 2.9% in the 12 months ending in April 2005. Also in April, underlying inflation rose to 2.0% and wholesale price inflation, to 8.0%. The central bank has estimated that the inflation rate will be

2.8% in the 12 months up to December 2005, and will vary between 3% and 3.5% in the subsequent 12 months.

In 2004 real hourly wages increased by an average of 1.8% relative to 2003. Despite the upturn in economic activity, unemployment rose from 8.5% in 2003 to 8.8% in 2004, which kept it above the pre-1999 level. This reflected the fact that, in response to economic expansion, the labour force participation rate increased from 52.9% to 53.2% in the same period, thus outstripping the employment rate, which rose by only a tenth of a percentage point on average over the year.

Job creation picked up at the end of the year, bringing the employment rate up from 49.2% in the last quarter of 2003 to 50.0% in December 2004 and boosting the employed population by 3.3% over that period. The sectors with the highest rates of job creation were construction (10.7%), commerce (5.7%) and financial services (4.2%), contrasting with the transport sector, where this variable recorded a contraction.

The government in office has continued to support the most vulnerable sectors of the population through employment schemes and the *Chile Solidario* (Solidarity Chile) programme, and has systematically expanded the coverage of pre-school education in the last five years.

(c) The external sector

The value of goods exports showed an expansion of 48.8% in 2004, far outstripping of the 18.4% increase seen in 2003. The current account recorded a surplus of US$ 1.39 billion (1.5% of GDP) and the trade balance (f.o.b.) exceeded US$ 8.4 billion. The value of exports expanded by 88.5% in the mining sector, by 25.9% in manufacturing and by 12.6% in agriculture, livestock, forestry and fishing. Imports grew 27.8%, with imports of fuels and lubricants rising 41.8%. Imports of capital goods rose 28.3% and consumer goods imports climbed 25.9%.

The merchandise trade surplus widened from US$ 3.522 billion to US$ 9.019 billion, but this was offset by a US$ 8.1-billion deficit on the factor income account. The current account turned in a surplus of US$ 1.39 billion and the balance of payments shows a deficit of US$ 191 million (0.2% of GDP).

Growth in the value of exports accelerated in the early months of 2005, sharpening the steady uptrend carried over from 2004, chiefly because of rises in the prices of export products. In 2005 the merchandise trade balance is expected to differ little from the 2004 figure, at US$ 9.3 billion, and the current-account balance should be equivalent to 0.7% of GDP.

International reserves increased from US$ 15.851 billion in December 2003 to US$ 16.016 billion the following December and US$ 17,053,900,000 in April 2005.

External debt declined from 58.7% to 46.4% of GDP, partly thanks to the appreciation of the peso against the United States dollar, and the debt ratio of both public and private sectors deceased.

Colombia

1. General trends

In 2004 the Colombian economy turned in a real GDP growth rate of 4.1%, which was similar to the figure observed in 2003. Private investment and exports were the main drivers of growth. Both unemployment and inflation trended downwards and interest rates were low and steady. Market liquidity and credit availability were at acceptable levels. The peso rose in value in 2004 after having depreciated sharply between June 2002 and March 2003. Fiscal policy continued to dominate the agenda, while the balance on the public accounts improved. International conditions provided a boost to economic activity, thanks to growth in global demand, an upswing in the Bolivarian Republic of Venezuela, higher commodity prices and larger capital inflows.

The signs are that growth will continue at a similar rate in 2005. Investment will continue to climb rapidly, owing to an upturn in public works; consumption will rise thanks to positive developments in the labour market and the buoyancy of activity in the coffee-growing areas; and inflation will continue to decline. The government projects a growth rate of 4.0%, a current-account deficit of 1.4% of GDP, a fiscal deficit of 2.5% and an inflation rate of 5%.

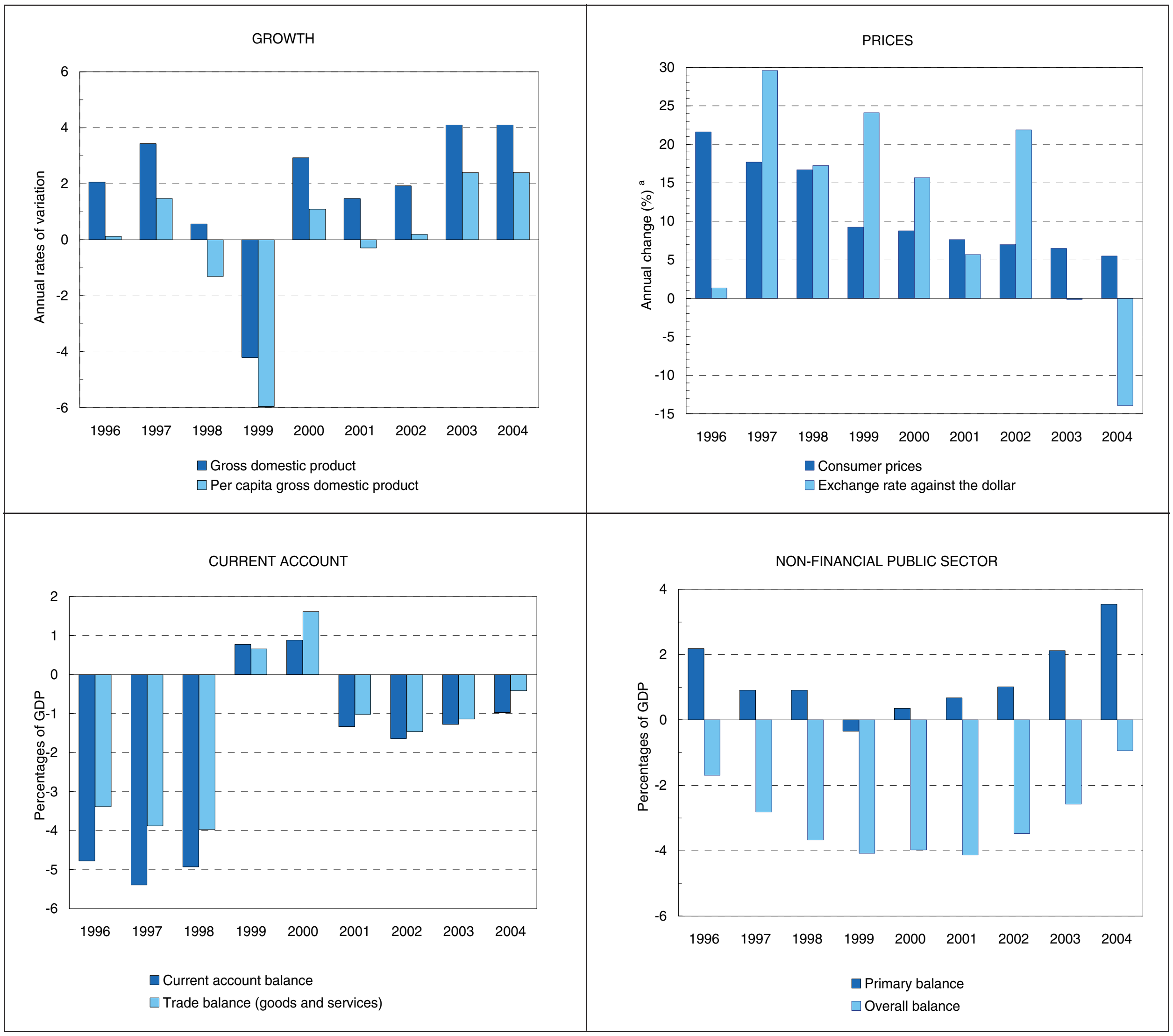
2. Economic policy

Economic policy has been geared towards boosting growth and reducing unemployment, while safeguarding the achievements with respect to macroeconomic stabilization. The good performance of inflation allowed the central bank to keep its benchmark interest rates low, which helped to fuel domestic demand. The central bank intervened in the foreign-exchange market in order to halt the appreciation of the peso and maintain export competitiveness. Colombia's high level of indebtedness means that the fiscal situation continues to be difficult, even though the country met its fiscal deficit targets comfortably.

(a) Fiscal policy

Fiscal affairs went favourably in 2004, on the back of the economy's good performance. The consolidated public sector deficit came in at 1.2% of GDP, lower than the target of 2.5% agreed upon with IMF. The central government's deficit was 5.6% of GDP and the decentralized sector returned a surplus of 4.2%, with this last result reflecting the departmental and municipal authorities' spending of a relatively small proportion of the resources budgeted, as well as the accumulation of resources in the Petroleum Stabilization Fund, thanks to the high price of petroleum.

Figure 1
COLOMBIA: MAIN ECONOMIC INDICATORS



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

The central government's deficit not only came in high, but is showing a tendency to increase, while expenditures continue to mount. Revenues represented 16% of GDP, which was one percentage point higher than in 2003. This rise was mainly a result of an increase in tax income, particularly receipts from domestic activity, with income tax being the main contributor in this category. Prominent on the spending side is growth in transfers and pensions, reflecting the structural problem in central government's finances. The authorities made prepayments on costly external debt with a view to reducing future expenditure. In addition, Congress approved a pension system reform which eliminated special pension regimes and the system known as "mesada 14" (which provided two additional months of pension payments annually) for future pensioners; brought forward the entry into force of the 1993 law 100 provisions from 2014 to 2010; set a cap of 25 times the minimum wage on pensions; and prohibited workers from securing better retirement conditions than the general regime through collective agreements. The fiscal impact of this reform is expected to represent a saving equivalent to 18% of GDP in 2005.

The government is expected to submit a fresh proposal on the basic budget law, which would be crucial to the achievement of the fiscal targets. Still to be considered are initiatives on reforms to the tax structure and to territorial transfers.

The net debt of the non-financial public sector amounted to 46.6% of GDP in December 2004, which was a lower figure than was recorded at the end of 2003 (51%). The government has been making efforts to swap net external for net domestic credit. The central government's debt came down from 54.7% of GDP in 2003 to 51.6% in 2004, with domestic debt representing 30.8% of GDP and external debt, 20.8%. The external component of public debt declined from 46% in 2003 to around 40% in 2004, with much of this drop being attributable to the appreciation of the Colombian peso.

IMF approved the government's macroeconomic programme and extended a new standby arrangement for 2005 and 2006, the main objectives of which are to reduce the fiscal deficit and bring down public debt. Colombia will have access to this credit in the event of difficulties in obtaining financing on international markets, but the authorities anticipate that, like in previous years, this will not be necessary.

According to government estimates, the consolidated public sector deficit will be equivalent to 2.5% of GDP in 2005; the decentralized sector's surplus, at 3.7%, will be smaller than in 2004 (4.2%); and the central government's deficit will be larger (6.1%, compared to 5.6% in 2004).

In the first quarter of 2005 the central government's deficit came in at 2.2% of GDP, thereby exceeding the figure seen in the same period of 2004 (1.7% of GDP), since growth of expenditure (22.8%) outpaced that of revenues (12%). Revenues increased by 3.6% of GDP, thanks to an expansion equivalent to 3.5% of GDP in tax receipts, especially from income and value added taxes. The rise in spending was accounted for by an increase of 41.4% in transfers, mainly for pension payments. Interest payments on the debt dropped by 8.2%, owing to the effect of exchange-rate appreciation on debt denominated in United States dollars.

(b) Monetary policy

The inflation trends both observed and projected in 2004 allowed the central bank to adopt a looser monetary stance. As a result, deposit and lending rates alike dropped in nominal terms. The benchmark rate decreased from 7.25% to 6.5% in 2004, following a drop of 50 basis points in the first quarter and a further 25-point dip in December. Real interest rates remained low in comparison with previous years. The real rate on deposits was 2.2% (12-month average) and the real lending rate amounted to 9.1%. The drop in interest rates on securities was a feature of the domestic public debt market throughout 2004.

M1 liquidity grew at a much faster rate than GDP, at an average annual rate of 15%, which was 1.6 percentage points lower than in 2003. Broad money (M3) expanded by 13%, exceeding the rate of 10.4% posted in 2003. The financial sector achieved faster growth and a better quality of loan portfolios, especially in business and consumer lending.

Annual growth in monetary aggregates picked up between December 2004 and June 2005. The rate of expansion of M1 increased from 16.8% to 17.4%, thanks to an increase in current accounts and cash; the rate for M3, meanwhile, rose from 16% to 18.5%.

The nominal deposit rate came down from 7.8% at the end of 2004 to 7.2% (representing a real rate of 2.2%) in May 2005, and the lending rate held steady at 15% (or a real rate of 9.5%). Consumer loans and micro-credit expanded strongly, by 31% and 53%, respectively.

(c) Exchange-rate policy

The Colombian peso appreciated in 2004, mainly because of an increase in net capital inflows (in the form of foreign direct investment and asset movements); an upturn in terms of trade; a rise in the volumes and values of exports; and higher remittances. In the course of the year the peso's average nominal exchange rate against the dollar decreased by 8.7% with respect to 2003. The real exchange rate index declined 10.5%, even though the monetary authorities took measures to slow the peso's appreciation. As part of this effort, they stepped up their purchases of foreign currency in the domestic market; slowed the rate of monetization of resources from external credit; required banks to provide more backing in dollars for their liabilities in that currency; lowered the cap on the permissible physical transport of dollars; suspended the purchase of notes from intermediaries in the foreign-exchange market and lowered the benchmark interest rate by 75 basis points.

In 2005 the central bank has continued to purchase dollars on a discretionary basis, in order to control the decline of the exchange rate. In June the exchange-rate regime was simplified and the liquidity supply made more transparent. In the first semester of 2005 the nominal exchange rate was about 2,350 pesos per dollar, which represented a 3% appreciation in the local currency with respect to December.

Table 1
COLOMBIA: MAIN ECONOMIC INDICATORS

	1996	1997	1998	1999	2000	2001	2002	2003	2004 [a]
	Annual growth rates [b]								
Gross domestic product	2.1	3.4	0.6	-4.2	2.9	1.5	1.9	4.1	4.1
Per capita gross domestic product	0.1	1.5	-1.3	-6.0	1.1	-0.3	0.2	2.4	2.4
Gross domestic product, by sector									
Agriculture, livestock, hunting, forestry and fishing	-1.2	0.7	0.0	0.0	3.9	-0.4	0.0	3.2	2.6
Mining	7.3	3.7	15.6	18.5	-10.3	-6.1	-2.4	13.3	2.9
Manufacturing	-1.9	0.4	-0.3	-8.4	11.7	1.5	1.2	4.2	4.8
Electricity, gas and water	4.9	1.0	1.8	-4.2	0.9	3.0	2.3	3.7	3.0
Construction	-12.9	2.2	-7.2	-27.0	-3.9	3.9	12.5	13.4	9.7
Wholesale and retail commerce, restaurants and hotels	-0.3	1.8	-1.5	-15.7	7.5	2.9	2.0	5.8	5.9
Transport, storage and communications	3.8	5.8	2.5	-1.9	1.5	4.0	2.5	4.3	5.1
Financial institutions, insurance, real estate and business services	5.2	4.9	-1.3	-4.9	-1.0	2.2	2.4	4.6	4.3
Community, social and personal services	16.2	7.2	1.8	3.3	0.6	0.7	0.2	0.8	2.8
Gross domestic product, by type of expenditure									
Consumption	5.2	5.3	-0.1	-3.2	1.4	2.3	2.3	2.0	3.7
General government	23.9	15.8	2.1	3.6	-0.3	3.9	0.2	4.8	3.3
Private	1.0	2.4	-0.8	-5.4	2.0	1.7	3.0	1.2	3.9
Gross domestic investment	-12.0	-0.6	-6.3	-38.7	12.3	1.9	9.9	23.6	12.4
Exports (goods and services)	9.6	3.2	7.4	5.9	6.1	2.4	-6.1	3.5	10.2
Imports (goods and services)	2.3	6.2	-3.9	-24.7	6.0	6.8	1.1	9.7	16.7
	Percentages of GDP								
Investment and saving [c]									
Gross domestic investment	22.2	20.9	19.7	12.9	13.7	14.3	15.4	18.2	18.8
National saving	17.4	15.5	14.8	13.7	14.6	12.9	13.8	17.0	17.7
External saving	4.8	5.4	4.9	-0.8	-0.9	1.3	1.6	1.3	1.1
	Millions of dollars								
Balance of payments									
Current account balance	-4 641	-5 751	-4 857	671	740	-1 094	-1 340	-1 021	-952
Merchandise trade balance	-2 092	-2 638	-2 450	1 775	2 633	579	239	524	1 368
Exports, f.o.b.	10 966	12 065	11 480	12 037	13 722	12 848	12 316	13 782	17 246
Imports, f.o.b.	13 058	14 703	13 930	10 262	11 090	12 269	12 077	13 258	15 878
Services trade balance	-1 193	-1 500	-1 461	-1 203	-1 279	-1 412	-1 435	-1 433	-1 773
Income balance	-2 062	-2 326	-1 697	-1 355	-2 286	-2 615	-2 848	-3 446	-4 193
Net current transfers	706	713	750	1 455	1 673	2 354	2 704	3 334	3 647
Capital and financial balance [d]	6 370	6 028	3 460	-983	121	2 311	1 479	837	3 493
Net foreign direct investment	2 784	4 753	2 033	1 392	2 069	2 509	1 258	855	2 862
Financial capital [e]	3 587	1 276	1 427	-2 376	-1 948	-198	221	-18	631
Overall balance	1 729	278	-1 398	-312	862	1 217	138	-184	2 541
Variation in reserve assets [f]	-1 729	-278	1 398	312	-862	-1 217	-138	184	-2 541
Other external-sector indicators									
Real effective exchange rate (index: 2000=100) [g]	83.6	78.0	83.1	91.4	100.0	104.0	105.3	119.3	108.5
Terms of trade for goods (index: 2000=100)	84.3	93.3	81.2	87.2	100.0	94.2	92.5	95.2	108.5
Net resource transfer (percentage of GDP)	4.4	3.5	1.8	-2.7	-2.6	-0.4	-1.7	-3.3	-0.7
Total gross external debt (millions of dollars)	31 114	34 409	36 681	36 733	36 130	39 109	37 336	38 066	39 561
Total gross external debt (percentage of GDP)	32.0	32.3	37.2	42.6	43.1	47.7	45.7	47.5	40.5
Net profits and interest (percentage of exports) [h]	4.9	4.0	-0.2	-2.1	4.2	6.2	7.4	10.0	12.0
	Average annual rates								
Employment									
Labour force participation rate [i]	59.7	59.9	62.2	63.1	63.5	64.2	64.2	64.5	62.9
Open unemployment rate [j k]	11.2	12.4	15.3	19.4	17.2	18.2	17.6	16.7	15.4
Visible underemployment rate [j]	...	...	...	...	11.7	13.4	14.0	12.7	12.9

Table 1 (concluded)

	1996	1997	1998	1999	2000	2001	2002	2003	2004 [a]
			Annual percentages						
Prices									
Variation in consumer prices (December-December)	21.6	17.7	16.7	9.2	8.8	7.6	7.0	6.5	5.5
Variation in producer prices (December-December)	14.5	17.5	13.5	12.7	11.0	6.9	9.3	5.7	4.6
Variation in nominal exchange rate (December-December)	1.4	29.6	17.3	24.1	15.7	5.7	21.9	-0.2	-13.9
Variation in average real wage	2.3	4.1	0.2	4.4	3.9	-0.3	2.8	-0.1	1.0
Nominal deposit rate [l]	...	23.8	31.7	20.8	11.9	12.3	8.9	7.7	7.7
Nominal lending rate [m]	...	...	44.5	29.4	18.8	20.7	16.3	15.2	15.1
			Percentages of GDP						
Non-financial public sector									
Current income	28.7	28.8	28.3	32.9	33.2	35.1	34.5	35.2	37.3
Current expenditure	21.5	22.5	24.8	29.6	29.4	30.6	29.8	29.8	30.6
Current balance	7.2	6.2	3.5	3.3	3.9	4.4	4.7	5.3	6.6
Net capital expenditure	8.8	9.0	7.2	7.4	7.7	8.5	8.1	7.9	7.7
Primary balance	2.2	0.9	0.9	-0.3	0.4	0.7	1.0	2.1	3.5
Overall balance	-1.7	-2.8	-3.7	-4.1	-4.0	-4.1	-3.5	-2.6	-0.9
Public debt of consolidated NFPS	29.7	34.6	39.1	50.1	57.2	58.7	71.1	67.5	62.5
Domestic	16.9	20.2	22.1	28.4	33.6	35.8	40.8	38.8	38.9
External	12.8	14.5	17.0	21.7	23.5	22.9	30.3	28.7	23.6
Interest payments (percentage of current income)	13.5	12.9	16.2	11.3	13.0	13.7	13.0	13.4	12.0
Money and credit [n]									
Domestic credit [o]	19.2	20.8	24.6	26.5	23.5	25.4	27.2	27.3	27.6
To the public sector	2.6	3.3	3.8	5.3	5.4	7.0	8.2	8.8	9.3
To the private sector	16.5	17.5	20.7	21.2	18.1	18.4	19.0	18.6	18.2
Liquidity (M3)	35.1	36.9	38.6	38.0	34.0	33.8	33.7	33.3	33.9

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

(d) Trade policy

In 2004 the Andean Community and the MERCOSUR countries concluded negotiations on a free trade agreement, which came into effect in February 2005. In May 2004 negotiations began on a free trade agreement encompassing Colombia, Ecuador, Peru and the United States. Up until June 2005, 10 rounds of talks had been held, with the discussions due to conclude in the middle of the second semester. The outcomes are expected to be submitted to the respective national congresses for approval with a view to entry into force in January 2007. The most controversial issues have revolved around agricultural goods (maize, rice, beans, cereals and poultry) and intellectual property, especially as regards access to medicines. With regard to industrial goods, the authorities hope to consolidate and extend preferences in the framework of the Andean Trade Promotion and Drug Eradication Act (ATPDEA), eliminate tariff and technical barriers in order to secure genuine access to markets and agree on rules of origin that would broaden the export supply.

Table 2
COLOMBIA: MAIN QUARTERLY INDICATORS

	2003				2004 [a]				2005 [a]	
	I	II	III	IV	I	II	III	IV	I	II
Gross domestic product (variation from same quarter of preceding year) [b]	4.5	2.5	4.5	5.0	4.0	4.9	3.1	4.5	3.6	...
Merchandise exports, f.o.b. (millions of dollars)	2 991	3 278	3 439	3 420	3 406	2 756	4 568	4 733	4 604	...
Merchandise imports, c.i. f. (millions of dollars)	3 331	3 306	3 611	3 642	3 598	2 728	4 260	4 803	4 560	...
International reserves (millions of dollars)	10 616	10 500	10 863	10 916	11 330	11 588	12 115	13 536	12 780	...
Real effective exchange rate (index: 2000=100) [c]	121.3	118.6	118.1	119.1	112.5	109.5	106.6	105.4	98.4	97.3 [d]
Unemployment rate	17.9	17.2	17.0	14.7	17.1	15.8	15.1	13.7	15.5	...
Consumer prices (12-month percentage variation)	7.6	7.2	7.1	6.5	5.5	6.1	5.9	5.5	5.0	4.8
Average nominal exchange rate (pesos per dollar)	2 941	2 871	2 855	2 843	2 713	2 691	2 602	2 509	2 354	2 340
Average real wage (variation from same quarter of preceding year)	0.7	-1.1	-0.5	0.9	1.0	1.3	1.3	0.5	0.8	...
Nominal interest rates (annualized percentages)										
Deposit rate [e]	7.7	7.7	7.7	7.8	7.8	7.7	7.7	7.6	7.4	7.1
Lending rate [f]	14.9	15.2	15.2	15.4	15.1	15.2	15.0	15.0	15.1	14.8
Interbank interest rate [g]	6.1	7.0	7.3	7.3	7.1	6.8	6.8	6.8	6.6	6.5
Sovereign bond spread (basis points)	602	451	478	431	379	486	408	...	...	...
Stock price index (in dollars, December 2000=100)	134	156	152	175	252	234	278	376	403	495
Domestic credit (variation from same quarter of preceding year) [h]	16.1	8.3	4.8	10.0	12.0	13.7	15.4	16.0	13.6	...
Non-performing loans as a percentage of total credit [i]	8.6	8.1	7.9	6.8	6.7	5.4	4.4	3.3	3.5	3.5 [d]

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

3. The main variables

(a) Economic activity

Private investment and exports were the main drivers of the 4.1% economic growth rate.[1] Private consumption continued to increase at a rate slightly below GDP, reflecting mainly consumption of durable goods fuelled by the appreciation of the peso and low rates of interest in the domestic market. The expansion took place across the board, with the upturn particularly strong in construction (9.7%), commerce (5.9%), transport (5.1%), manufacturing (4.8%) and the financial sector (4.3%).

In the first quarter of 2005 the Colombian economy expanded by 3.6%, which represents a slight slowdown with respect to the annual rate of 4.0% posted in the first quarter of 2004. The fastest-growing sectors were construction (10.6%), mainly thanks to an upturn in public works (43.6%), commerce (7.3%) and mining (5.1%). Manufacturing and the financial sector contracted

1 Factoring the illegal-crop eradication scheme out of aggregate production gives a growth rate of 4.2%.

by 1% and 2.7%, respectively. Investment continued to climb; household consumption slowed and public consumption went up. Import growth outpaced that of exports. The second quarter data available point to an upturn in manufacturing in April and positive indicators for energy demand. A surge in imports could undermine output growth, however.

(b) Prices, wages and employment

Inflation eased down once again in 2004; at the year's end the consumer price index had risen 5.5%, thus remaining within the target range. Except for a few short-lived upsurges associated with sharp rises in food prices, consumer inflation trended downwards throughout the year, thanks to positive developments in tradable goods prices which were attributable, in turn, to exchange-rate appreciation. For 2005 the central bank set a range of 4.5% to 5.5% as the annual inflation target.

Overall inflation dropped to 4.8% in the first semester of 2005. The basic inflation rate, from which food is the most notable exclusion, trended downwards in response to the decrease in the exchange rate, though the drop in the prices of non-tradable goods also contributed. Food prices rose, although this did not put strong pressure on inflation.

Producer prices rose 4.6% in 2004, which represented a slowdown with respect to 2003 (5.7%). The downtrend steepened in the first semester of 2005 and the index shows a rise of only 2.7% in 12 months.

Urban unemployment remained high in 2004 (15.4% in 13 cities), although it came down from the rate of 16.7% registered in 2003. This drop is attributable mainly to a contraction in labour force participation, which decreased from 64.5% in 2003 to 62.9% in 2004. A worrying development was the drop in the employment rate, from 53.8% to 53.2%. Conversely, the decline in underemployment (from 32.0% to 30.9%) was a positive factor. Nationwide, the reduction in unemployment was smaller (from 14.2% to 13.6%). The nationwide employment rate also declined, from 53.3% to 52.5%, and the labour force participation rate decreased from 62.1% to 60.8%, while underemployment remained broadly stable (at 31.6%, compared with 31.9%).

The results recorded in the first five months of 2005 were positive. Urban unemployment continued to decline, from 16.6% to 15.1% (in 13 cities), and the employment rate appeared to be recovering, up from 52.5% to 52.8%. Underemployment was unchanged at 30.1%. The figures for the national level show a larger decrease in unemployment (from 14.9% to 13.0%) and a drop in both employment and underemployment rates, from 52.2% to 51.8% and from 31.7% to 30.8%, respectively.

The monthly minimum wage (equivalent to US$ 136) reflected a real increase of 1.8% in 2004. The real wages of industrial workers rose 2.5% and those of manual labourers and technical workers, 1.1%.

(c) The external sector

Exports picked up in 2004, thanks to high commodity prices and growth in world demand, with the recovery in Bolivarian Republic of Venezuela contributing strongly. Exports rose 26%, as both traditional and non-traditional exports performed well. The United States continued to be the main destination for Colombia's exports (39% of total exports), followed by the countries of the Andean Community (19%), principally the Bolivarian Republic of Venezuela (10%).

Traditional exports benefited from the increase in international prices. The output of the segments exporting hydrocarbons, coal, coffee and ferronickel increased, even though the export volumes of these products declined. Non-traditional exports were very buoyant, especially machinery and equipment (consisting mainly of transport materials), textiles and clothing, and chemicals.

Imports increased significantly, fuelled by the low price of the United States dollar and tax incentives to invest in machinery and equipment. Total imports expanded by 21%, led by imports of raw materials and intermediate and capital goods for industry (26% and 17%, respectively). Imports of consumer goods increased by 18%, particularly durable goods (28%).

Exports picked up by 36% in the first four months of 2005, thanks to a strong boost from traditional exports (43%), while non-traditional exports kept up their good performance (29%). Meanwhile, imports increased 29%, led by capital goods, raw materials and intermediate goods for industry. Imports of consumer goods continued to increase (29%), with an upturn in imports of non-durables.

In 2004, the balance of payments posted a current-account deficit of US$ 952 million, or 1.0% of GDP, with net capital inflows of US$ 3.493 billion and an increase in gross reserves of US$ 2.541 billion. In December the reserve stock amounted to US$ 13.536 billion, or the equivalent of 8.2 months of imports of goods and services.

Merchandise trade turned in a surplus of US$ 1.368 billion, which exceeded the 2003 surplus by US$ 844 million. The deficits on the non-factor services and factor income accounts were partly offset by the increase in net transfers, consisting mainly of workers' remittances, which rose by 9% and amounted to US$ 3.647 billion.

The capital and financial account recorded a large inflow of resources, as a result of a strong increase in net foreign direct investment, which stood at US$ 2.862 billion in 2004 and was 235% higher than the year before, mainly thanks to investments in mining and petroleum. Short-term financial flows to the private sector also increased in volume.

In the first quarter of 2005 the balance-of-payments current account returned a deficit of US$ 517 million (1.8% of quarterly GDP) and the capital account, a deficit of US$ 227 million (0.8% of quarterly GDP), while the balance on the errors and omissions account rose to US$ 151 million. The overall balance showed a decline of US$ 593 million in gross international reserves, which reflected the transfer to the government of central bank profits and proceeds from foreign-currency sales to prepay external debt.

External debt dropped from 47.5% of GDP in 2003 to 40.5% in 2004. Of this total, external borrowing by the private sector decreased from 16.9% to 14.2% of GDP and by the public sector, from 30.7% to 26.5% of GDP. Colombia's external debt stock represented 33.5% of GDP in February 2005, compared with 39.3% in the same month of 2004. Of this, private debt represented 11.7% of GDP and public debt, 21.8%, with this positive outcome being largely attributable to the drop in the exchange rate.

Ecuador

1. General trends

In 2004, Ecuador recorded its highest growth in a decade, at 6.9%. GDP growth of 3% is forecast for 2005, however, with the slowdown attributable to the disappearance of the impetus provided by the heavy crude pipeline that came on stream in the third quarter of 2003.

Notwithstanding GDP growth in 2004, unemployment increased. Job creation is expected to remain weak in 2005.

Although the fiscal situation is under control, thanks mainly to surging revenues from petroleum, the government has little political leeway for carrying out a number of essential economic reforms (particularly in electricity, hydrocarbons and social security) which are crucial for ensuring the country's future growth and have yet to be implemented.

In 2004, the banking sector started to use a larger proportion of its rising deposit takings to extend loans, especially consumer credit. This expansion is expected to continue into 2005, though possibly at a slower rate.

The external sector was very dynamic in 2004, thanks to a sharp increase in the volume and value of crude petroleum exports, together with significant (albeit smaller) rises in imports. The merchandise trade balance was positive and contributed to the first current account surplus since 2000. Migrant remittances expanded more moderately than in 2003, but even so totalled US$ 1.604 billion (5.3% of GDP) in 2004, thus representing a source of income whose magnitude virtually rivaled that of all the country's traditional non-petroleum exports combined.[1]

2. Economic policy

The stand-by agreement signed with the International Monetary Fund (IMF) was not renewed when it expired in April 2004.

In July 2004, Congress upped the pensions paid by the Ecuadorian Social Security Institute (IESS), with this increase to be paid by the central government.[2] In March 2005, the executive branch sent to Congress a bill for economic rationalization of the State, better known as the "*Ley Topo*", which sought to modify legislation in several areas, including hydrocarbons, social security and the electricity sector. In the case of hydrocarbons, the proposal was to allow contracts for works, goods or services to be signed between the State-owned Petroleum Corporation of Ecuador (Petroecuador) and the private sector at all stages of the oil industry, including work in fields operated by Petroecuador. In social security, a number of reforms were proposed with a view to establishing a mixed social security system. Under the proposed changes in the electricity sector, the government would be authorized to subsidize electricity consumption, but with the overall aim of making distributors more efficient. The State would be responsible for the difference between charges to consumers and the (higher) real costs of that energy (including generation, transmission and distribution)

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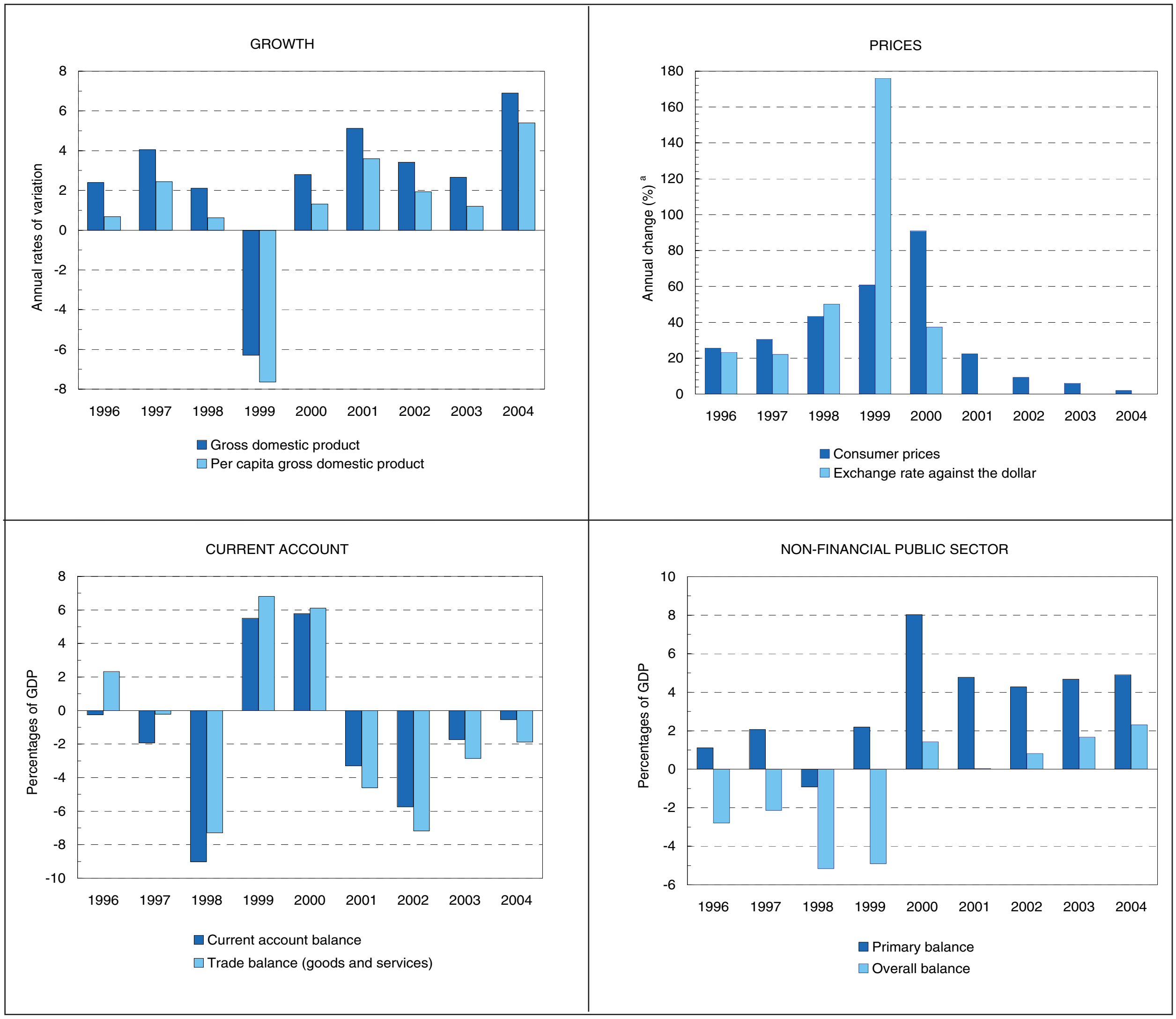
1 Traditional non-petroleum exports are banana and plantain, coffee and related products, shrimp, cocoa and related products, tuna and unprocessed fish.

2 IESS had already increased pensions in 2004 following an actuarial study.

Figure 1
ECUADOR: MAIN ECONOMIC INDICATORS



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

between April 1999 and December 2004, with an issue of public bonds proposed to cover those costs. Congress rejected the *Ley Topo*, however.

(a) Fiscal policy

In 2004, the primary surplus of the non-financial public sector (NFPS) was equivalent to 4.9% of GDP, while the overall surplus amounted to 2.3% of GDP. This was a slight improvement with respect to 2003. Conversely, the central government recorded a deterioration in its fiscal accounts. The primary surplus diminished from 2.6% to 1.6% of GDP, while the overall deficit increased from 0.4% to 1.1% of GDP. For 2005, the primary surplus and the total NFPS surplus are projected to reach 4.8% and 2.2%, respectively, while the central government is expected to return a primary surplus of 0.9% of GDP and a global deficit of 1.8%.[3]

[3] If the government secures approval for its proposal to include the resources of the Fund for Stabilization, Social and Productive Investment and Reduction of Public Debt (FEIREP) in the budget, then the primary surplus will be 2.6% of GDP and the central government's overall deficit, 0.1% of GDP.

NFPS spending increased by 13.4% in 2004, with the main items contributing to this increase being salaries and social security transfers. These same items account for 80% of the expansion in central government spending: salaries increased by 9.9% in nominal terms (coming to represent 37.3% of total central government spending or 6.8% of GDP) and current transfers expanded by 42.2%, owing to pension increases in 2004. NFPS revenue was up by 18% in 2004, driven especially by revenue from petroleum exports. Revenues from import duties and income tax also showed strong gains, up by 18.6% and 19.6%, respectively. Domestic sales of hydrocarbon derivatives (such as liquefied petroleum gas) brought in notably low receipts in the first quarter of 2005, since they were sold at less than the import price.

The central government borrowing requirements in 2005, especially for short-term debt repayments, were covered by domestic debt issues, for which the largest purchaser, as in 2004, was the Ecuadorian Social Security Institute. The central government's domestic debt rose by US$ 472.9 million in 2004 and represented 11.5% of GDP in December 2004, while external public debt (including the central bank) fell by US$ 431.6 million to stand at 36.5% of GDP. In the first five months of 2005, domestic debt was up by US$ 365.3 million with respect to December 2004.

Large public investment projects planned for 2005 include two irrigation projects (one in Manabí and the other in the south of the country), the construction of a bridge and work on the Amazon Highway.

Following the departure of President Lucio Gutiérrez in April 2005 and his replacement by the Vice President, the new government submitted to Congress a proposed reform to the Organic Law on Responsibility, Stabilization and Fiscal Transparency. The proposal was, first, to maintain the current cap of a real annual 3.5% on increases in budgeted expenditures only for salaries and central government current transfers. Second, it proposed to bring the entire Fund for Stabilization, Social and Productive Investment and Reduction of Public Debt (FEIREP) into the budget, and to shift the allocation of these funds to other areas of expenditure. In 2004, the government used FEIREP essentially to buy back domestic debt (US$ 381 million) and to compensate for the decline in fiscal revenue caused by domestic sales of hydrocarbon derivatives. By mid-June 2005, FEIREP had built up some US$ 460.6 million.

(b) Monetary policy

The benchmark lending rate fell, with some fluctuation, from 11.2% in December 2003 to 8% in December 2004, but rose again to 9.4% in June 2005. This last rise was directly related to the political commotion that led to the departure of President Gutiérrez in May 2005. The benchmark deposit rate, in contrast, declined throughout the period, falling to 3.6% in May 2005. It should be noted that interest rates in Ecuador are less and less a measure of the real cost of credit to the debtor, given the growing significance of banks' income from commissions. Unlike interest rates, such commissions are not subject to a legal maximum. The Superintendency of Banks therefore issued a series of regulations in April 2005, in order to make bank commissions more transparent.

The balances of open private banks show strong growth in their assets and liabilities in 2004 (20.5% between December 2003 and December 2004). This rate of growth slowed somewhat in the first five months of 2005, but continued to be high.

After fluctuating in 2004, bank liquidity in cash and deposits represented 19.7% of assets in December. Since then, this liquidity has contracted sharply and in May 2005 stood at 14.2%, reflecting a decrease in deposits held abroad. Foreign securities accounted for 12.1% of assets in May 2005. Thus, in April 2005, highly liquid assets with a low average return amounted to US$ 2.471 billion (26.3%) of the banking sector's assets, of which US$ 1.944 billion (20.7% of assets) were held abroad. The strong preference for keeping liquidity abroad was due in part to the absence of a lender of last resort; it also appeared to indicate the sector's inclination to keep a foreign-currency-denominated "insurance fund" outside the country.

In 2004 and early 2005, bank lending to businesses varied from 28% to 29% of total assets, growing at a slightly lower rate than the sector's overall holdings. Consumer loans increased by a nominal 63.5% during this period, rising from 19.5% of assets in December 2003 to 21.2% in May 2005. On the supply side, this increase was due to the growing availability of bank funds for loans, the high returns on consumer lending in comparison with other credit alternatives and low rates of arrears. On the demand side, the expansion was attributable to economic growth driven by oil and services, combined with lower rates of interest.

(c) Other policies

Ecuador's real effective exchange rate showed a 7.4% year-on-year depreciation in December 2004. Around half of this real depreciation was attributable to the real appreciation of the euro and the Colombian peso against the United States dollar; most of the rest was associated with real appreciations in the currencies of Peru, Brazil and the Republic of Korea with respect to the dollar, as well as a drop in inflation to below the United States rate. In the first five months of 2005, the real effective exchange rate varied very little.

Table 1

ECUADOR: MAIN ECONOMIC INDICATORS

	1996	1997	1998	1999	2000	2001	2002	2003	2004 [a]
				Annual growth rates [b]					
Gross domestic product	2.4	4.1	2.1	-6.3	2.8	5.1	3.4	2.7	6.9
Per capita gross domestic product	0.7	2.4	0.6	-7.6	1.3	3.6	1.9	1.2	5.4
Gross domestic product, by sector									
Agriculture, livestock, hunting, forestry and fishing	7.6	10.0	-3.0	9.1	-0.1	0.7	7.2	1.5	0.7
Mining	0.8	-1.9	-1.6	1.4	8.0	1.7	-3.5	6.5	25.0
Manufacturing	-2.8	8.5	8.3	-23.5	-32.4	20.8	-0.3	9.2	-3.2
Electricity, gas and water	11.9	6.8	8.5	23.0	2.6	4.6	2.4	-3.0	5.0
Construction	1.3	2.7	-0.2	-24.9	18.3	4.0	14.7	0.5	1.2
Wholesale and retail commerce, restaurants and hotels	5.2	4.4	1.1	-11.3	3.8	4.3	3.7	1.8	3.2
Transport, storage and communications	3.2	8.2	9.4	-0.3	7.7	1.7	1.3	1.3	3.5
Financial institutions, insurance, real estate and business services	6.7	1.6	-5.0	-20.6	2.3	15.0	2.7	3.6	1.7
Community, social and personal services	1.1	3.4	5.1	-1.3	5.8	1.6	1.3	0.0	1.4
Gross domestic product, by type of expenditure									
Consumption	0.4	4.3	3.6	-6.8	3.9	4.8	4.6	2.5	4.2
General government	-5.2	4.7	-2.2	-5.5	4.7	0.5	3.2	1.1	2.0
Private	1.4	4.2	4.5	-7.0	3.8	5.4	4.8	2.7	4.6
Gross domestic investment	-8.8	12.6	14.2	-49.4	29.0	36.8	21.8	0.2	5.1
Exports (goods and services)	2.4	7.8	-5.1	7.8	-1.0	-1.3	0.9	3.2	15.1
Imports (goods and services)	-10.2	15.4	7.0	-29.5	15.8	17.2	17.2	0.8	8.4
				Percentages of GDP					
Investment and saving [c]									
Gross domestic investment	19.7	21.5	25.3	14.7	20.1	25.7	27.7	27.7	27.2
National saving	19.4	19.5	16.2	20.2	25.9	22.4	22.1	26.0	26.9
External saving	0.3	1.9	9.0	-5.5	-5.8	3.3	5.6	1.7	0.4
				Millions of dollars					
Balance of payments									
Current account balance	-55	-457	-2 099	918	921	-695	-1 398	-472	-166
Merchandise trade balance	921	491	-1 132	1 588	1 395	-397	-998	-71	321
Exports, f.o.b.	4 929	5 360	4 326	4 615	5 137	4 781	5 198	6 197	7 813
Imports, f.o.b.	4 008	4 869	5 458	3 028	3 743	5 179	6 196	6 268	7 492
Services trade balance	-427	-543	-563	-451	-420	-572	-748	-708	-888
Income balance	-1 040	-1 026	-1 171	-1 308	-1 405	-1 364	-1 305	-1 464	-1 493
Net current transfers	492	621	767	1 090	1 352	1 639	1 652	1 772	1 894
Capital and financial balance [d]	-71	-65	1 314	-1 862	-6 618	436	1 275	591	447
Net foreign direct investment	500	724	870	648	720	1 330	1 275	1 555	1 160
Financial capital [e]	-571	-789	444	-2 511	-7 338	-894	0	-964	-713
Overall balance	-126	-521	-784	-944	-5 697	-258	-123	119	281
Variation in reserve assets [f]	-247	-253	461	489	-307	106	66	-152	-277
Other financing [g]	373	774	324	455	6 004	152	58	33	-4
Other external-sector indicators									
Real effective exchange rate (index: 2000=100) [h]	68.3	65.8	65.0	88.8	100.0	71.4	62.6	61.1	63.7
Terms of trade for goods (index: 2000=100)	80.5	89.1	75.8	89.1	100.0	84.6	86.8	89.8	91.5
Net resource transfer (percentage of GDP)	-3.5	-1.3	2.0	-16.3	-12.7	-3.7	0.1	-3.1	-3.5
Total gross external debt (millions of dollars)	14 586	15 099	16 400	16 282	13 565	14 411	16 287	16 595	17 010
Total gross external debt (percentage of GDP)	68.6	63.9	70.5	97.6	85.1	68.5	67.0	61.0	56.2
Net profits and interest (percentage of exports) [i]	3.4	3.2	4.6	4.7	4.7	5.9	5.0	5.2	4.6
				Average annual rates					
Employment									
Labour force participation rate [j]	55.8	57.3	58.4	60.0	56.8	55.6	54.1	53.8	55.8
Open unemployment rate [k]	10.4	9.3	11.5	15.1	14.1	10.4	8.6	9.8	11.0
Visible underemployment rate [l]	...	...	13.6	15.2	13.8	11.3	9.3	8.8	7.2

Table 1 (concluded)

	1996	1997	1998	1999	2000	2001	2002	2003	2004 [a]
				Annual percentages					
Prices									
Variation in consumer prices (December-December)	25.7	30.6	43.4	60.7	91.0	22.4	9.3	6.1	1.9
Variation in producer prices (December-December)	...	...	...	186.9	64.9	-5.6	17.7	4.5	4.3
Variation in nominal exchange rate (December-December) [m]	23.4	22.2	50.1	176.0	37.3	0.0	0.0	0.0	0.0
Variation in minimum urban wage	9.7	-3.5	-7.2	-10.7	-3.5	11.4	1.2	6.0	2.2
Nominal deposit rate [n]	...	...	...	...	...	6.6	5.1	5.3	4.0
Nominal lending rate [n]	...	...	...	...	...	15.5	14.1	12.6	10.2
				Percentages of GDP					
Non-financial public sector									
Total income	21.9	19.9	17.3	21.1	25.9	23.6	26.2	25.4	26.9
Total expenditure [o]	24.6	22.1	22.1	25.0	24.4	23.5	25.3	24.2	24.7
Net capital expenditure	6.8	5.3	5.0	6.0	5.0	6.7	6.5	5.4	5.3
Primary balance [o]	1.1	2.1	-0.9	2.2	8.0	4.8	4.3	4.7	4.9
Overall balance [o]	-2.8	-2.1	-5.2	-4.9	1.4	0.0	0.8	1.7	2.3
Public debt	64.4	56.6	62.5	93.7	79.7	63.4	55.6	51.8	47.1
Domestic [p]	8.8	7.0	11.1	19.8	17.8	13.3	11.4	11.1	11.5
External	55.6	49.6	51.4	73.9	62.0	50.1	44.2	40.7	35.6
Interest payments (percentage of total income)	17.9	21.1	24.5	33.7	25.5	20.1	13.2	11.9	9.8
Money and credit [q]									
Domestic credit [r]	26.6	27.0	34.2	41.6	34.5	27.5	22.8	16.8	16.7
To the public sector	0.8	1.2	2.2	4.5	3.9	-0.4	-1.2	-2.2	-2.9
To the private sector	25.9	25.8	32.0	37.1	30.6	27.9	24.1	19.1	19.5
Liquidity (M3)	...	...	...	...	...	22.3	23.2	20.1	21.0

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.
[a] Preliminary figures. [b] Based on figures in local currency at constant 2000 prices. [c] Based on figures in local currency expressed in dollars at current prices. [d] Includes errors and omissions. [e] Refers to the capital and financial balance (including errors and omissions), minus net foreign direct investment. [f] A minus sign (-) denotes an increase in reserves. [g] Includes the use of IMF credit and loans and exceptional financing. [h] Annual average, weighted by the value of merchandise exports and imports. [i] Refers to net investment income as a percentage of exports of goods and services as shown on the balance of payments. [j] Economically active population as a percentage of the working-age population, three cities; up to 1998, urban total. [k] Unemployment rate as a percentage of the economically active population, three cities; up to 1998, urban total. Includes hidden unemployment. [l] Underemployment rate as a percentage of the economically active population, three cities; up to 1998, urban total. [m] In January 2000, the country adopted the United States dollar as its official currency. [n] Reference rate in dollars, monthly average. [o] 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. [p] Refers to the central government. [q] The monetary figures are annual averages. [r] Refers to net credit extended to the public and private sectors by commercial banks and other financial and banking institutions. As of 2000, includes net credit extended by the Central Bank of Ecuador and the National Finance Corporation.

3. The main variables

(a) Economic activity

GDP increased by 6.9% in 2004, generating a 5.4% gain in per capita GDP, to 9.3% above the 1994 level.

Economic growth in 2004 was attributable mainly to a 54.4% expansion in private oil extraction, which drove a 26.1% increase in total oil extraction (108,000 more barrels per day, on average). The petroleum sector now accounts for 23% of GDP. Conversely, the production of the State company Petroecuador, which has declined every year since 1994, dipped by 3.4% in 2004. The non-oil economy, as in 2003, recorded only meagre growth. Services was the only sector of the economy to expand by over 3%. This was further confirmation that the economy's fresh momentum was essentially on the back of hydrocarbon exports, although there has also been a recovery in shrimp farming, contrasting with the poor results in the fishing sector due to climatic factors.

Domestic demand grew more strongly than in 2003 (up 4.8%), driven mainly by rising household consumption thanks to improved access to credit and higher pensions, among other factors. Gross fixed capital formation and

Table 2
ECUADOR: MAIN QUARTERLY INDICATORS

	2003				2004 [a]				2005 [a]	
	I	II	III	IV	I	II	III	IV	I	II
Gross domestic product (variation from same quarter of preceding year) [b]	3.4	-0.8	2.1	6.0	6.3	10.0	7.4	4.3	3.2	...
Merchandise exports, f.o.b. (millions of dollars)	1 513	1 423	1 486	1 616	1 657	1 316	2 011	2 014	2 120	...
Merchandise imports, c.i. f. (millions of dollars)	1 549	1 601	1 666	1 718	1 663	1 230	2 048	2 246	2 087	...
International reserves (millions of dollars)	770	762	991	813	824	885	1 180	1 070	1 025	...
Real effective exchange rate (index: 2000=100) [c]	60.1	60.9	61.2	62.0	63.1	62.5	63.7	65.5	67.0	66.8 [d]
Unemployment rate	9.9	10.2	9.9	9.3	11.2	11.4	10.7	11.1	11.5	10.7
Consumer prices (12-month percentage variation)	9.2	7.6	7.6	6.1	3.7	2.9	1.6	1.9	0.8	1.9
Average nominal exchange rate (sucres per dollar) [e]	25 000	25 000	25 000	25 000	25 000	25 000	25 000	25 000	25 000	25 000
Nominal interest rates (annualized percentages)										
Deposit rate [f]	5.4	5.3	5.2	5.2	4.8	4.1	3.7	3.7	3.6	...
Lending rate [f]	13.3	13.0	12.2	11.9	11.5	10.7	9.6	8.9	8.4	...
Interbank interest rate [g]	1.1	0.9	0.8	0.8	0.7	0.8	0.7	0.7	1.0	...
Sovereign bond spread (basis points)	1 372	1 178	1 121	799	701	952	778	...	...	...
Domestic credit (variation from same quarter of preceding year) [h]	-26.8	-30.5	-5.5	-2.4	3.4	11.3	17.9	17.6	18.2	19.9 [i]
Non-performing loans as a percentage of total credit [j]	25.0	24.6	23.8	20.7	19.7	18.2	18.1	15.0	15.7	15.0 [d]

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.
[a] Preliminary figures. [b] Based on figures in local currency at constant 2000 prices. [c] Quarterly average, weighted by the value of merchandise exports and imports. [d] Data to May. [e] In January 2000, the country adopted the United States dollar as its official currency. [f] Reference rate in dollars, monthly average. [g] Interbank market, weighted average. [h] Refers to net credit extended to the public and private sectors by commercial banks and other financial and banking institutions. [i] Data for April. [j] Refers to total credit extended by the banking system.

government consumption expanded more moderately (by 3.5% and 2.9%, respectively). Exports were particularly buoyant, with a 7.1% rise. This took place alongside a strong increase in imports (7.5%).

GDP growth for 2005 is projected at 3%; the year-on-year increase in the first quarter of 2005 was 3.2%. Oil production is expected to expand only slightly in 2005, even though there is substantial transport capacity still available in the heavy crude pipeline and some companies in the consortium have not attained their intended production and transport capacity. The production of crude in 2005 had increased by only 1.8% up to May, although there are no technical reasons why oil activity should cease to expand: Ecuador has unexploited fields with extensive proven and probable reserves (for example, Pungarayacu-Oglán and Ishpingo Tambococha Tiputini) as well as vast areas yet to be explored (for example, in the south-east). In 2004, the pipeline transported an average of 170,000 barrels per day, compared with a capacity of 450,000; thus, ample transport capacity is still available. Owing to the natural decline of fields in production, heavy investments would be needed in order to boost oil extraction significantly; according to preliminary figures for the first quarter of 2005, however, foreign direct investment was down on the same period of 2004. The backdrop to these developments is that some private oil companies have reservations over how much to invest in view, for example, of lawsuits outstanding with the State of Ecuador over tax refunds and the general political instability. It is therefore unlikely that activity in this sector will increase much in 2005. Conversely, an upturn is expected in fishing production, due to climatic conditions, and in construction. In the banana sector, growth prospects are limited by developments in international prices for bananas.

Lastly, the electricity sector needs wide-ranging reform in order to boost efficiency, reduce the cost of electricity to the productive sector and consumers, increase generation capacity and lower the explicit and implicit fiscal costs of operating the system.

(b) Prices, wages and employment

Inflation was lower than the United States rate, at just 1.9% in 2004. Twelve-month inflation to June 2005 was 1.7%, while the minimum wage in the private sector increased by 3.1% in real terms between December 2003 and December 2004.

The unemployment situation deteriorated in 2004 and early 2005, notwithstanding sharp rises in GDP and in the gross employment rate, which strengthened from an average of 48.5% in 2003 to 49.7% in 2004 and stood at 49.4% during the first five months of 2005. The total jobless rate increased from an average of 9.8% in 2003 to 11% in 2004 and climbed to an average of 11.2% in the first five months of 2005. This higher unemployment was due to the fact that the economically active population increased more rapidly than the number of employees. The slowdown in economic growth does not augur well for any significant reduction in unemployment in 2005.

(c) The external sector

The balance-of-payments current-account deficit continued to shrink in 2004, closing the year at US$ 166.2 million (0.5% of GDP) compared with US$ 471.9 million, or 1.7% of GDP, in 2003 and well below the figure of US$ 1,398,500,000 (5.8% of GDP) recorded in 2002. The steep rise in the volume and prices of oil exports boosted the merchandise trade balance, which yielded its first surplus since 2000, at US$ 320.6 million (1.1% of GDP).

The income balance continued to reflect the increase in prior years of investment and loans to residents, with net payments of economic rents up to 5% of GDP. Income from remittances also continued to expand (4.2%), although at almost half the rate of 7.5% recorded in 2003, and amounted to US$ 1,604,200,000 (5.3% of GDP).

A prominent development in 2004 was the 25.4% slump in foreign direct investment (FDI), which thus dropped to US$ 1,160,300,000 (3.8% of GDP). This was because 2003 had been an exceptional year in terms of petroleum-sector investments, with work on the heavy oil pipeline and related infrastructure and investment in the drilling of crude oil to be transported through the pipeline. FDI is unlikely to increase significantly in 2005.

With respect to other financial movements, along with the aforementioned developments in the banking sector, placements of currency and deposits abroad doubled, from US$ 611.6 million (2.2% of GDP) in 2003 to US$ 1,249,600,000 (4.1% of GDP) in 2004.

Exports climbed by 26.8% in 2004, boosted by the surge in hydrocarbons (62.4% or US$ 1.627 billion). Other export items, mainly bananas, vehicles, fresh and canned fish and cocoa, showed declines. Exports of coffee and shrimp also rose significantly, although in much lower amounts than hydrocarbons. Oil and oil derivatives have thus become consolidated as Ecuador's main export items and foreign-exchange earners: in 2002, crude petroleum accounted for 36.5% of total exports and bananas (the second export item in terms of value) accounted for 19.2%; by 2004, crude represented 50.9% and bananas, 13.4%.

Imports went up by 19.8% in 2004, in step with rapid growth in GDP and consumption over the year. Imports of raw materials and fuels and lubricants recorded the steepest rises (26.7% and 21.1%, respectively), reflecting high international prices for raw materials (including oil derivatives) during the year and a tight domestic supply of fuels and lubricants. Imports of consumer goods grew by 16.4%, while capital goods imports increased by 14.5%.

In 2005, the expansion in petroleum export volumes will slow considerably, which will limit the increase in the value of total exports. In the first five months of 2005, for example, crude petroleum exports were up by only 2.8% in volume, although average price increases translated into a value gain of 28.8%. In 2005, upturns are also expected in exports of shrimp and of tuna and other fish. During the first four months of the year, exports in those two categories expanded by 22.6% and 5.7%, respectively.

Imports expanded by 25.3% in the first five months of 2005, with the rise taking place across all the import categories and led by capital goods (34%), closely followed by raw materials (27.5%).

Paraguay

1. General trends

Paraguay's GDP grew by 4% in 2004, which was the highest rate since 1995.[1] This result was not exclusively attributable to expansion in the agricultural sector (as in 2003), but was also driven by an upturn in non-agricultural activities, especially meat production and commerce. The rate of inflation dropped considerably, to 2.8%, but is expected to come in around 8% in 2005, which coincides with the maximum rate stipulated in Paraguay's agreement with IMF. Unemployment stood at 7.3%, compared to 8.1% in 2003.[2] A more moderate expansion of GDP, of around 2.8%, is forecast for 2005, as agricultural output drops and the economy faces less propitious international conditions.

The government's fiscal accounts exhibited a surplus of close to 1.6% of GDP, which represented a reversal of the previous year's deficit (-0.4%). The primary surplus was equivalent to 2.7% of GDP, compared with 0.7% in 2003. The government has continued and, in some cases, stepped up its policy measures to improve tax collection and cut spending.

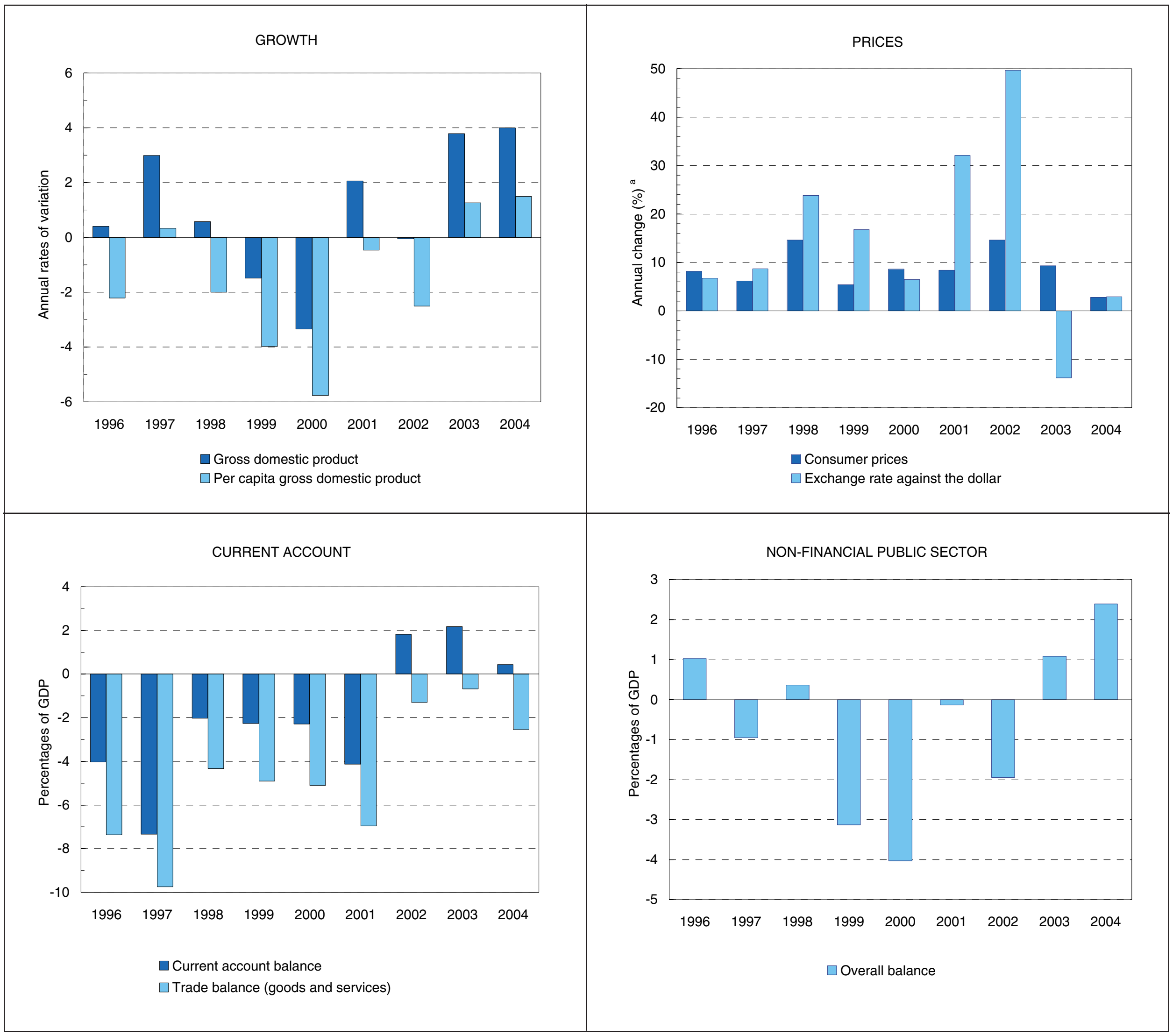
The value of Paraguay's exports of goods and services rose 19%, thanks to expansion in the country's main trading partner economies, but imports posted an even steeper climb of 24%. This resulted in a deficit on the goods and services account, which was, in turn, offset by positive trends in the income and current transfers accounts. Overall, the current-account balance was positive for the third year running, at 0.44% of GDP. The guaraní has depreciated by 13% in real effective terms since the end of 2003.

Agricultural output is projected to contract in 2005, owing to a drought early in the year. Particularly affected are soybean and cotton, with a drop in production as well as unfavourable price trends in the international markets. Inflation is expected to rise substantially, but should remain in single figures. The fiscal balance may deteriorate owing to the combination of lower economic growth and higher spending.

1 The Central Bank of Paraguay is now using 1994 as the base year for its national accounts, instead of 1982 as previously. Calculations based on this new series give a growth rate of 4% for 2004, whereas the rate based on the previous methodology would be 2.9%.

2 The Department of Statistics, Surveys and Censuses used a new sample framework, based on the 2002 census, for its 2004 permanent household survey.

Figure 1
PARAGUAY: MAIN ECONOMIC INDICATORS



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

2. Economic policy

The real sector's performance was set within a context of rationalization of the economy and the public administration, involving the adoption of legislation and resolutions that have made the economy more transparent and efficient. Most of these measures are part of the set of actions agreed upon with IMF and governed by the standby arrangement signed in December 2003.

The government met most of the IMF targets established for 2004. These included turning the fiscal deficit into a surplus, reducing inflation to 8% by the end of the year and accumulating at least US$ 855 million in international reserves. Indeed, the deficit of -0.4% of GDP in 2003 became a surplus of 1.6% in 2004, that year's inflation was 2.8% and in December international reserves stood at US$ 1.17 billion. Since there was a delay in the presentation of the government's plan to allow private investors to buy stakes in State-owned enterprises, the respective target will be included, with a later deadline, in the new agreement due to be signed soon.

(a) Fiscal policy

A number of milestones were achieved in fiscal policy, including a customs code reform and a social security reform and sustainability act which were ratified at the end of 2003; and a fiscal reform bill passed into law in 2004. Briefly, under the new customs code, customs becomes independent from the Ministry of Finance, while the social security reform establishes a new contribution rate for workers and reduces the database of beneficiaries. The fiscal reform introduces a personal income tax, broadens the value added tax base; establishes a general rate of 10% for value added tax, with a lower rate of 5% on staples in the domestic household basket; and raises corporate tax. These changes and adjustments have gone a long way to reduce spending and increase fiscal revenues, by making the system more formal, expedient and transparent.

The central government's overall fiscal balance yielded a surplus of 1.6% of GDP in 2004, after a deficit of -0.4% of GDP at the end of 2003. The primary balance rose from 0.7% in 2003 to 2.7% in 2004. Total revenues were up by a nominal 26%, and the central government's expenditures climbed by 11.4%. Tax revenues posted a 34% increase, with the main contributions coming from taxes on net income and profits and on external trade, which rose by 41% and 36%, respectively. Receipts from taxes on goods and services rose 30%, with fuel tax revenues up by 43% (reflecting higher petroleum prices) and overall VAT receipts by 23%. Current expenditures climbed 8%, with staff outlays rising 9.5%. Capital spending expanded by 25%.

The fiscal balance will be subjected to opposing pressures in 2005. On the one hand, slackening economic growth this year will mean a smaller tax take. On the other, the positive effects of the fiscal reforms should continue to make themselves felt. Indeed, some of the reforms ratified in 2004, including the fiscal reform, do not become effective until this year or next. In any case, the government has sent a strong signal to economic agents regarding its commitment to enforce its economic rationalization principles and the reforms may be expected to do much to increase the formal economy's impact on the country's economy in general.

(b) Monetary and exchange-rate policy

Headway was made, too, in legislation relating to monetary policy, some pieces of which were already under way. These advances are important for the smooth operation of the economy and include, in particular, an act governing deposit guarantees and insolvency resolution for financial intermediation agencies subject to the provisions of the general act on banks, personal loan providers and other lending agencies, which guarantees privately-funded deposits. Other prominent pieces of legislation were a banks act, which aims to bring a larger number of financial intermediaries under the surveillance of the Superintendence of Banks; and a public banking act (now in the process of being approved), which establishes a first tier for lending operations and a second tier to collect and channel funds into the first. The approval of this last piece of legislation is an important step in building up the credit system and the development banking segment. The National Development Bank, which handles 8% of the banking sector's assets and holds 58% of non-performing loans,[3] is still to be restructured.

In an effort to tighten control of the money supply and make its own operations more flexible, the central bank established a mechanism to buy back monetary regulation instruments, similarly to a repo scheme. This mechanism consists of credit lines known as "RIRs", whose purpose is to inject liquidity into the financial system. Credit line operations partly compensate for the illiquidity of the monetary regulation instruments, which are medium-term instruments with no secondary market. The central bank's strategy is to inject vigour into the short-term securities market and link its rates more closely to the international rates. The rates of longer-term issues have a built-in time premium.

Monetary aggregates expanded less sharply than the year before: at the end of 2004 base money posted a year-on-year expansion of 17.3% and M1, of 24.2%. This increase was driven mainly by the variation

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[3] Data from IMF.

Table 1
PARAGUAY: MAIN ECONOMIC INDICATORS

	1996	1997	1998	1999	2000	2001	2002	2003	2004 [a]
				Annual growth rates [b]					
Gross domestic product	0.4	3.0	0.6	-1.5	-3.3	2.1	0.0	3.8	4.0
Per capita gross domestic product	-2.2	0.3	-2.0	-4.0	-5.8	-0.5	-2.5	1.3	1.5
Gross domestic product, by sector									
Agriculture, livestock, hunting, forestry and fishing	-1.3	6.9	1.2	1.3	-7.0	11.6	4.2	8.0	2.9
Mining	-6.1	-3.0	-3.8	-0.4	-5.2	-8.3	-9.1	15.6	2.7
Manufacturing	1.9	0.8	-0.2	-1.9	-0.9	-0.6	-1.4	0.7	3.3
Electricity, gas and water	-1.2	2.4	1.9	1.7	1.9	1.9	1.1	4.6	2.9
Construction	-6.7	-2.5	-0.7	-5.8	-7.8	-1.4	-8.9	14.4	2.0
Wholesale and retail commerce, restaurants and hotels	1.4	-1.2	1.5	-6.0	-3.6	0.0	-1.6	5.5	5.8
Transport, storage and communications	5.8	18.7	2.2	1.3	1.4	2.1	2.0	0.7	4.3
Financial institutions, insurance, real estate and business services	1.2	1.9	-1.9	0.6	-0.8	1.2	0.8	-4.9	1.8
Community, social and personal services	4.0	4.2	0.9	2.3	-1.9	-5.1	-1.1	0.2	6.2
Gross domestic product, by type of expenditure									
Consumption	3.6	4.3	-1.1	-1.1	-4.7	1.4	-6.7	2.3	5.5
General government	2.7	-1.6	1.1	-0.9	-2.6	-8.6	-3.2	-2.0	23.7
Private	3.8	5.0	-1.3	-1.1	-5.0	2.6	-7.1	2.8	3.5
Gross domestic investment	-0.7	7.4	-14.4	-14.1	-9.1	11.0	-13.7	8.5	2.2
Exports (goods and services)	-10.9	-9.6	5.8	-25.5	8.0	-9.6	15.9	4.4	29.5
Imports (goods and services)	-5.8	-3.7	-4.5	-26.2	0.9	-6.1	-6.2	3.6	33.8
				Percentages of GDP					
Investment and saving [c]									
Gross domestic investment	25.4	26.5	22.7	20.8	18.8	18.7	18.7	21.0	22.1
National saving	21.4	19.1	20.7	18.5	16.5	14.6	20.5	23.1	22.5
External saving	4.0	7.3	2.0	2.3	2.3	4.1	-1.8	-2.2	-0.4
				Millions of dollars					
Balance of payments									
Current account balance	-353	-650	-160	-165	-163	-266	93	122	30
Merchandise trade balance	-587	-865	-393	-441	-537	-614	-280	-275	-410
Exports, f.o.b.	3 797	3 328	3 549	2 312	2 329	1 890	1 858	2 175	2 706
Imports, f.o.b.	4 383	4 192	3 942	2 753	2 866	2 504	2 138	2 450	3 116
Services trade balance	-58	0	50	82	175	165	214	237	235
Income balance	110	33	6	18	22	16	43	-4	10
Net current transfers	182	181	177	175	177	167	116	165	194
Capital and financial balance [d]	306	435	177	-148	-181	217	-217	109	238
Net foreign direct investment	144	230	336	89	98	78	12	30	64
Financial capital [e]	162	205	-160	-237	-280	138	-229	79	174
Overall balance	-46	-216	17	-313	-344	-50	-124	231	268
Variation in reserve assets [f]	39	206	-23	-104	215	45	84	-301	-179
Other financing [g]	7	10	7	418	129	5	40	70	-89
Other external-sector indicators									
Real effective exchange rate (index: 2000=100) [h]	97.2	93.3	99.2	96.6	100.0	102.4	106.3	111.7	107.4
Terms of trade for goods (index: 2000=100)	104.7	106.2	108.0	101.7	100.0	100.2	96.7	101.4	104.3
Net resource transfer (percentage of GDP)	4.8	5.4	2.4	3.9	-0.4	3.7	-2.6	3.1	2.3
Total gross external debt (millions of dollars)	1 801	1 926	2 133	2 697	2 819	2 652	2 866	3 086	2 994
Total gross external debt (percentage of GDP)	20.6	21.7	26.9	36.9	39.7	41.1	56.3	54.9	43.6
Net profits and interest (percentage of exports) [i]	1.8	3.8	4.3	3.6	2.9	3.6	1.6	2.0	2.0
				Average annual rates					
Employment									
Labour force participation rate [j]	...	...	57.9	57.3	63.7	59.2	61.2	59.8	63.4
Open unemployment rate [k]	8.2	7.1	6.6	9.4	10.0	10.8	14.7	11.2	10.0
Visible underemployment rate [k]	6.1	6.3	5.9	5.3	8.2	7.4	8.1	7.8	7.5

Table 1 (concluded)

	1996	1997	1998	1999	2000	2001	2002	2003	2004 [a]
				Annual percentages					
Prices									
Variation in consumer prices (December-December)	8.2	6.2	14.6	5.4	8.6	8.4	14.6	9.3	2.8
Variation in nominal exchange rate (December-December)	6.7	8.7	23.8	16.8	6.5	32.1	49.7	-13.8	2.9
Variation in average real wage	3.1	-0.4	-1.9	-2.1	1.3	1.4	-6.4	-2.0	-2.7
Nominal deposit rate [l]	...	8.8	6.8	8.7	9.7	9.8	12.3	10.2	2.7
Nominal lending rate [m]	...	27.8	30.5	30.2	26.8	28.3	34.3	30.5	21.2
				Percentages of GDP					
Non-financial public sector									
Current income	28.9	31.6	32.9	32.2	33.1	35.0	32.6	31.4	35.0
Current expenditure	23.1	23.9	24.5	23.6	30.5	29.3	28.9	25.9	27.5
Current balance	5.8	7.7	8.4	8.6	2.6	5.6	3.6	5.6	7.5
Net capital expenditure	4.8	8.7	8.0	11.8	6.7	5.8	5.7	4.8	5.3
Global balance	1.0	-1.0	0.4	-3.1	-4.0	-0.1	-1.9	1.1	2.4
Public debt	16.5	23.2	23.5	33.5	35.3	44.0	63.0	46.3	40.9
Domestic	0.9	6.3	3.2	3.3	4.1	6.4	8.2	4.9	4.2
External	15.6	16.9	20.3	30.2	31.2	37.6	54.8	41.4	36.7
Money and credit [n]									
Domestic credit [o]	23.4	24.9	26.3	24.8	24.5	25.3	24.8	17.5	14.5
To the public sector	-2.3	-3.4	-2.7	-1.8	-1.5	-1.8	-1.6	-0.7	-1.0
To the private sector	25.7	28.3	29.0	26.6	26.0	27.0	26.4	18.2	15.5
Liquidity (M3)	24.9	27.2	27.9	28.6	30.5	31.5	29.5	27.1	26.8
Currency in circulation and local-currency deposits (M2)	15.9	16.7	14.7	13.5	13.9	13.5	12.3	11.7	13.0
Foreign-currency deposits	9.0	10.6	13.2	15.1	16.7	18.0	17.2	15.5	13.8

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

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

in international reserves, which climbed to around US$ 1.17 billion, or more than twice the record low registered in mid-2002, when they amounted to only US$ 530 million. Monetary regulation instruments have expanded less strongly and their yields have dipped steeply, from an annual rate of 12.8% in late 2003 to 4.3% at the end of 2004.

Money demand has centered on more liquid assets, such as notes and coins and sight deposits, which reflect the difficulty in channelling resources into financing for production. At the end of 2004, interest rates were 0.4% for sight deposits and 5.1% for time deposits, while the weighted average for lending rates was 22.5%.[4] The first quarter of 2005 saw an upward trend in lending rates, combined with an across-the-board drop in deposit rates. The former appear to be adjusting to expectations of higher inflation, while the latter are determined in great measure by the rates on monetary regulation instruments, which are continuing to decline.

At the end of 2004, bank lending to the private sector posted an increase of 16% in relation to 2003, thereby reversing a real downward trend that had lasted more than three years. In March 2005, bank credit to the private sector exceeded the figure registered at the end of the previous year, although the nature of the banking sector's assets means that the funds available in the system are

[4] Effective nominal rates.

Table 2
PARAGUAY: MAIN QUARTERLY INDICATORS

	2003				2004 [a]				2005 [a]	
	I	II	III	IV	I	II	III	IV	I	II
Gross domestic product (variation from same quarter of preceding year) [b]	-1.4	2.8	5.6	8.0	3.9	3.4	4.3	4.4	4.3	...
Merchandise exports, f.o.b. (millions of dollars) [c]	402	667	629	477	620	752	731	604	438	...
Merchandise imports, f.o.b. (millions of dollars) [c]	494	581	704	671	646	740	882	848	567	...
International reserves (millions of dollars)	688	769	810	969	1 001	1 071	1 180	1 168	1 188	...
Real effective exchange rate (index: 2000=100) [d]	113.6	114.1	111.1	108.2	108.2	102.4	104.8	114.6	119.9	119.2 [e]
Consumer prices (12-month percentage variation)	20.2	15.7	8.1	9.3	1.6	5.5	6.7	2.8	4.4	6.1
Average nominal exchange rate (guaraníes per dollar)	6 961	6 514	6 152	6 070	6 062	5 816	5 916	6 104	6 290	6 231
Nominal interest rates (annualized percentages)										
Deposit rate [f]	14.5	13.1	7.8	5.5	4.9	2.9	1.8	1.1	0.6	0.8 [d]
Lending rate [g]	39.6	32.9	25.8	23.5	25.0	23.1	19.4	17.2	15.6	15.5 [d]
Interbank interest rate	23.7	13.7	12.5	12.1	9.9	7.4	4.8	4.1	4.3	4.0
Domestic credit (variation from same quarter of preceding year) [h]	-2.2	-15.7	-18.3	-20.3	-19.4	-5.3	-1.0	8.6	12.2	9.5 [d]
Non-performing loans as a percentage of total credit [i]	21.7	21.6	22.7	20.6	18.6	17.4	14.9	10.4	10.3	10.3 [d]

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.
[a] Preliminary figures. [b] Based on figures in local currency at constant 1994 prices. [c] The figure for 2005 includes reported trade only. [d] Quarterly average, weighted by the value of merchandise exports and imports. [e] Data to May. [f] Weighted average of effective interest rates on deposits. [g] Weighted average of effective interest rates on loans, excluding overdrafts and credit cards. [h] Refers to net credit extended to the public and private sectors by commercial banks and other financial and banking institutions. [i] Refers to total credit extended by the banking system.

short term. Long-term lending is, moreover, constrained by the generalized climate of mistrust in the country, which is largely motivated by events occurring outside the economic sphere and notwithstanding the country's achievements in that area, and this factor undoubtedly places serious limits on economic recovery.

The central bank's intervention in the foreign-exchange market helped to stabilize the price of the guaraní and keep its real parity reasonably competitive. The real effective exchange rate dropped in the first half of the year, but this was more than offset by the depreciation that began in June and sharpened towards the end of the year, when the guaraní's real effective parity was almost 13% higher than at the end of 2003. The currency's real depreciation against the dollar amounted to about 3.9%, while the real exchange rate rose 22% against the Brazilian real and 8.5% against the Argentine peso in the same period. At the start of the second quarter of 2005 the tendency was towards a nominal appreciation of the guaraní against the dollar, coupled with a slight depreciation against the real and a stable rate of exchange with the Argentine peso.

(c) Other policies

At the end of March 2005, IMF completed the fourth review of its agreement with Paraguay, thereby making some further US$ 4.5 million available to the authorities. The government has not yet drawn on these funds, however, and continues to consider the arrangement a precautionary one.

Early in the second quarter of 2005, the government decided to continue Fund surveillance, for which it must either request an extension of the existing agreement or negotiate a new accord with the institution. The current arrangement terminates at the end of June 2005 and its final review is due in September.

3. The main variables

(a) Economic activity

In 2004 GDP growth, at 4%, exceeded the previous year's rate of 3.8%.[5] Much of this expansion occurred in the fourth quarter, when the economy surged by 12% relative to the previous quarter. Measured year-on-year, quarterly GDP was positive from the second quarter of 2003 onward, after the contraction of 2002.

Items of spending show the strongest boost to the economy coming from general government consumption, which rose by 24% after having fallen steadily since 1999. Private consumption continued to be the largest component of output, growing at a similar rate to GDP (3.5%) and above the rate of increase in investment, which was 2.7% in 2004. This last figure was lower than the 7.4% recorded in 2003, owing chiefly to a sluggish performance by the construction sector. Imports expanded at a rate that was more than high enough to offset the expansion in exports.

The main stimulus to aggregate production came from sectors producing goods of agricultural origin, as well as commerce and communications. Contrasting with the previous year, in 2004 non-arable activities made a substantial contribution to GDP growth, with an expansion of 4.6%.[6] Arable farming output rose 1.4%.

Soybean production stood at 3.6 million tons, down from 4.2 million tons in 2003, owing to poor weather conditions. International trends in soybean prices were highly favourable, however, which contributed to a steep rise in this sector's income. Cotton production came in at 330,000 tons, which was an increase of around 91% with respect to 2003.

The livestock subsector was very buoyant, with an expansion of 8%. Industrial activity was fuelled by the performance of meat packing plants and, with growth of 3%, reflected the overall trends seen in the goods production segment. Conversely, construction posted a more modest upturn of 2%, while services expanded by 5%, thanks to trends in general government services and communications and commerce, as well as fresh momentum in business services and transport and a rise in electricity generation.

In 2005 soybean production continues to feel the effects of the drought and production tonnage is likely to drop 2% in relation to 2004, which will hurt agricultural output. International prices for soybean, as well as for cotton, will also be less favourable. Cotton production will contract by close to 45%.

Per capita GDP climbed for the second year in a row (1.5% in 2004 and 1.3% in 2003), putting an end to a long stretch of zero or negative growth. Population growth has held steady at around 2.5% per year for the last four years, meaning that GDP will have to increase at an annual rate of over 4%, provided that population growth continues at the same rate, just to recoup the level of per capita GDP recorded in 1995. In 2004 Paraguay attained a good rate of growth which, if it continued, would contribute significantly to reducing the country's poverty gap; the slowdown in GDP growth this year will push this goal further away, however.

(b) Prices, wages and employment

Variations in the real exchange rate in 2004 have reflected the movements of the consumer price index (CPI), which exhibited a monthly rate of variation of 0.3% at the start of the year, followed by negative movements for several months in the middle of the year, and a monthly variation of 1.6% in December. The rate of inflation came in at 2.8% for the year overall, after reaching 9.3% in 2003 and 14.6% in 2002. The guaraní posted a year-on-year nominal depreciation of 2.9% against the United States dollar in December 2004.

Consumer price variations reflected the sum of opposite movements in two groups of products: downward pressure coming from foods, especially non-processed products, and upward pressure generated by fuels.

The rate of inflation for 2005 is expected to be around 8%, close to the upper limit stipulated under the standby agreement with IMF, which sets a target of 6% with a 2% margin on either side. If this inflation rate of 8% is to be achieved at the year's end, monthly consumer prices rises may average no more than 0.35% from June to December (which would be lower than the rates recorded in the

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5 Based on the methodology used previously, growth for 2003 would have been 2.6%.

6 Corresponds to the aggregate growth of sectors other than arable farming: livestock, forestry, and fishing; mining and manufacturing; electricity and water; construction; commerce, services and goods imports.

preceding months). The movements of the CPI will be closely tied to diesel fuel prices and imported inflation from Brazil, Paraguay's main trading partner.

The nationwide rate of open unemployment eased back from 8.1% in 2003 to 7.3% in 2004, at the same time as the labour force participation rate increased from 59.8% to 63.4%. Urban unemployment stood at 10%, which was lower than the rate of 11.2% posted in 2003, while the underemployed population expanded by 8.2% countrywide and by 6.3% in urban areas. Real wages for manual workers fell by almost 2.7%, signifying a fresh loss in their purchasing power. In the first quarter of 2005 the nationwide minimum wage was raised 12%, but given the proportion of the economy in the informal sector, this measure could have only a limited impact on income redistribute income and poverty reduction.

(c) The external sector

The external-sector accounts show a surplus of some US$ 268 million on the overall balance of payments. This was an increase of 16% with respect to 2003 and enabled the government to build up international reserves and pay off external liabilities.

The current-account balance continued to run a surplus, this time of US$ 30 million. Year on year, the value of goods exports climbed by 24% compared to 2003, but the export basket is heavily concentrated in a small range of goods which go, moreover, mainly to a limited number of countries, thus exacerbating the Paraguayan economy's vulnerability. Good imports increased at a faster rate than exports, rising by 27% with respect to the previous year on the back of the economic upswing. As a result, the trade balance turned in a deficit of US$ 410 million, sharply up from the same period of 2003 when the negative balance stood at US$ 275 million. The balances on services, income and current transfers have been fairly favourable, which has contributed to the positive trends seen in the current-account balance. Weaker growth in the economies of Paraguay's main trading partners is expected to slacken the country's export growth in 2005, and this will diminish its current-account surplus. In Brazil, Paraguay's foremost trading partner, more subdued private consumption and investment caused, in turn, by domestic interest rate rises, will lead to a more sluggish performance than in 2004 (4.9%). Economic trends in Argentina remain positive, but are expected to slow in 2005.

The balance on the capital and financial accounts has remained positive, although, like the current-account balance, with a smaller surplus than in 2003.[7] Foreign direct investment performed well, increasing by 114% with respect to 2003 and 432% compared with the ten-year low recorded in 2002. Most of the investment flows went to the utilities sector.

The external public debt stock[8] declined in relation to 2003, thanks to payments of capital and interest by the public sector. At the year's end, the external public debt amounted to US$ 2.4 billion, or the equivalent of 36% of GDP, which represented a lightening of the external public debt burden compared with the figure of 44% of GDP registered in 2003. The bulk of the external public debt is long term and carries favourable rates of interest. With regard to the distribution of creditors, in 2004 most of Paraguay's external debt fell into two categories: debt equivalent to 54.5% of the total owed to international agencies, and debt owed to foreign governments, amounting to 45.5%. Commercial banks and private creditors no longer account for a significant proportion of Paraguay's external creditors. At the end of the first quarter of 2005, the external public debt amounted to US$ 2.379 billion.

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7 Not including errors and omissions.

8 Refers to gross external debt.

Peru

1. General trends

In 2004 Peru's economy outstripped early expectations to post a growth rate of 4.8%, thanks to export buoyancy and an upturn in private investment. Favourable external conditions and the macroeconomic rationalization begun in previous years were also contributing factors. In this context, Peru's trade balance closed with a hefty US$ 1.95 billion surplus, while the balance-of-payments current-account deficit dropped to just US$ 10 million. International reserves climbed by over US$ 2.4 billion, to stand at US$ 12.6 billion, which sufficed to cover the totality of dollar liabilities in the banking system, in addition to short-term external debt.

Price stability was undermined in the course of 2004 by the high cost of fuels. Nevertheless, the year-on-year increase in prices was 3.5% at the end of 2004, which was in fact the ceiling of the range established by the authorities in the context of their inflation-targeting regime.

Economic growth had little effect on labour indicators. Although there was a fair amount of formal job creation, this was not enough to bring down unemployment, which remained at 9.4%. The slack performance of the labour market also meant that real wages stood still.

Exports and investment continued to expand apace in early 2005. With spending expected to increase more briskly this year, annual GDP growth should be slightly higher than last year, while inflation will remain within the 1.5% to 3.5% range allowed by the authorities.

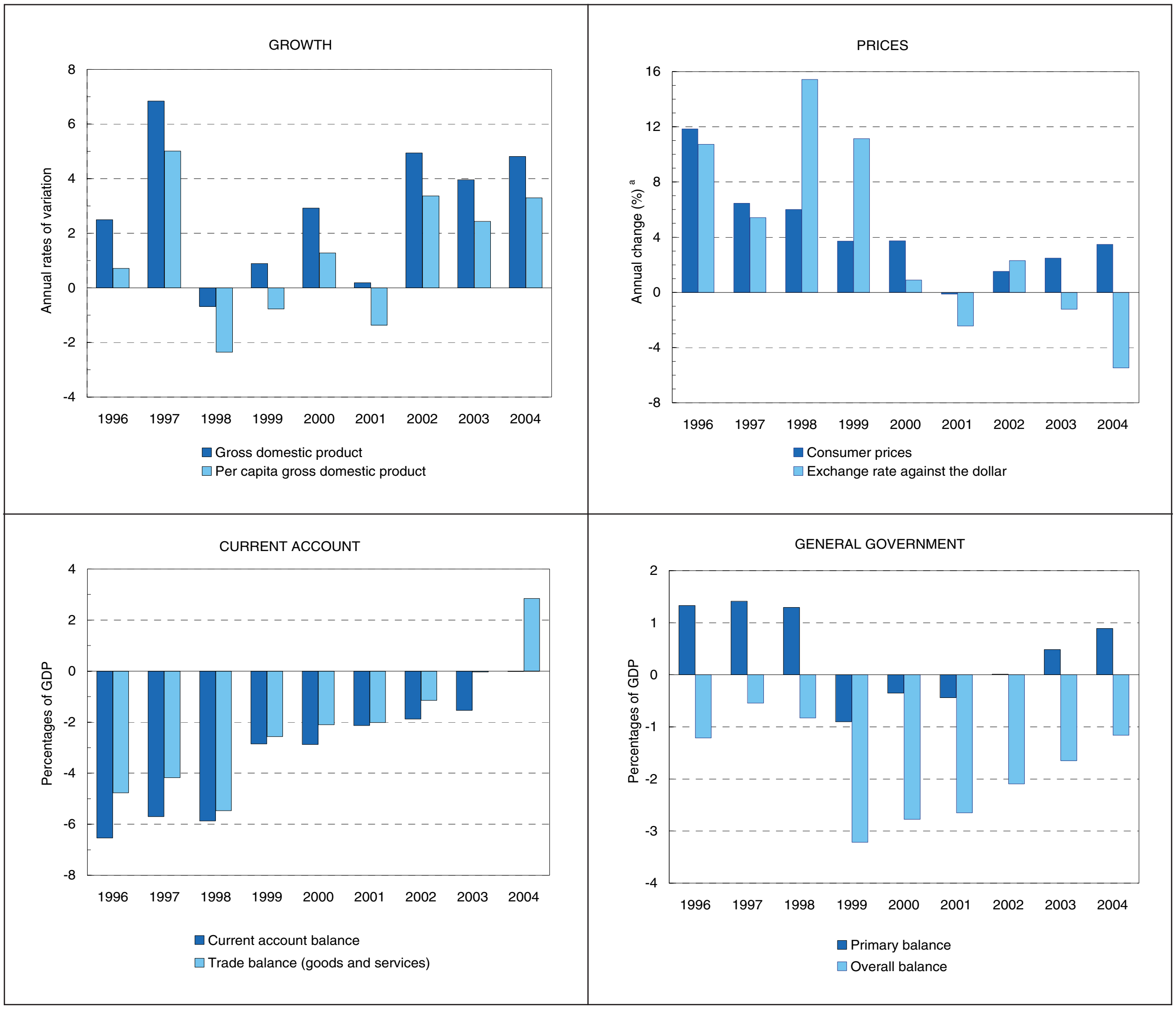
2. Economic policy

In 2004 and the first semester of 2005, economic policy continued in the same vein as recent years. The main policy objectives were to foster economic growth and price stability, reduce the vulnerability of the economic and financial sectors and strengthen Peru's trading position in the international markets.

The favourable external conditions smoothed the way for substantial progress in improving the fiscal accounts, reducing the degree of dollarization of the financial system, augmenting international reserves and managing external debt. Monetary policy helped to spur economic growth since, although benchmark interest rates rose twice in 2004, they remained low in real terms. Meanwhile, the tax authorities took the opportunity to further consolidate the public finances.

As a result, the government did not need to draw on the funds available under its arrangement with the International Monetary Fund (IMF), but nevertheless signed a new standby agreement in June 2004. Efforts to deepen the country's trade integration revolved around negotiations, conducted jointly with Colombia and Ecuador, on a free trade agreement with the United States.

Figure 1
PERU: MAIN ECONOMIC INDICATORS



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

(a) Fiscal policy

Seeking to ensure the sustainability of its public debt, Peru has instituted a multi-year plan that envisages steadily reducing the fiscal deficit by generating a growing primary surplus. Auspicious economic circumstances in 2004 enabled faster progress in this direction than had been scheduled. The deficit of the non-financial public sector (NFPS) narrowed from 1.7% of GDP in 2003 to 1.1%, compared with the target of 1.4%. At the same time, the primary surplus increased from 0.4% to 1.0% of GDP (as against the target of 0.7%).

The targets for 2005 —a NFPS deficit of 1.0% and a primary surplus of 1.2% of GDP— therefore look quite feasible, especially since fiscal revenues rose in the early months of the year. This more ample room for manoeuvre could put extra pressure on spending, however, especially in a year preceding elections.

During this reporting period the authorities took a number of steps to boost fiscal income, which was considered insufficient to sustain physical and social infrastructure expenditures. In particular, the highest rate of income tax payable by private individuals was increased from 27% to 30%. A three-year tax on financial transactions was also introduced, at a rate of 0.1% for 2004 and 0.08% for 2005. In addition, a temporary tax on net assets was approved, levying a rate of 0.6% on corporate net assets in excess of 5 million new soles. Efforts to improve the efficiency of collection procedures also continued.

Combined with the beneficial effects of economic growth, these measures more than compensated for the drop in income resulting from the January 2004 cut in the rate of the special "solidarity tax" and its elimination in December, and from the lowering of the excise tax on fuels in response to rising petroleum prices. Between 2003 and 2004 the central government's income thus climbed from 15.1% to 15.2% of GDP, thanks in large part to the hikes in income tax and general sales tax, as well as the contribution of the tax on financial transactions (0.3% of GDP).

The central government's current income continued to expand in the first semester of 2005, with an increase of 16% in real terms.

Public spending management was a contributing factor in the better fiscal performance in 2004, since although all the major items of the central government's current spending increased in real terms, they were outpaced by GDP. Despite an upsurge at the end of the year, capital spending continued to trend downwards with respect to output, at only 1.8% for the central government and 3.0% for the NFPS (compared with a high of 5.9% in 1994). The central government's total spending dropped from 16.9% to 16.5% of GDP.

One measure that will have a major impact on fiscal affairs, albeit essentially in the long term, is the reform enacted in early 2005 to the pension regime governed by Decree Law 20530 (a special indexed pension scheme known as "cédula viva"). This reform stopped up a source of major potential increase in expenditure by establishing ceilings on pensions and closing the system to new entrants.

By contrast to the previous year, in 2004 the deficit was financed from external sources, principally two issues of sovereign bonds. Amortizations of domestic debt exceeded fresh domestic issues, and privatizations and concessions accounted for a mere 0.2% of GDP. Public debt dropped from 47.3% to 43.3% of GDP.

(b) Monetary and exchange-rate policy

The monetary authorities continued to apply an inflation-targeting regime in 2004 and 2005. The target was a rate of 2.5% by the end of 2004, with a one percentage point margin on either side. Between June and November, the inflation rate breached the ceiling of the band and, although the authorities considered the upsurge to be only temporary, they raised the benchmark rate of interest on two separate occasions (August and November), bringing it to 3.0%, compared to 2.5% early in the year. The interbank rate followed suit but, as competition mounted in the financial market, commercial bank lending rates in local currency continued to inch downwards, from an average of 20.2% in 2003 to 18.7% in 2004 and 18.3% in the first semester of 2005 (average fixed rates).

The achievement of the inflation target was eased by the real appreciation of the new sol in the second semester of 2004, a trend which continued into early 2005. Contributing factors in this were the local currency's real appreciation against the United States dollar (an average of 2.8% in 2004), sparked by the turn for the better in the country's external accounts, and the dollar's weakness against other foreign currencies. A result of this was that the authorities built up US$ 2.34 billion in 2004 and US$ 2.118 billion in the first semester of 2005 and therefore had to step up sterilization measures. The balance on deposit certificates in the central reserve bank increased from 4.097 billion new soles in December 2003 to 10.465 billion in June 2005. Even so, primary money creation recorded an expansion of over 25% in 2004, though this did not trigger a surge in inflation thanks to a strong demand for local currency driven, in turn, by the de-dollarization process.

Lending by the financial system, which had tended to wane in previous years, gathered fresh momentum with an expansion of loans both in new soles (a nominal 11.0%) and in United States dollars (3.9%), thus helping to fuel economic growth. This trend steepened into the early months of 2005.

This expansion occurred in the context of greater stability in the financial system, as illustrated by the steady shrinking of the arrears portfolio, which narrowed from 5.8% in December 2003 to 3.3% in May 2005. In order to spur de-dollarization, in October 2004 and February 2005 the central bank reduced the rate of interest payable on the additional reserve held by financial entities with the central bank, and legislation was passed requiring that all commercial prices be expressed in local currency. Dollar-denominated loans extended by the financial system to the private sector did in fact drop from 73.1% in late 2003 to 69.7% in May 2005. Given that the new sol is expected to appreciate further, de-dollarization is occurring faster in savings: in the same period, the dollar-denominated proportion of liquidity declined from 47.2% to 41.0%. The appreciation of the local currency clearly has a role in shaping these results.

(c) Other policies

The authorities forged ahead with their efforts to integrate Peru more deeply into the international markets.

Table 1

PERU: MAIN ECONOMIC INDICATORS

	1996	1997	1998	1999	2000	2001	2002	2003	2004 [a]
				Annual growth rates [b]					
Gross domestic product	2.5	6.8	-0.7	0.9	2.9	0.2	4.9	4.0	4.8
Per capita gross domestic product	0.7	5.0	-2.4	-0.8	1.3	-1.4	3.4	2.4	3.3
Gross domestic product, by sector									
Agriculture, livestock, hunting, forestry and fishing	4.5	5.0	-0.3	11.0	6.8	-0.1	5.9	1.3	0.4
Mining	5.1	9.0	3.7	13.1	2.4	9.9	12.5	6.8	5.4
Manufacturing	1.5	5.3	-3.5	-0.7	5.8	0.7	4.1	2.4	6.7
Electricity, gas and water	5.9	12.7	6.2	3.0	3.2	1.6	5.5	4.9	4.6
Construction	-2.3	14.9	0.6	-10.5	-6.5	-6.5	7.9	4.2	4.7
Wholesale and retail commerce, restaurants and hotels	1.4	7.5	-2.7	-0.6	3.4	0.7	3.8	3.5	4.9
Transport, storage and communications	5.6	5.6	-1.0	2.1	2.6	-0.4	3.7	4.9	7.2
Financial institutions, insurance, real estate and business services	5.3	8.1	0.3	-1.1	2.0	-1.5	4.9	4.2	3.8
Community, social and personal services	2.1	2.8	0.4	3.9	1.7	0.0	3.8	4.7	3.9
Gross domestic product, by type of expenditure									
Consumption	3.2	4.8	-0.6	0.0	3.6	1.1	4.1	3.2	3.5
General government	4.4	7.6	2.5	3.5	3.1	-0.9	0.2	3.8	4.1
Private	3.1	4.5	-0.9	-0.4	3.6	1.4	4.6	3.1	3.4
Gross domestic investment	-4.9	14.9	-2.3	-13.6	-2.7	-7.5	4.4	4.6	5.8
Exports (goods and services)	8.9	13.1	5.6	7.6	8.0	7.2	6.9	6.3	14.7
Imports (goods and services)	0.1	12.2	2.3	-15.2	3.8	2.7	2.6	3.5	10.4
				Percentages of GDP					
Investment and saving [c]									
Gross domestic investment	22.8	24.1	23.7	21.2	20.2	18.8	18.7	18.8	18.5
National saving	16.3	18.4	17.8	18.3	17.4	16.7	16.9	17.3	18.5
External saving	6.5	5.7	5.9	2.8	2.9	2.1	1.9	1.5	0.0
				Millions of dollars					
Balance of payments									
Current account balance	-3 646	-3 367	-3 321	-1 464	-1 526	-1 144	-1 063	-935	-10
Merchandise trade balance	-1 991	-1 678	-2 437	-655	-411	-195	292	836	2 793
Exports, f.o.b.	5 878	6 825	5 757	6 088	6 955	7 026	7 714	9 091	12 617
Imports, f.o.b.	7 869	8 503	8 194	6 743	7 366	7 221	7 422	8 255	9 824
Services trade balance	-671	-786	-657	-663	-705	-890	-941	-854	-843
Income balance	-1 899	-1 822	-1 204	-1 112	-1 410	-1 101	-1 457	-2 144	-3 421
Net current transfers	914	920	977	966	999	1 042	1 043	1 227	1 461
Capital and financial balance [d]	4 526	5 421	2 080	602	1 384	1 568	2 030	1 459	2 427
Net foreign direct investment	3 488	2 054	1 582	1 812	810	1 070	2 156	1 275	1 816
Financial capital [e]	1 038	3 367	498	-1 210	575	498	-125	184	611
Overall balance	880	2 055	-1 241	-862	-142	423	968	525	2 417
Variation in reserve assets [f]	-1 784	-1 493	1 142	985	440	-275	-852	-516	-2 443
Other financing [g]	904	-562	99	-122	-298	-148	-116	-9	26
Other external-sector indicators									
Real effective exchange rate (index: 2000=100) [h]	90.6	90.7	91.7	101.5	100.0	97.8	95.6	99.8	101.3
Terms of trade for goods (index: 2000=100)	104.9	115.5	103.4	100.8	100.0	95.6	98.4	102.2	111.3
Net resource transfer (percentage of GDP)	6.3	5.1	1.7	-1.2	-0.6	0.6	0.8	-1.1	-1.4
Total gross external debt (millions of dollars)	33 781	28 863	30 142	28 586	27 981	27 195	27 872	29 587	31 117
Total gross external debt (percentage of GDP)	60.5	48.9	53.2	55.6	52.7	50.6	49.3	48.7	45.3
Net profits and interest (percentage of exports) [i]	9.3	11.0	2.9	0.2	4.1	1.5	5.2	10.3	15.9
				Average annual rates					
Employment									
Labour force participation rate [j]	60.3	63.3	65.4	66.9	64.4	66.7	68.4	67.4	68.1
Open unemployment rate [k]	8.0	9.2	8.5	9.2	8.5	9.3	9.4	9.4	9.4
Visible underemployment rate [k]	16.1	14.5	11.6	11.3	11.3	11.7	10.7	8.8	8.6

Table 1 (concluded)

	1996	1997	1998	1999	2000	2001	2002	2003	2004 [a]
				Annual percentages					
Prices									
Variation in consumer prices (December-December)	11.8	6.5	6.0	3.7	3.7	-0.1	1.5	2.5	3.5
Variation in wholesale prices (December-December)	11.4	5.0	6.5	5.5	3.8	-2.2	1.7	2.0	4.9
Variation in nominal exchange rate (December-December)	10.7	5.4	15.4	11.1	0.9	-2.4	2.3	-1.2	-5.5
Variation in average real wage	-4.7	-0.7	-2.0	-2.1	0.8	-0.9	4.6	1.6	-1.7
Nominal deposit rate [l]	...	10.3	10.9	11.8	9.8	7.5	3.5	3.1	2.4
Nominal lending rate [l]	...	31.0	32.7	35.1	30.0	25.0	20.8	21.0	24.7
				Percentages of GDP					
General government									
Current income	18.6	19.0	18.9	17.7	17.9	17.2	17.2	17.6	17.8
Current expenditure	15.6	15.0	15.8	16.9	17.3	17.0	16.8	16.7	16.3
Current balance	2.9	4.0	3.2	0.8	0.6	0.2	0.5	0.9	1.5
Net capital expenditure	4.1	4.5	4.0	4.0	3.4	2.9	2.6	2.5	2.6
Primary balance	1.3	1.4	1.3	-0.9	-0.4	-0.4	0.0	0.5	0.9
Overall balance	-1.2	-0.5	-0.8	-3.2	-2.8	-2.6	-2.1	-1.6	-1.2
Central government public debt	47.8	32.6	43.6	49.1	46.1	45.2	46.8	47.3	43.3
Domestic	0.0	0.0	6.3	9.7	9.6	10.6	10.2	10.0	9.1
External	47.8	32.6	37.3	39.4	36.5	34.7	36.6	37.3	34.3
Interest payments (percentage of current income)	15.9	11.1	11.9	14.4	14.7	15.0	13.8	13.3	12.5
Money and credit [m]									
Domestic credit [n]	16.1	20.3	25.4	27.7	27.1	26.4	25.0	22.3	19.4
To the public sector	-1.9	-1.1	-0.5	-0.3	0.9	1.3	1.6	1.3	0.7
To the private sector	18.0	21.4	25.9	28.0	26.2	25.1	23.3	21.0	18.7
Liquidity (M3)	19.7	21.5	23.3	25.2	25.0	25.4	25.4	24.5	23.0
Currency in circulation and local-currency deposits (M2)	6.7	7.0	7.6	7.4	7.3	7.7	8.5	8.8	9.3
Foreign-currency deposits	12.9	14.5	15.7	17.8	17.7	17.8	16.9	15.7	13.7

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.
[a] Preliminary figures. [b] Based on figures in local currency at constant 1994 prices. [c] Based on figures in local currency expressed in dollars at current prices. [d] Includes errors and omissions. [e] Refers to the capital and financial balance (including errors and omissions), minus net foreign direct investment. [f] A minus sign (-) denotes an increase in reserves. [g] Includes the use of IMF credit and loans and exceptional financing. [h] Annual average, weighted by the value of merchandise exports and imports. [i] Refers to net investment income as a percentage of exports of goods and services as shown on the balance of payments. [j] Economically active population as a percentage of the working-age population, Lima metropolitan area; 1996-2000, urban total. [k] Unemployment and underemployment rates as percentages of the economically active population, Lima metropolitan area. [l] Average rate. [m] The monetary figures are annual averages. [n] Refers to net credit extended to the public and private sectors by commercial banks and other financial and banking institutions.

To this end, in May 2004 Peru began negotiations, jointly with Colombia and Ecuador, on a free trade agreement with the United States.

After the privatization of two electricity companies was called off in 2002 amid massive protests, no further large-scale privatization projects were broached. In 2004, the State sold its stake in the La Pampilla refinery and awarded concessions for the operation of the Yuncán hydroelectric project, the copper mine of Las Bambas and, at the start of 2005, the Bayóvar phosphate mine.

3. The main variables

(a) Economic activity

As in previous years, in 2004 exports were the main engine of overall demand, climbing 15.0%. Thanks in particular to the thrust of private investment, net fixed capital formation rose 8.7% in real terms, which nudged gross domestic investment up from 18.2% to 18.3% of GDP (at constant prices).

Table 2

PERU: MAIN QUARTERLY INDICATORS

	2003				2004 [a]				2005 [a]	
	I	II	III	IV	I	II	III	IV	I	II
Gross domestic product (variation from same quarter of preceding year) [b]	5.8	3.8	3.3	3.2	4.8	3.2	4.7	6.6	5.4	...
Merchandise exports, f.o.b. (millions of dollars)	2 023	2 188	2 320	2 454	2 747	1 967	3 389	3 607	3 707	...
Merchandise imports, c.i. f. (millions of dollars)	2 043	1 983	2 087	2 144	2 131	1 591	2 545	2 732	2 658	...
International reserves (millions of dollars)	10 443	9 997	9 755	10 194	10 411	10 855	11 187	12 631	13 555	14 044
Real effective exchange rate (index: 2000=100) [c]	97.2	99.4	100.2	102.3	103.1	101.9	99.9	100.3	100.9	100.7 [d]
Unemployment rate	10.0	9.3	9.0	9.4	10.6	9.5	8.9	8.7	11.3	9.7
Consumer prices (12-month percentage variation)	3.4	2.2	2.0	2.5	2.8	4.3	4.0	3.5	1.9	1.5
Average nominal exchange rate (new soles per dollar)	3.49	3.48	3.48	3.48	3.47	3.48	3.40	3.30	3.26	3.26
Average real wage (variation from same quarter of preceding year)	...	0.2	...	2.6	...	1.6	...	...	...	...
Nominal interest rates (annualized percentages)										
Deposit rate [e]	3.5	3.3	3.0	2.7	2.4	2.4	2.4	2.5	2.5	2.7
Lending rate [e]	20.2	20.2	21.5	22.2	24.1	24.6	25.1	25.0	26.2	25.9
Interbank interest rate	3.8	3.8	3.1	2.9	2.5	2.5	2.6	3.0	2.9	3.0
Sovereign bond spread (basis points)	478	491	355	312	343	439	323	220	239	206
Stock price index (in dollars, December 2000=100)	171	186	209	263	294	245	273	295	313	304
Domestic credit (variation from same quarter of preceding year) [f]	-4.1	-5.6	-7.4	-5.1	-3.9	-2.2	-5.1	-2.9	-1.4	-1.3 [g]
Non-performing loans as a percentage of total credit [h]	7.7	7.7	7.6	5.8	5.8	5.1	4.6	3.7	3.6	3.0

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

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

Reflecting a small increase in the employment rate —and stoked by the expansion of credit— private consumption rose a moderate 3.4%. Overall, domestic demand increased by 3.8% (compared with 3.5% in 2003) and global demand, by 6.9%. In contrast to previous years, imports, too, responded to the economic upturn and rose in volume by 10.1%. GDP expanded by 4.8%.

The upswing spread across the board, with almost all branches of activity growing by over 4%. Agriculture alone experienced a downturn, which was attributable to poor weather conditions that reduced the area sown and lowered the yield of many crops, though the livestock segment recorded a modest gain. The outlook for 2005 is brighter, with an estimated growth rate of 4% for the sector. Fishing outstripped the other branches of activity, more than compensating for its contraction in 2003, thanks to greater availability of marine species for human consumption and industrial processing alike.

The expansion of mining slackened, partly due to a drop in the metal content of the ore extracted, as well as the fact that no major new deposits came on stream. By contrast, the start-up of operations in the Camisea gas field reversed the downward trend in hydrocarbons production. Mining is expected to expand by 6% in 2005.

Manufacturing posted a climb of 6.7%, mainly on the back of expansion of over 7% in the non-primary segment, which benefited from access to the United States market (especially in the case of textiles), and a modest upturn in domestic demand. This robust performance carried over into 2005, with non-primary activities again leading the way, and the sector is expected to turn in a growth rate of 5% for the year overall.

Construction was up by 4.7%, continuing the upswing begun in 2002. The increase was mainly attributable to private investment projects and was fuelled by an increase in mortgage lending. Commerce got off to a slow start in

2004, but was revitalized in the second semester by the swell in consumption and recorded a rate of 4.8% for the year overall. Other services expanded by 4.7%. All three segments should record similar or slightly higher rate of expansion in 2005.

Based on the Peruvian economy's buoyant performance in the first five months of 2005, when it expanded by 6.0%, it is expected to report a growth rate of around 5.5% for the year overall.

(b) Prices, wages and employment

Higher prices for certain agricultural goods, domestic and imported alike (due to adverse weather conditions in the former case), and, especially, for fuels drove up consumer inflation in Metropolitan Lima, which thus in the first half of the year came in over target to post a year-on-year increase of 4.6% in July. In August, inflation began to ease back down and ended the year at the upper limit of the band set as part of the authorities inflation-targeting scheme, at 3.5%.[1] At the start of 2005, this downward trend steepened and in June inflation was 1.5%, although fuel prices continued to exert upward pressure.

Formal employment in urban areas climbed by an average of 2.7% over the year. The employment rate in Metropolitan Lima rose by half a percentage point. Since the economic growth encouraged people who had not been economically active into the labour market, however, the rate of unemployment did not give ground, but remained at an annual average of 9.4%. The weakness of the labour market was also a factor in prompting large-scale emigration, involving some 300,000 people in 2004. At the start of 2005 the creation of formal employment gathered pace (up 3.7% in the first five months), although this positive development failed to have an a effect on unemployment in Metropolitan Lima.

Mounting demand for labour did not impact on wages, since in 2004 the average nominal labour income of employed inhabitants of Lima increased by only 1.9%, which represented a drop of 1.7% in their purchasing power.

(c) The external sector

Thanks to strong demand for raw materials from Asia and access to the United States market —facilitated by the Andean Trade Promotion and Drug Eradication Act (ATPDEA)— exports surged by almost 40% to over US$ 12.6 billion. This expansion reflected an increase in both traditional and non-traditional exports (42% and 33%, respectively). Prominent among the first group were certain metals, which benefited from high international prices, especially copper, of which sales almost doubled, but also lead, tin, silver, iron and gold. In some cases, again notably copper, export volumes also increased. Agricultural goods (such as coffee) and fishing products were also served by improvements in both prices and production. All the non-traditional export segments performed very strongly, with a case in point being textiles, whose sales exceeded US$ 1 billion for the first time.

Following on from the positive trend in export prices, terms of trade improved by 8.9%.

As a result of the uptick in investment, capital goods imports increased by 19%, but remained below the figures seen in the second half of the 1990s. High fuel prices contributed to an expansion in imports of intermediate goods (23%) and a small rise in private consumption signified an increase in imports of consumer goods (7%), which outstripped the previous high recorded in 1998.

The vigorous expansion in exports produced a large trade surplus which, despite a hefty increase in the factor services deficit, practically wiped out the balance-of-payments current-account deficit. This was also partly attributable to an increase (to US$ 1.467 billion) in current transfers. Exports continued to grow strongly in the first part of 2005 (36% in the first five months) and it is estimated that they will represent over US$ 14 billion for the year overall.

Due in part to an increase in foreign direct investment, in 2004 the financial account recorded its largest surplus since 1997. As a result, the overall balance was in surplus by over US$ 2.4 billion, boosting net international reserves from US$ 10.194 billion at the end of 2003 to US$ 12.631 billion twelve months later and over US$ 13.8 billion at the end of the first semester of 2005.

External public debt rose in 2004, as the government floated bonds for US$ 500 million in April and 650 million euros in October, taking advantage of relatively favourable borrowing conditions created by the drop in sovereign bond spreads from an average of 429 basis points in 2003 to 349 in 2004. This trend was still in evidence at the start of 2005, with a the figure of 229 basis points for the first semester. External debt measured in dollars also expanded due to the appreciation of the euro. In terms of GDP, however, total external debt came down from 48.7% to 45.3%, thanks to a decrease in private debt. A new bond issue was launched in January 2005, this time for US$ 400 million. The authorities were also able to reprofile Peru's debt to the Paris Club, which eased its amortization schedule. To this end, in July a fresh bond issue was launched on the domestic market and another, for US$ 750 million, was floated on the external market.

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[1] The more recently instituted nationwide consumer price index showed a 3.7% year-on-year increase in December.

Uruguay

1. General trends

In 2004 the Uruguayan economy recorded GDP growth of 12.3%, which was much higher than expected. The fastest-growing sector was manufacturing (21.6%), and it was also the largest contributor to overall growth (3.7%). Despite this exceptional result, per capita GDP was 9.5% less than in 1998. Domestic demand increased by 13.3%, with rises of 11.4% in final consumption expenditure and 27% in gross capital formation.

This favourable economic performance occurred amid significant political events, such as the national elections in October 2004, which were won by a political grouping which was new to national government. The new authorities taking office in March 2005 carried on the existing macroeconomic policy, aiming to maintain a tight rein on the fiscal accounts, keep inflation low and ensure an unpressured external situation. They also adopted important social measures, including the implementation of a social emergency plan to help the most needy sectors.

The country also reduced its vulnerability in real and financial terms. First, exports diversified: sales to MERCOSUR came down to 26% of the total (from 55% in 1998), while exports going to the United States and Europe expanded to 20% and 22%, respectively. Second, as regards finance, high economic growth, combined with the Uruguayan peso's appreciation against the dollar, helped to reduce the external debt to GDP ratio, which diminished from 98% in 2003 to 88% at the end of 2004. The gross external debt stood at US$ 11.597 billion at the end of the year.

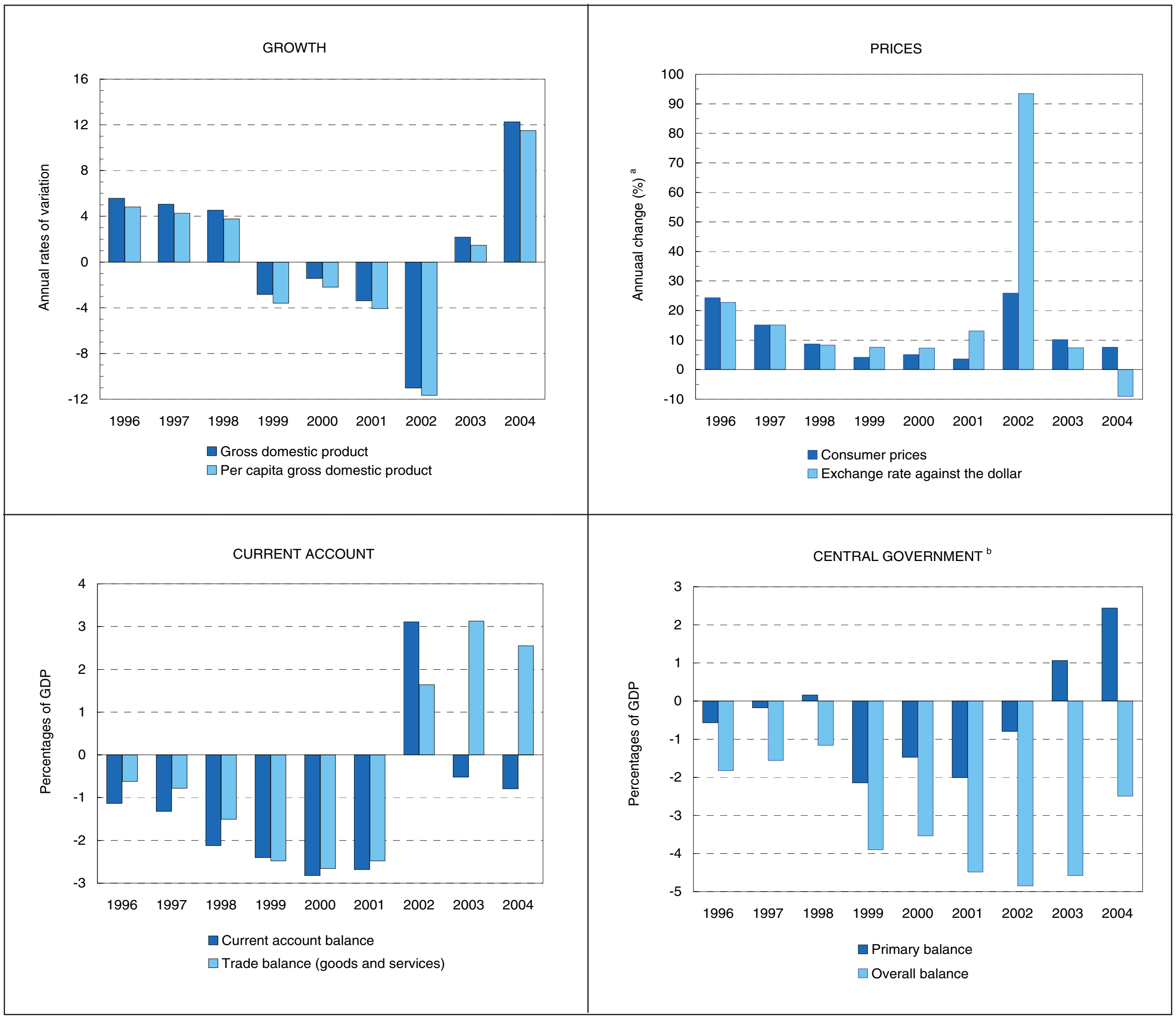
The December-December inflation rate declined by almost three percentage points in 2004 and was close to the floor of the target range of 7%-9%, after the upward trend of the price index had been broken by a dip of 0.33% in October, the first monthly deflation since August 2001. With the inflation target on track, the government loosened its monetary policy, thus allowing the monetary base to expand by 1.574 billion pesos in 2004.

Although fiscal policy was not countercyclical, since the current primary expenditure of the non-financial public sector (NFPS) was up by a nominal 11.6%, rising income resulted in a public-sector primary surplus of around 3.9% of GDP, together with an overall deficit of 2% of GDP. Both figures were well within the targets set out in the agreement with the International Monetary Fund (IMF), which allowed a primary surplus of 3.4% of GDP and a deficit of 2.9%.

Unemployment continued to trend downwards to reach a moving average of 12.1% in the last quarter and the real average wage showed no change in relation to 2003. The informal sector of employment expanded and the percentage of individuals living below the poverty line continued to increase, reaching 31.2% of the population (up from 30.9% in 2003).

In 2005, the Uruguayan economy is expected to achieve 6% growth in a favourable regional context. Inflation will come in at around 5.5%-6.5% and the primary surplus will be 3.5% of GDP, with an overall deficit of 1.5% of GDP.

Figure 1
URUGUAY: MAIN ECONOMIC INDICATORS



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.
[a] December-December variation.
[b] In 1999 the accounting methodology was changed.

2. Economic policy

(a) Fiscal policy

Although in 2004 Uruguay easily met the primary surplus and overall balance targets agreed upon with IMF, part of the primary surplus accumulated in the first nine months of the year (4.3% of GDP) was spent during the fourth quarter. Moreover, some of the reforms set out in the respective Letter of Intent were not implemented, including a tax reform intended, among other things, to eliminate certain exemptions and reduce the number of taxes (though without raising the tax burden), and a reform to the pension funds for police, military and bank personnel.

In addition, the large taxpayer unit proposed within the Tax Administration Department was not set up, although evasion control and higher levels of economic activity led to an increase in receipts, to which VAT contributed prominently with 19% real growth over the year.

Central government income also expanded by 13.7% in real terms, while NFPS revenue grew by a somewhat lower 9.2%, in view of losses sustained by public enterprises. NFPS disbursements were up by a real 3.1% over the 2003 figure, thanks to the limited increase in social security benefits (0.4%). Central government investment rose by about 34%, although in constant terms it amounted to only two thirds of the level reached in 1998.

By May 2005, the 12-month moving average of the primary surplus stood at 3.9% of GDP and the overall deficit was 1.4%, while the Tax Administration Department's receipts grew by 6.4% in real terms over the first five months of the year.

In view of the heavy debt/GDP ratio, the government's fiscal policy will have to remain tight on the expenditure side in order to ensure compliance with the agreed primary surplus targets and bring the external debt/GDP ratio down to 60% within five years. Spending is under pressure, however, both to improve wage levels and to increase public investment, in the energy sector among others. Nevertheless, civil servants and private-sector wage earners alike benefited from the income tax reduction brought in last year. In January, social security benefits were delinked from rises in the minimum wage.

As of 2006, Uruguay will be facing large payments on maturing external debt, representing 20% of GDP, and will have to turn to the international financial markets to secure the necessary resources. In November 2004, the successful review of the current drawing rights agreement with IMF led to the release of US$ 212.3 million, which went to pay debt maturing in the first quarter of 2005. Uruguay's financing needs for 2005 amount to US$ 500 million, which led the government to issue US$ 300 million, then a further US$ 200 million, in bonds maturing in 2017. These bonds carry an annual interest rate of 9.25% and are repayable at maturity. These issues, together with another for 300 million euros (maturing in 2016 at an annual interest rate of 6.875%), will cover more than 60% of the country's financing needs in 2006.

The new government gave priority to the national social emergency plan (PANES). The plan, costing the equivalent of 0.5% of GDP, will be implemented by the new Ministry of Social Development. It is a temporary, two-year programme, directed towards population groups living in extreme poverty, and is intended not only to guarantee basic needs coverage, but also to offer an exit from indigence and poverty for the most vulnerable sectors of the population.[1] PANES will include the provision of food assistance, contingent monetary transfers, emergency health services, temporary work and services for the homeless.

(b) Monetary policy

At the beginning of 2003 the Uruguay's central bank started to apply a monetary policy directed towards controlling monetary aggregates, in order to meet its inflation targets. Some of the targets were altered in 2004 to increase flexibility, with one of the most significant changes being the adoption of a target range instead of a single value for the monetary base. In addition, greater use was made of a number of local-currency-denominated instruments in order to reduce the economy's degree of dollarization.

Given the extent of dollarization in the economy, and in view of the decline of the exchange rate and the change in the monthly inflation trend in October, the central bank shifted to a more flexible monetary policy stance. In the last quarter of the year, consumer prices showed a variation of -0.5%, which compared to rates of 2.8%, 2.6% and 2.5% in the previous three quarters.

At the end of November 2004, the central bank raised the operating target of the monetary base to 1.9% below the ceiling of the target range. In 2004, the monetary base expanded by 1.574 million Uruguayan pesos, bringing the annual average to the level envisaged by the central bank. Meanwhile, interest rates trended downwards. Interest rates on peso-denominated bills placed on the primary market went down from 20% in September to 6% at the end of December. The one-day interbank rate behaved in a similar fashion. In December, the central bank began to publish the variations in monetary assets and liabilities on a daily basis in order to enhance the transparency of financial information.

Private-sector deposits in the financial system by both residents and non-residents were 16% higher than in the previous year. As in 2003, sight deposits expanded, and they accounted for 74% of total deposits in December. Among the assets of the financial system, the most prominent development was an increase in liquid assets. Although the year-end figures show a contraction of US$ 54 million in gross credit to the non-financial sector, once transfers of gross non-performing loans to memorandum accounts and credit in the form of crossed loans have been factored out, performing loans in fact showed an increase of 4%, mostly in the form of local-currency transactions. The profits of the private banks amounted to

[1] The National Institute of Statistics reports that approximately 200,000 individuals live in extreme poverty.

Table 1

URUGUAY: MAIN ECONOMIC INDICATORS

	1996	1997	1998	1999	2000	2001	2002	2003	2004 [a]
	Annual growth rates [b]								
Gross domestic product	5.6	5.0	4.5	-2.8	-1.4	-3.4	-11.0	2.2	12.3
Per capita gross domestic product	4.8	4.3	3.8	-3.6	-2.2	-4.1	-11.7	1.5	11.5
Gross domestic product, by sector									
Agriculture, livestock, hunting, forestry and fishing	9.4	-6.1	5.2	-7.5	-3.0	-7.1	5.1	10.6	12.8
Mining	7.6	22.1	29.4	-5.8	-8.8	-5.2	-37.6	14.1	7.2
Manufacturing	4.0	5.9	2.3	-8.4	-2.1	-7.6	-13.9	4.7	21.6
Electricity, gas and water	4.3	6.7	11.5	-0.1	5.0	1.7	-0.6	-7.4	1.2
Construction	-1.8	2.4	9.8	8.9	-11.1	-8.7	-22.0	-7.1	7.2
Wholesale and retail commerce, restaurants and hotels	6.0	8.8	2.4	-3.4	-5.3	-3.2	-24.5	-1.0	21.0
Transport, storage and communications	8.0	6.0	4.5	3.7	1.5	0.3	-9.1	3.1	11.7
Financial institutions, insurance, real estate and business services	5.2	5.4	6.8	6.4	2.2	1.7	-0.9	-5.3	-1.6
Community, social and personal services	2.2	3.4	2.7	-0.5	-0.6	-2.3	-3.3	0.7	3.5
Gross domestic product, by type of expenditure									
Consumption	7.8	5.4	6.4	-1.3	-1.4	-2.1	-15.9	1.1	11.4
General government	5.0	2.3	4.0	0.6	-0.3	-2.9	-9.3	-4.8	2.5
Private	8.3	5.9	6.8	-1.5	-1.6	-2.0	-16.9	2.0	12.8
Gross domestic investment	-1.0	8.3	12.1	-9.8	-13.0	-9.1	-34.5	18.0	27.0
Exports (goods and services)	10.3	13.0	0.3	-7.4	6.4	-9.1	-10.3	4.2	22.7
Imports (goods and services)	11.3	13.2	7.6	-5.8	0.1	-7.1	-27.9	5.8	24.5
	Percentages of GDP								
Investment and saving [c]									
Gross domestic investment	15.2	15.2	15.9	15.1	14.0	13.8	11.5	12.6	13.3
National saving	14.1	13.9	13.7	12.7	11.1	11.1	14.6	12.1	12.5
External saving	1.1	1.3	2.1	2.4	2.8	2.7	-3.1	0.5	0.8
	Millions of dollars								
Balance of payments									
Current account balance	-233	-287	-476	-502	-566	-498	382	-58	-105
Merchandise trade balance	-687	-704	-772	-896	-927	-775	48	183	35
Exports, f.o.b.	2 449	2 793	2 829	2 291	2 384	2 139	1 922	2 281	3 025
Imports, f.o.b.	3 135	3 498	3 601	3 186	3 311	2 915	1 874	2 098	2 990
Services trade balance	560	536	436	377	394	316	153	167	302
Income balance	-189	-193	-198	-34	-61	-68	109	-491	-531
Net current transfers	83	74	59	50	27	30	72	82	89
Capital and financial balance [d]	386	687	831	675	833	824	-4 310	1 092	447
Net foreign direct investment	137	113	155	238	274	291	180	401	300
Financial capital [e]	249	574	676	437	559	533	-4 490	691	147
Overall balance	152	400	355	173	267	326	-3 928	1 033	342
Variation in reserve assets [f]	-141	-392	-515	-11	-222	-278	2 328	-1 380	-454
Other financing [g]	-12	-8	160	-162	-45	-49	1 600	347	112
Other external-sector indicators									
Real effective exchange rate (index: 2000=100) [h]	111.2	108.5	107.0	98.3	100.0	101.2	117.0	150.3	151.8
Terms of trade for goods (index: 2000=100)	108.6	110.2	116.7	106.2	100.0	103.8	104.8	107.4	108.4
Net resource transfer (percentage of GDP)	0.9	2.2	3.5	2.3	3.6	3.8	-21.2	8.5	0.2
Total gross external debt (millions of dollars) [i]	11 595	12 485	13 582	8 261	8 895	8 937	10 548	11 013	11 597
Total gross external debt (percentage of GDP) [i]	56.5	57.5	60.7	39.5	44.3	48.2	85.9	98.4	87.8
Net profits and interest (percentage of exports) [j]	0.9	0.9	1.4	2.0	2.4	3.1	-11.7	3.6	3.3
	Average annual rates								
Employment									
Labour force participation rate [k]	58.2	57.7	60.5	59.3	59.6	60.6	59.1	58.1	58.5
Open unemployment rate [l]	11.9	11.5	10.1	11.3	13.6	15.3	17.0	16.9	13.1
Visible underemployment rate [l]	6.0	5.2	4.7	6.5	10.3	13.0	15.3	16.0	13.7

Table 1 (concluded)

	1996	1997	1998	1999	2000	2001	2002	2003	2004 [a]
				Annual percentages					
Prices									
Variation in consumer prices (December-December)	24.3	15.2	8.6	4.2	5.1	3.6	25.9	10.2	7.6
Variation in producer prices, local products (December-December)	23.5	13.3	3.3	-0.3	9.5	3.8	64.6	20.5	5.1
Variation in nominal exchange rate (December-December)	22.7	15.1	8.3	7.6	7.3	13.1	93.5	7.4	-9.1
Variation in average real wage	0.6	0.2	1.8	1.6	-1.3	-0.3	-10.7	-12.5	0.0
Nominal deposit rate [m]	27.1	19.1	14.9	13.8	12.0	14.7	43.8	28.1	...
Nominal lending rate [n]	90.6	69.3	56.5	53.4	57.9	58.3	92.0	121.0	50.3
				Percentages of GDP					
Central government [o]									
Current income	17.8	18.8	19.5	20.9	20.3	20.8	21.2	21.4	21.6
Current expenditure	17.9	18.5	18.5	22.2	22.0	23.4	24.7	24.7	22.6
Current balance	-0.1	0.3	1.0	-1.3	-1.7	-2.6	-3.5	-3.3	-1.0
Net capital expenditure	1.7	1.9	2.2	2.6	1.9	1.8	1.4	1.3	1.5
Primary balance	-0.6	-0.2	0.2	-2.1	-1.5	-2.0	-0.8	1.1	2.4
Overall balance	-1.8	-1.6	-1.2	-3.9	-3.5	-4.5	-4.9	-4.6	-2.5
Public debt	22.0	22.6	24.0	26.2	31.9	41.9	98.7	94.3	74.7
Interest payments (percentage of total income)	7.0	7.4	6.8	8.4	10.2	12.0	19.1	26.3	22.9
Money and credit [p]									
Domestic credit [q]	24.8	26.4	31.3	50.4	53.7	55.7	68.5	54.5	39.2
To the public sector	1.9	2.1	1.6	3.4	3.3	3.6	7.4	6.9	4.5
To the private sector	22.9	24.3	29.7	47.0	50.4	52.1	61.1	47.6	34.7
Liquidity (M3) [r]	49.4	49.0	52.1	60.1	67.5	81.7	84.9	76.0	72.0
Currency in circulation and local-currency deposits (M2) [r]	10.1	10.0	10.1	10.7	10.7	11.0	8.6	8.2	8.1
Foreign-currency deposits [r]	39.3	39.0	42.0	49.4	56.8	70.8	76.3	67.8	63.8

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

US$ 7 million. The interest rate for dollar-denominated deposits remained stable despite rises in international rates, while the dollar lending rate diminished for all types of loans. The lending rate for peso-denominated loans stood at 29% in the last quarter.

In view of the high level of non-performing loans in the portfolio of the State development bank, Banco de la República Oriental del Uruguay (64.5% of all credits to the non-financial sector), the institution created three financial trust funds, in late 2003 and the course of 2004, to take over and administer the poorest quality loans. Meanwhile, the delinquency rate for the private bank portfolio was down to 10% in December 2004, as compared with 18.5% a year earlier. As of January 2006, banks will classify their risk portfolios according to debtors' ability to pay, which will reduce the significance of guarantees.

(c) Exchange-rate policy

Uruguay maintained its currency float in 2004. Over the year, the Uruguayan peso appreciated by 13% against the United States dollar, with a competitiveness loss of 10% in relation to Argentina and Brazil, and 6% at the extraregional level. Nevertheless, the effective exchange rate with all countries is 51% higher than in February 2002. This appreciation continued in the first five months of 2005 with a further 8%.

(d) Other policies

Despite an upturn in gross capital formation, it still represented only 13.3% of GDP at the end of 2004, which was lower than the 16% recorded in 1998. Seeking to

Table 2
URUGUAY: MAIN QUARTERLY INDICATORS

	2003				2004 [a]				2005 [a]	
	I	II	III	IV	I	II	III	IV	I	II
Gross domestic product (variation from same quarter of preceding year) [b]	-7.8	-4.8	6.8	15.0	14.1	12.4	12.7	10.3	7.1	...
Merchandise exports, f.o.b. (millions of dollars)	441	580	579	606	589	522	788	796	711	...
Merchandise imports, c.i. f. (millions of dollars)	471	519	583	617	662	493	817	899	915	...
International reserves (millions of dollars)	787	1 163	1 716	2 087	2 243	2 244	2 351	2 512	2 095	2 525
Real effective exchange rate (index: 2000=100) [c]	146	153	147	156	159	155	149	145	141	139 [d]
Urban unemployment rate	18.6	17.5	16.0	15.4	13.9	13.1	13.3	12.1	12.1	...
Consumer prices (12-month percentage variation)	28.5	24.6	11.6	10.2	8.7	9.6	9.6	7.6	5.5	4.1
Average nominal exchange rate (pesos per dollar)	28.33	28.20	27.53	28.78	29.53	29.72	28.77	26.80	25.33	24.72
Average real wage (variation from same quarter of preceding year)	-19.9	-16.7	-7.4	-3.8	-1.9	-1.3	0.5	2.4	4.6	4.4
Nominal interest rates (annualized percentages)										
Deposit rate [e]	34.8	21.4	...	...	...	...	...	...	...	...
Lending rate [f]	146.3	157.2	109.7	70.8	53.2	50.8	51.0	46.2	44.5	41.6
Sovereign bond spread (basis points)	2 367	729	695	624	560	693	491	373	429	400
Domestic credit (variation from same quarter of preceding year) [g]	13.7	-4.4	-23.0	-25.0	-7.0	-1.3	-14.0	-12.4	...	...
Non-performing loans as a percentage of total credit [h]	25.6	24.8	22.9	18.5	17.0	15.0	11.9	9.8	...	...

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.
[a] Preliminary figures. [b] Based on figures in local currency at constant 1983 prices. [c] Quarterly average, weighted by the value of merchandise exports and imports. [d] Data to May. [e] Average rate for deposits of six months or less. [f] One-year non-readjustable cash loans in local currency to families. [g] Refers to net credit extended to the public and private sectors by commercial banks and other financial and banking institutions. [h] Refers to total credit extended by commercial and private banks and commercial establishments.

remedy this situation, the government proposes to attract foreign direct investment and break into new export markets, among other things. In this connection, two large pulp mill construction projects have been approved, one by Botnia of Finland, with an investment of US$ 1.1 billion, and the other by the Spanish group ENCE, for US$ 600 million. With regard to encouraging private ventures, in May 2004 Telefónica de España and América Móvil were awarded rights to use airwave space.

In the area of trade policy, having signed a free trade accord with Mexico and an investment protection agreement with the United States, Uruguay is now looking at the possibility of a free trade deal with Japan. In addition, MERCOSUR is to begin negotiations this year with Canada, China, Egypt, Israel, Morocco and the Republic of Korea. Another important development is the MERCOSUR project to establish a structural convergence fund starting in 2006.

3. The main variables

(a) Economic activity

On the supply side, growth in 2004, unlike in 2003, was led by manufacturing (21.6%), which was fuelled by domestic demand and the expansion of external demand. Production was up across all the sectors of industry, with the most dynamic branches being foodstuffs, beverages and tobacco; and chemicals and metal products, specifically machinery and equipment. The sector of commerce, restaurants and hotels grew by 21.0% owing, among other things, to the increased tourist arrivals. Transport and communication activity was up by 11.7%, while agricultural activity expanded by 12.8% thanks to a simultaneous increase in agricultural and fishing production. Construction expanded by 7.2%, as a result of a rise in public and private construction.

Economic growth slowed in the first quarter of 2005. GDP was up by 7.1% in relation to the same period in 2004 and by 0.1%, in seasonally adjusted terms, on the fourth quarter of 2004. This standstill was the result of a slowdown recorded in almost all the sectors, with the exception of transport and communications and others.

(b) Prices, wages and employment

In 2004 consumer prices rose by 7.6% and wholesale prices, 5.1%. In the last quarter, consumer prices dropped by 0.5%, after an average increase of 2.6% in the previous quarters. Underlying the fall in prices at the end of the year were the drop in the exchange rate and in meat prices, and a reduction in international oil prices and telecommunications rates. Inflation stood at 2.1% in the first half of 2005, which translated into a cumulative rise of 4.1% in the 12 months ending in June. The target range for inflation has been set at 5.5%-7.5% for 2005.

Throughout 2004 the real average wage remained unchanged compared to 2003, which meant a decline of 1.4% in the private sector and a rise of 2.6% in the public sector. In the first four months of 2005 wages in both sectors increased slightly, by about 0.7%.

In July 2004 the minimum wage was raised by 9.7%. The adoption of legislation creating a unit of account for adjusting social security benefits removed the fiscal impact of adjustments to the minimum wage, which had previously performed this function. The minimum wage was then increased by 56% as of January 2005, bringing it to approximately US$ 80.

In the labour market, the average employment rate was 50.9% in 2004, compared to 48.3% in 2003. Nevertheless, 15.9% of those employed were underemployed, in other words, working a limited number of hours. This was exacerbated by the fact that 40.7% of those employed lacked social security coverage. Unemployment continued to ternd downwards, coming to stand at 12.1% as a moving average for the quarter ending in December 2004; this trend then changed direction for the quarters ending in March and April with moving averages of 12.1% and 12.6%.

(c) The external sector

In 2004, exports amounted to US$ 3.025 billion, which was a rise of 32.6%, while imports expanded to US$ 2.99 billion, with an increase of 42.5%. The balance of trade in goods posted a small surplus of US$ 35 million, while the overall trade balance built up a surplus of US$ 337 million and the current account showed a deficit of US$ 105 million, equivalent to 0.8% of GDP (0.5% in 2003), since the deficit on the income balance widened with respect to 2003.

In view of the economic upturn, imports of capital goods increased by 89.9% and those of intermediate and consumer goods grew by 38.2% and 37.2%, respectively. Electricity imports were a prominent item, with a cost of US$ 51 million, compared to US$ 5.3 million in 2003. In 2004, the company Usinas y Trasmisiones Eléctricas imported 350 MWh from Brazil in view of the drought and Uruguay's heavy dependence on hydroelectric generation. For this reason, another of the new government's priorities is to increase regional energy interconnection.

Exports of beef amounted to 402,784 tons, which was an increase of 26% on 2003; meat sales in general brought US$ 724 million dollars into the country, or 58% more than in 2003. The main export market was the United States, which accounted for 66% of the total. Meat export prices rose by 29% with respect to the previous year and averaged US$ 1,545 per ton.

Uruguay received net foreign direct investment of US$ 300 million (2.3% of GDP) in total, while the overall balance showed a surplus of US$ 342 million.

Mexico and Central America

Costa Rica

1. General trends

Following an exceptional upswing of 6.5% in 2004, the Costa Rican economy expanded at a more moderate pace that was close to the trend growth rate.

Real gross domestic product (GDP) rose by 4.2% (4.4% excluding the high-technology sector), on the strength of the expansion of exports (6.8%) and higher revenues from the tourist industry. Per capita GDP rose by 2.3%, whereas national disposable income grew by only 0.7%, owing to worsening terms of trade.

Although the economy grew by an average rate of over 5% in the last two years, employment increased by only 2.1% in 2004, while the open unemployment rate dipped slightly, from 6.7% to 6.5%. In addition, average income decreased by 6% in real terms, and minimum wages declined again (-1.6%).

In terms of public accounts, the deficit of the overall narrowly defined public sector shrank from 4.5% of GDP to 3.6%, despite delays in the adoption of the Fiscal Covenant and Structural Fiscal Reform Act.

Although monetary policy was tight, especially in the second half of the year, inflation came in at a high 13.1%, the colón appreciated in real terms and the trade deficit widened, mostly as a result of sharply rising international prices for petroleum and certain industrial commodities.

Total liquidity in the banking system (which includes M1 plus commercial banks' quasi-monetary liabilities in local and foreign currency) expanded considerably (34.1%) as a result of the crisis in investment and pension funds in April and May. This prompted a shift in the composition of financial savings, with funds previously invested in public debt instruments being transferred to the banking system. Private sector demand for credit cooled, however, reflecting sluggish growth in sectors producing to meet domestic demand and the poor expectations of economic agents regarding future interest rates. In these circumstances, the banks (especially State institutions) lowered their lending rates, in an effort to boost demand for credit in local currency. Given the level of liquidity, borrowing rates remained relatively stable throughout the year.

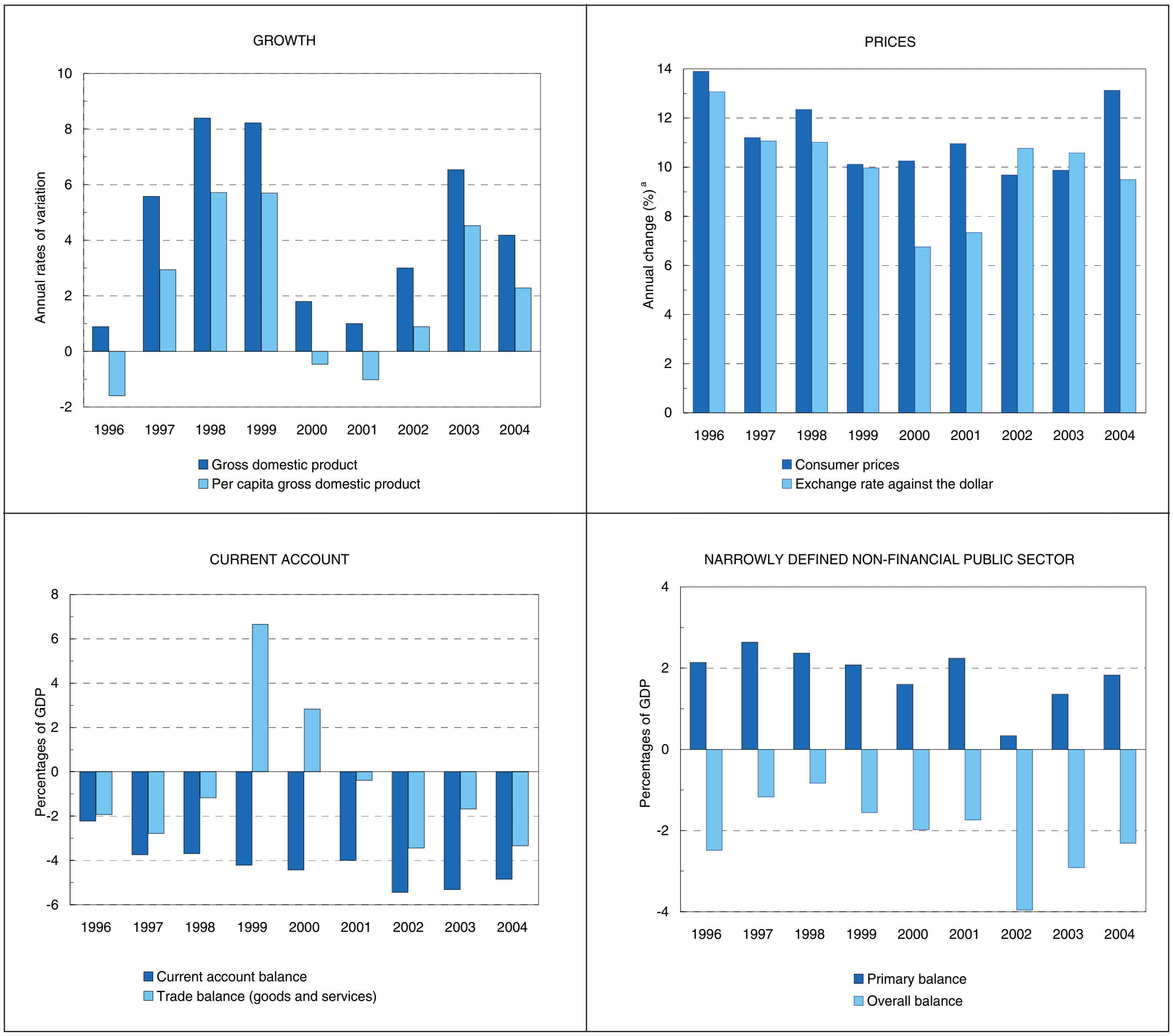
In the external sector, the balance-of-payments current-account deficit (4.8% of GDP) narrowed slightly, which, combined with inflows of external financial resources, helped to swell international reserves.

The monetary programme for 2005-2006 shows projected GDP growth of 3.2% and inflation at 10% for 2005. The consolidated public-sector deficit is expected to be similar to the level recorded in 2004 and the current-account deficit should drop to 4.2% of GDP.

2. Economic policy

For 2005, the principal aim of the central bank's monetary policy is to reduce inflation. To this end, it has been using open market operations as the main instrument of monetary control, since the legal reserve requirement remained at 12% up to June. In keeping with monetary policy, the authorities have sought to maintain a neutral stance on exchange-rate policy, in order to avoid real depreciation or appreciation of the colón in relation to

Figure 1
COSTA RICA: MAIN ECONOMIC INDICATORS



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

the level recorded at the end of 2004. This is in addition to a tight fiscal policy, with domestic spending controls expected to bring down inflation. In the first five months of 2005, however, the liquidity in the financial system expanded by 4%, owing to a limited increase in credit (2.5%) combined with a rise in savings (6%). At the same time, the monetary base expanded, reflecting considerable inflows of foreign capital attracted by high rates of interest and the stability conferred on the foreign exchange market by the policy of mini-devaluations. In May cumulative inflation stood at 6.37%, which was a larger increase than in the year-earlier period (5.14%). Year-on-year inflation rose from 11.45% to 14.46%. In those circumstances, the central bank decided to raise the legal reserve requirement from 12% to 15% in June 2005.

In 2004, various external and domestic factors encumbered the management of economic policy. Given the limited manoeuvring room available for fiscal policy, much of the adjustment burden fell to monetary policy. The economy did absorb most of the destabilizing effect of adverse variations in those factors. High international prices for the main imported raw materials and problems in the supply of certain agricultural goods contributed to a terms-of-trade downturn, an increase in domestic prices, a real appreciation of the colón and a widening of the trade gap. Mounting expectations of a rise in United States interest rates brought down the prices of Costa Rica's sovereign debt on the international market, leading, in turn, to large adjustments in the local financial market. With returns on investment and pension funds thus reduced, investors began to transfer some of their resources to short-term fixed-rate banking instruments. This sharply reduced the stock of assets held in those funds, sent the prices of the respective securities plummeting and pushed up interest rates. In May 2004, the central bank was therefore forced to buy back bonds from its own issues, in order to inject liquidity into the financial market and thus contain withdrawals from investment funds and stabilize interest rates.

(a) Fiscal policy

In 2004, the deficit of the overall narrowly-defined public sector shrank from 4.5% to 3.6% of GDP. This performance was thanks to all the components of that sector: central government, the rest of the non-financial public sector (NFPS) and the central bank.

Higher income and the curbing of expenditure narrowed the central government's financial imbalance, from 2.9% of GDP to 2.7%. About a third of the difference was covered with external resources from the most recent issue of eurobonds (US$ 250 million) authorized as part of the financing programme approved in 1999.

Current income remained constant at 13.7% of GDP. The strongest income categories corresponded to general tax on domestic sales, customs duties and income tax. Total expenditure dipped from 16.8% of GDP to 16.4%, as growth in current expenditure slowed owing to wage and salary adjustments and lower interest payments on the public debt.

The net result of the rest of the non-financial public sector also posted an improvement on the previous year. The surplus (0.4% of GDP) reflected a larger positive balance registered by the Costa Rican Social Security Fund (thanks to stricter monitoring of spending) and a reduction in the Costa Rican Electricity Institute's deficit (attributable to higher income from sales of electricity and mobile telephone services).

The central bank reduced its losses from 1.6% to 1.3% of GDP, thanks to the combined effect of various factors: partial capitalization conducted by the government; a higher legal reserve requirement, an active public-debt management policy and a decrease in the average cost of monetary management. At the beginning of 2004, resources from the 2003 domestic issue of fixed-term, dollar-denominated deposit certificates were used to make prepayments on all the country's series B Brady bonds. This operation resulted in better financial conditions for Costa Rica's foreign-currency-denominated debt.

In 2004, total public debt expanded by 14%, which was lower than the 17.6% rise recorded the previous year. Contributing factors included a reduction in the debt of the central bank and a smaller increase in the debt of the rest of the NFPS, given that growth in central government debt was higher than in 2003. The ratio of total public debt to GDP held steady at around 60%, however.

(b) Monetary policy

Several supply shocks affected the Costa Rican economy in 2004, prompting the central bank to review its policy and take remedial measures to ease inflationary pressures and avoid sharpening the external imbalance. In July 2004, the central bank raised the legal reserve requirement from 10% to 12%, increased the short-term interest rate and the daily devaluation rate, and stepped up open market operations.

Despite these measures, liquidity rose sharply, reflecting an expansion in quasi-money, since narrow money expanded at a lower rate than in the past two years. The behaviour of monetary aggregates was affected by the crisis in investment and pension funds, whose administrators were forced to sell part of their security holdings to commercial banks in order to deal with liquidity problems brought on by mass withdrawals.

Private-sector credit climbed by 17.6%, which was below the 19.9% recorded in 2003. This was mainly due to negative expectations about future interest rates on the part of economic agents. The housing sector has become consolidated as the largest recipient of credit to the private sector, while consumer credit grew at a similar rate to the previous year's figure.

(c) Exchange-rate policy

In 2004 the authorities continued to implement the policy of daily mini-devaluations based on the expected difference between domestic inflation and inflation in Costa Rica's main trading partners. Slackening of the colón's nominal year-on-year depreciation against the dollar, rising domestic prices and a widening trade gap prompted the central bank to raise the rate of its daily nominal currency devaluations from 15 to 17 cents in July. Nevertheless, although the nominal rate of devaluation of the colón stood at 9.6% at the end of the year, the inflation differential translated into a 1.9% real appreciation against the dollar.

Table 1

COSTA RICA: MAIN ECONOMIC INDICATORS

	1996	1997	1998	1999	2000	2001	2002	2003	2004 [a]
	Annual growth rates [b]								
Gross domestic product	0.9	5.6	8.4	8.2	1.8	1.0	3.0	6.5	4.2
Per capita gross domestic product	-1.6	2.9	5.7	5.7	-0.5	-1.0	0.9	4.5	2.3
Gross domestic product, by sector									
Agriculture, livestock, hunting, forestry and fishing	1.8	1.5	8.2	4.5	0.7	1.4	-3.3	7.5	0.8
Mining	-4.7	13.0	9.2	-6.1	6.3	6.4	-3.1	3.8	7.7
Manufacturing	0.5	7.7	11.4	24.7	-2.9	-9.1	3.4	8.7	2.2
Electricity, gas and water	2.6	5.6	8.7	6.2	6.4	4.1	5.3	5.8	4.6
Construction	-17.9	6.1	17.4	-1.6	4.4	14.4	-1.5	4.8	6.6
Wholesale and retail commerce, restaurants and hotels	-0.6	6.1	8.5	2.4	1.5	1.9	1.6	2.9	5.1
Transport, storage and communications	4.8	9.9	8.1	6.9	10.2	9.3	12.2	13.7	11.3
Financial institutions, insurance, real estate and business services	2.1	4.8	4.7	7.6	8.1	6.8	4.6	7.0	6.2
Community, social and personal services	1.4	2.6	4.6	3.0	2.6	2.0	3.0	3.1	2.0
Gross domestic product, by type of expenditure									
Consumption	2.0	5.1	5.0	2.1	1.1	1.4	3.0	2.9	3.0
General government	-0.6	4.6	2.2	1.8	1.4	3.6	2.2	0.2	2.4
Private	2.4	5.1	5.4	2.2	1.0	1.1	3.2	3.3	3.1
Gross domestic investment	-10.4	24.9	25.4	-15.7	-1.5	31.4	9.3	-4.1	9.4
Exports (goods and services)	6.2	8.6	27.1	21.3	-0.3	-9.6	3.8	12.3	7.1
Imports (goods and services)	2.7	14.7	25.2	0.4	-2.6	1.1	6.9	1.3	7.8
	Percentages of GDP								
Investment and saving [c]									
Gross domestic investment	16.0	18.1	20.5	17.1	16.9	20.3	22.5	20.5	22.1
National saving	13.7	14.3	16.8	12.9	12.5	16.3	17.1	15.2	17.3
External saving	2.2	3.7	3.7	4.2	4.4	4.0	5.4	5.3	4.8
	Millions of dollars								
Balance of payments									
Current account balance	-264	-481	-521	-666	-707	-655	-916	-929	-892
Merchandise trade balance	-249	-498	-399	580	-210	-820	-1 267	-1 131	-1 522
Exports, f.o.b.	3 774	4 221	5 538	6 576	5 813	4 923	5 270	6 163	6 311
Imports, f.o.b.	4 023	4 718	5 937	5 996	6 024	5 743	6 537	7 294	7 832
Services trade balance	20	140	234	471	663	757	688	839	907
Income balance	-184	-249	-469	-1 822	-1 252	-748	-517	-849	-517
Net current transfers	149	126	113	104	93	155	181	213	239
Capital and financial balance [d]	194	288	16	896	365	669	1 079	1 268	973
Net foreign direct investment	421	404	608	614	404	447	624	547	535
Financial capital [e]	-227	-116	-592	282	-38	221	455	720	438
Overall balance	-69	-193	-504	230	-341	13	163	339	82
Variation in reserve assets [f]	77	-216	150	-481	153	-13	-163	-339	-82
Other financing [g]	-8	409	355	251	188	0	0	0	0
Other external-sector indicators									
Real effective exchange rate (index: 2000=100) [h]	100.9	100.9	114.0	101.7	100.0	97.1	97.6	103.6	106.5
Terms of trade for goods (index: 2000=100)	102.1	125.9	117.5	106.9	100.0	98.4	96.9	95.5	91.9
Net resource transfer (percentage of GDP)	0.0	3.5	-0.7	-4.3	-4.4	-0.5	3.3	2.4	2.5
Gross external public debt (millions of dollars)	2 859	2 640	2 872	3 057	3 151	3 243	3 338	3 753	3 884
Gross external public debt (percentage of GDP)	24.1	20.6	20.4	19.4	19.8	19.8	19.8	21.5	21.1
Net profits and interest (percentage of exports) [i]	1.8	3.4	5.6	20.9	14.7	8.2	4.9	7.8	4.0
	Average annual rates								
Employment									
Labour force participation rate [j]	52.2	53.8	55.3	54.8	53.6	55.8	55.4	55.5	54.4
Open unemployment rate [k]	6.2	5.7	5.6	6.0	5.2	6.1	6.4	6.7	6.5
Visible underemployment rate [k]	12.0	11.0	11.7	12.0	9.7	9.5	11.2	13.2	12.5
	Annual percentages								
Prices									
Variation in consumer prices (December-December)	13.9	11.2	12.4	10.1	10.2	11.0	9.7	9.9	13.1
Variation in industrial producer prices (December-December)	13.3	10.1	8.8	11.3	10.2	8.6	8.4	11.0	17.7
Variation in nominal exchange rate (December-December)	13.1	11.1	11.0	10.0	6.8	7.3	10.8	10.6	9.5
Variation in average real wage	-2.1	0.8	5.6	4.7	0.8	1.0	4.1	0.4	-2.6
Nominal deposit rate [l]	...	12.7	13.3	14.6	12.9	11.3	11.6	10.9	10.0
Nominal lending rate [m]	...	22.7	23.0	26.0	24.0	22.2	24.2	23.4	21.2

Table 1 (concluded)

	1996	1997	1998	1999	2000	2001	2002	2003	2004 [a]
	Percentages of GDP								
Non-financial public sector, narrowly defined									
Current income	22.2	22.5	22.3	19.7	21.5	22.9	22.7	22.6	22.7
Current expenditure	20.8	19.5	19.0	17.5	19.5	20.9	22.1	21.4	21.2
Current balance	1.4	3.1	3.3	2.2	2.0	2.0	0.6	1.2	1.5
Net capital expenditure	3.9	4.2	4.2	3.7	3.9	3.7	4.5	4.0	3.8
Primary balance	2.1	2.6	2.4	2.1	1.6	2.2	0.3	1.4	1.8
Overall balance	-2.5	-1.2	-0.8	-1.6	-2.0	-1.7	-4.0	-2.9	-2.3
Central government public debt	33.2	30.0	39.5	35.2	36.6	38.6	40.8	40.0	41.4
Domestic	24.0	22.2	31.4	26.6	26.4	27.7	28.6	26.9	27.8
External	9.2	7.8	8.1	8.6	10.1	10.9	12.2	13.1	13.7
Interest payments (percentage of current income)	20.9	16.9	14.3	18.5	16.6	17.3	18.9	18.9	18.2
Money and credit [n]									
Domestic credit [o]	14.9	15.5	18.1	19.0	24.3	28.0	32.0	34.2	37.4
To the public sector	3.1	3.1	3.1	2.4	3.4	4.3	5.0	6.0	8.5
To the private sector	11.8	12.4	15.0	16.6	20.9	23.7	27.0	28.2	29.0
Liquidity (M3)	28.4	28.1	28.4	28.4	30.8	32.0	33.3	34.1	38.3
Currency in circulation and local-currency deposits (M2)	18.9	18.2	17.1	16.5	18.0	17.9	17.9	18.7	19.5
Foreign-currency deposits	9.4	10.0	11.3	11.9	12.8	14.1	15.4	15.5	18.8

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

[a] Preliminary figures. [b] Based on figures in local currency at constant 1991 prices. [c] Based on figures in local currency expressed in dollars at current prices. [d] Includes errors and omissions. [e] Refers to the capital and financial balance (including errors and omissions), minus net foreign direct investment. [f] A minus sign (-) denotes an increase in reserves. [g] Includes the use of IMF credit and loans and exceptional financing. [h] Annual average, weighted by the value of merchandise exports and imports. [i] Refers to net investment income as a percentage of exports of goods and services as shown on the balance of payments. [j] Economically active population as a percentage of the working-age population; nationwide total. [k] Unemployment and underemployment rates as percentages of the economically active population; nationwide total. [l] 90-day deposits at State-owned banks. [m] Rate on loans to industry from State-owned banks. [n] The monetary figures are annual averages. [o] Refers to net credit extended to the public and private sectors by commercial banks and other financial and banking institutions.

(d) Trade policy

The main trade policy advances in 2004 consisted of the conclusion of free trade negotiations with the United States and the signing of a free trade agreement with the countries of the Caribbean Community (CARICOM). Activities were also stepped up in the framework of the Central American economic integration process, with a view to establishing a customs union, and initial steps were taken towards negotiating a trade agreement with the European Union.

In the first half of 2005 the adoption of the fiscal reform was delayed, which had negative repercussions for the ratification process of the free trade agreement with the United States and the Dominican Republic. This occurred in a context dominated by the political tensions of a pre-election year and lack of parliamentary support for the initiatives of the executive branch.

3. The main variables

(a) Economic activity

In 2004, output growth slowed from 6.5% to 4.2%. For the second year in a row, economic expansion was driven by buoyant exports (6.8%) and tourism. Domestic demand also picked up (3.9%). If restocking is not included, however, the rise in domestic demand is much smaller (1.5%), owing to the decline of gross fixed capital formation (3.6%) and stalled growth in consumption (2.9%). The main factor in the investment decrease was lower public investment in machinery and equipment and in construction, while private consumption reflected a downturn in disposable national income, as well as employment and wage trends.

On the supply side, imports expanded, especially purchases of raw materials and intermediate goods. In sectoral terms, as in the past five years, economic growth reflected expansion across the full range of service activities (6.1%), which generated 58.4% of GDP. The most buoyant sectors were transport, telecommunications

Table 2
COSTA RICA: MAIN QUARTERLY INDICATORS

	2003				2004 [a]				2005 [a]	
	I	II	III	IV	I	II	III	IV	I	II
Gross domestic product (variation from same quarter of preceding year) [b]	7.1	5.7	6.9	6.4	3.5	4.8	4.4	3.9	1.9	...
Merchandise exports, f.o.b. (millions of dollars)	1 530	1 648	1 500	1 425	1 571	1 112	1 523	1 568	1 594	...
Merchandise imports, c.i.f. (millions of dollars)	1 939	1 887	1 908	1 908	2 015	1 420	2 080	2 094	2 140	...
International reserves (millions of dollars)	1 790	1 688	1 596	1 836	1 746	1 634	1 656	1 918	2 101	2 191
Real effective exchange rate (index: 2000=100) [c]	101.0	103.3	104.5	105.7	105.7	105.9	106.1	108.3	108.1	107.9 [d]
Consumer prices (12-month percentage variation)	9.4	10.2	8.4	9.9	11.3	11.9	13.8	13.1	13.6	13.8
Average nominal exchange rate (colones per dollar)	384	394	404	414	423	433	443	453	464	473
Average real wage (variation from same quarter of preceding year)	...	...	...	...	0.1	-3.1	-4.0	-3.5	-1.1	...
Nominal interest rates (annualized percentages)										
Deposit rate [e]	11.5	11.1	10.6	10.2	10.1	10.0	10.0	10.0	10.1	10.5
Lending rate [f]	24.0	25.7	22.7	21.4	21.0	20.9	21.3	21.4	21.5	22.2
Interbank interest rate [g]	17.3	16.4	15.1	13.9	13.6	13.5	13.9	14.3	14.8	15.5
Domestic credit (variation from same quarter of preceding year) [h]	21.9	23.7	20.0	20.5	19.9	29.0	31.8	29.5	26.5	22.1 [i]
Non-performing loans as a percentage of total credit [j]	2.2	2.0	2.0	1.7	1.6	1.7	2.0	1.9	1.7	1.5

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.
[a] Preliminary figures. [b] Based on figures in local currency at constant 1991 prices. [c] Quarterly average, weighted by the value of merchandise exports and imports. [d] Data to May. [e] 90-day deposits at state-owned banks. [f] Rate on loans to industry from State-owned banks. [g] Average reference rate, calculated by the Central Bank of Costa Rica. [h] Refers to net credit extended to the public and private sectors by commercial banks and other financial and banking institutions. [i] Data for April. [j] Refers to total credit extended by the financial system.

(especially mobile telephones and Internet services), financial services and commerce.

Merchandise production edged up by only 2.1% and agricultural activity slackened considerably. Growth in agricultural value added dropped from 7.5% to 1.6% as a result of lower coffee, maize, bean and milk production, combined with only a slight increase in banana production. In contrast, production of pineapple, flowers and foliage, root crops, tubers and fresh fruit continued to climb strongly. The reduction in coffee production was attributable to early ripening of the 2003-2004 harvest and late maturation in the 2004-2005 season. Banana production was affected by weather conditions. The low prices fetched by basic grains were a disincentive to production. In the milk industry, however, the downturn in production was due to the fact that a number of dairy farms switched to growing pineapple, vegetables and cassava, which yield better returns. Growth in manufacturing value added (1.5%) was seven percentage points down on the previous year. This sharp decline was due mainly to fewer exports of microprocessors manufactured by the Intel plant and lower sales by a number of industrial enterprises producing for the domestic market. Construction, on the other hand, grew rapidly (6.6%) on the strength of private investment in projects to build housing, shopping centres and business premises.

(b) Prices, wages and employment

The rate of inflation, measured by the consumer price index (CPI), stood at 13.1%. This figure far exceeded the target of 11% established in the revised monetary programme and represented an eight-year high. Tight monetary policy and fiscal measures to contain public spending eased pressure on domestic demand. In this context, inflation was attributable mainly to rising international petroleum prices, higher utility rates (electricity and water) and supply problems that pushed up the prices of certain agricultural goods for domestic consumption. This was combined with the higher rate applied to nominal daily currency devaluation and the depreciation of the United States dollar against the euro and the yen, which resulted in higher prices for some imports.

Although the economy continued to grow, problems in the labour market worsened. The small increase in employment brought the nationwide open unemployment rate down only slightly, from 6.7% to 6.5%. Real average income retreated by 6%, reflecting shrinking income in public and private sectors alike. Despite adjustments made in the course of the year, real minimum wages slipped for the third consecutive year (-1.6%), raising the proportion of poor households from 18.5% to 21.7%.

(c) The external sector

Slackening growth in economic activity was accompanied by a slight decrease in the external imbalance. The balance-of-payments current-account deficit narrowed from 5.3% of GDP to 4.8%. In such a small and open economy, however, the current-account deficit remains a source of vulnerability to any harmful external developments such as a terms-of-trade downturn or a rise in interest rates.

The wider trade deficit was offset by a lower net outflow of investment income (reflecting, in turn, a decrease in repatriation of profits and dividends from foreign direct investment) and by larger surpluses on the services and transfers accounts. This increase in the trade deficit was the result of a rise in imports (7.4%), while exports grew by only 2.4%. Inflows of external financial resources, including foreign direct investment, covered the current-account deficit and helped to swell international monetary reserves, which rose by US$ 81.8 billion. Income from FDI amounted to US$ 596.8 million, which was slightly more than in 2003. FDI amounted to 3.3% of GDP and 67% of the current-account deficit. Most FDI corresponded to reinvestment by foreign firms already established in the country's free zones (especially in the electronics industry).

Despite a decline of 34.5% in external sales of microprocessors manufactured by the Intel plant, merchandise exports expanded, thanks mainly to non-traditional products, which represented 87% of total exports, with medical equipment and pharmaceutical product prominent in this category. Maquila exports also picked up. Industrial exports to other Central American countries performed particularly well, as did agricultural exports such as coffee, pineapple, melon, plants, flowers and foliage. In addition, revenues from the tourist industry, computer programming, call centres and business centres offset a sizeable chunk of the merchandise trade imbalance. In 2004, the number of tourist arrivals was up 16% on the previous year (with the highest growth rate in 15 years).

Raw materials and intermediate goods accounted for much of the rise in exports. This was a reflection of the imports of free zone enterprises; inventory stockpiling in the high-technology electronics industry; higher international prices for petroleum and a number of industrial commodities; and the depreciation of the United States dollar in relation to the euro and the yen (which pushed up the prices of some imports). At the same time, imports of capital goods declined due to a drop in purchases for the health, electricity and telecommunications sectors.

El Salvador

1. General trends

The Salvadoran economy grew by 1.5% in 2004, while per capita GDP fell for the fifth consecutive year. Rising inflows of foreign exchange in the form of family remittances (which amounted to 16.1% of GDP) and increased non-maquila exports were not enough to make up for the decline in maquila output and the sharp drop in public investment (40.4%) caused, in large part, by the delay in getting the national budget through Congress. With such a steep contraction of public investment and waning private investment in the construction sector, gross fixed capital formation was down by 3.8%.

The annual inflation rate was 5.3%. This was well above the 2003 figure of 2.5%, mostly because of rising fuel prices. The deficit of the non-financial public sector (NFPS), including pensions, fell to 2.4% of GDP from the previous year's figure of 3.7%. The stability of the main financial indicators was in large measure attributable to the still low level of international interest rates. Foreign direct investment (FDI) rose sharply to 2.9% of GDP. The current account deficit stood at 3.9% of GDP.

GDP is expected to grow by about 2.5% in 2005, with its expansion being buttressed by the higher public investment associated with a projected fiscal deficit of 2.7% of GDP. Lower inflation (3%) is anticipated, and aggregate demand should be boosted by stronger external demand for agricultural products, rising inflows of remittances and increased job creation. In the first few months of 2005, however, there was as yet no clear sign of a sustained economic recovery. On the domestic front, investment remained stagnant while, at the international level, high oil prices had a negative impact on supply conditions.

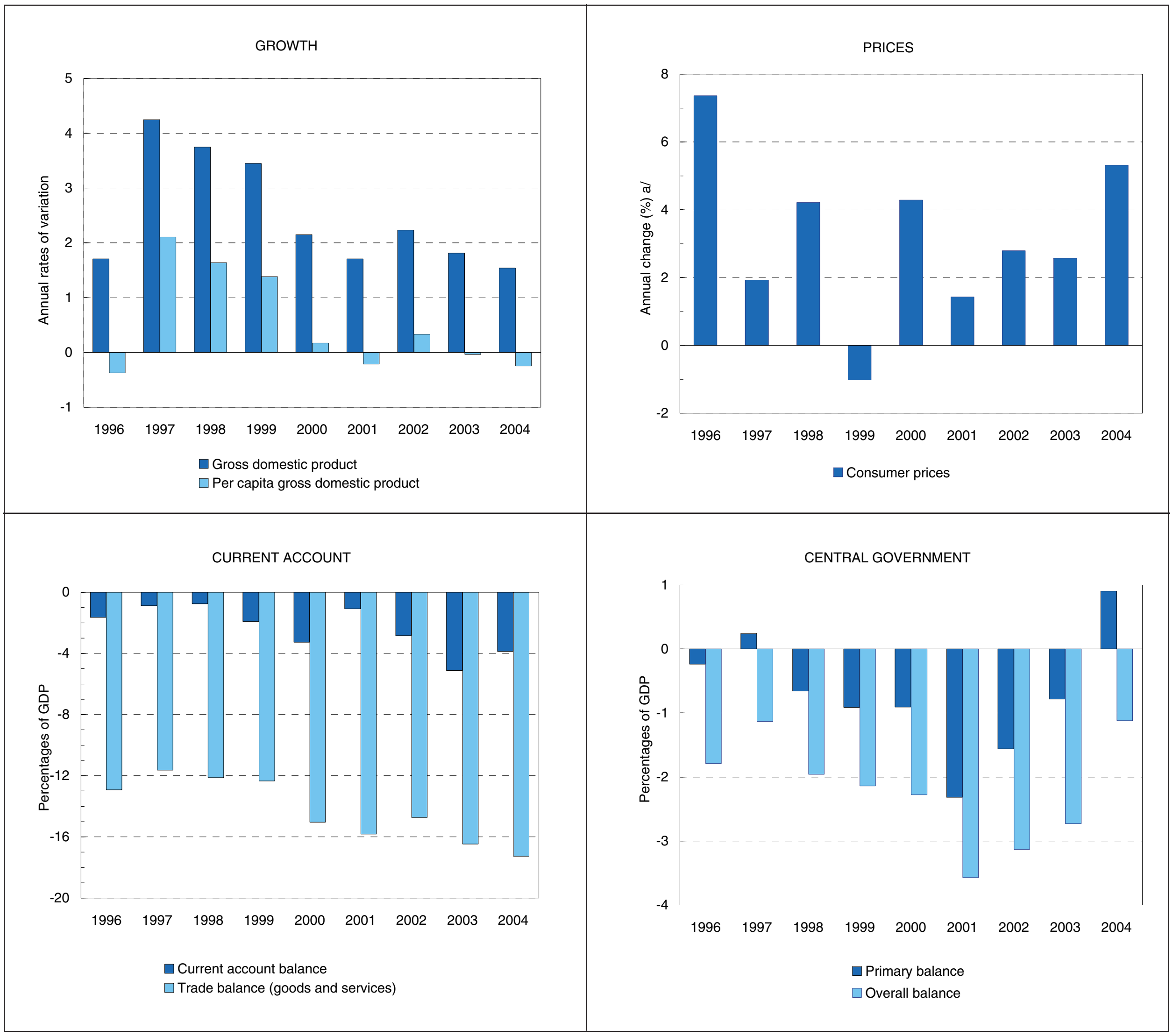
2. Economic policy

In 2004, the main economic policy challenges faced by El Salvador were to consolidate a stable tax base and finance more investment in order to spur growth, meet urgent social needs and curb the rapid increase in public debt seen in recent years.

(a) Fiscal policy

Because the budget took so long to win approval, the fiscal balance improved. The NFPS deficit, not counting pensions, decreased from 2.1% of GDP in 2003 to 0.6% in

Figure 1
EL SALVADOR: MAIN ECONOMIC INDICATORS



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

2004. This was mainly due to the fact that, in real terms, current revenue rose by 2% while total expenditure fell by 6.8%.

The central government's deficit amounted to 1.1% of GDP, as against 2.7% in 2003. This outcome reflected a 1.1% rise in total revenue in real terms, together with a steep decrease in capital expenditure, particularly real investment (-50.5%).

The very slight (0.3%) upturn in tax revenues was the net effect of a decline in VAT receipts and a 1.6% rise in income tax collections. This brought the tax ratio in El Salvador to 12.3% of GDP, which is still quite low, in view of the need to fund social programmes in the country. Non-tax revenue was up by 22.2% in real terms, mainly thanks to the rise in receipts from property income and the sale of goods and services by public agencies.

As of May 2005, public accounts showed a cumulative fiscal surplus of US$ 102 million thanks to the 14.8% increase in tax revenues and the delayed execution of public investments.

In early 2005, the Government of El Salvador earmarked a specific portion of its tax revenues to start up the Health Solidarity Fund (FOSALUD) and the Solidarity Network programme. These schemes are designed to assist people living in extreme poverty and to promote economic and productive development on a comprehensive basis. The initiative involves a large-scale mobilization of resources and a further intensification of what have, thus far, been evaluated as effective efforts to work towards the Millennium Development Goals. The country has also launched a programme known as the National Education Plan for 2021, whose goal is to achieve universal primary-education coverage and to upgrade preschool and secondary education.

The NFPS debt was held to 38.3% of GDP in 2004. The total public debt (which includes the non-financial public sector, the financial public sector and the central bank), however, came to US$ 7,282,600,000, or 46% of GDP. This result is 1.5 percentage points down on the preceding year, but the situation nonetheless warrants greater attention, particularly in relation to the pension system. Reducing the cost of the pension system to below 1.7% of GDP and cutting the public sector's overall liabilities represent a major challenge for the current Administration.

A total of US$ 286.4 million in Eurobonds was issued in 2004 (17.8% less than in 2003) on relatively favourable terms. The plan for 2005 is to issue US$ 400 million of the US$ 542 million that has been approved by Congress. Meanwhile, El Salvador has obtained a US$ 40 million loan from the Inter-American Development Bank (IDB) and a US$ 485 million loan from the World Bank, to be disbursed between 2005 and 2008, with US$ 100 million of this sum to be received during the first year. This loan is part of the World Bank's new Country Assistance Strategy (CAS), which is aimed at supporting the Government of El Salvador's efforts to speed up the pace of an equitable and sustainable form of economic growth that will promote social cohesion while helping to reduce poverty.

(b) Monetary policy

Domestic interest rates continued their downward trend. In real terms, the average annual rate for 180-day deposits was negative (-1.1%), and the interest rate on loans with terms of up to one year was 1.8%. Net domestic credit to the public sector rose in real terms by 6.2%, but credit to the private sector edged up by a mere 0.1%. M3 was down by 1.7% in real terms.

Nominal interest rates have gradually begun to climb in 2005. In real terms, the average annual rate for 180-day deposits has held steady as of June, while lending rates for terms of up to one year stand at 2.7%. Liquidity has declined by 1% in real terms since December 2004.

The central bank's net international reserves amounted to US$ 1,888,300,000 in 2004, which represented a 0.9% decrease from their 2003 level. This was equivalent to 3.8 months' worth of merchandise imports, or 117.6% of the liquidity reserves that the central bank requires commercial banks to hold in order to ensure the stability of the financial system. In June 2005, international reserves rose slightly, while the liquidity reserve stood at US$ 1,552,500,000.

(c) Trade policy

The United States-Central American Free Trade Agreement (CAFTA) has continued to be the pivotal component of the country's trade policy. In late 2004, the Salvadoran Congress ratified the agreement and, in May 2005, the Presidents of the five Central American countries met with President George W. Bush to press for its ratification by the United States Congress. The agreement, which is broader in scope than the unilateral preferences granted under the Caribbean Basin Initiative, is expected to boost exports and investment in the long term, particularly in the case of non-traditional items, ethnic products and agro-industrial production.

3. The main variables

(a) Economic activity

Factors holding back production activity in 2004 included the downturn in maquila exports caused by competition from Asian countries in the textiles sector, the uncertainty associated with the elections, declining public investment and rising international oil prices. Private investment climbed by only 3.4%.

In the first five months of 2005, economic activity remained as weak as it had been in late 2004. As of May, the economic activity index had fallen by 1.1% as a result of a 21.3% slump in the construction sector and a 3.0%

Table 1
EL SALVADOR: MAIN ECONOMIC INDICATORS

	1996	1997	1998	1999	2000	2001	2002	2003	2004 [a]
				Annual growth rates [b]					
Gross domestic product	1.7	4.2	3.7	3.4	2.2	1.7	2.2	1.8	1.5
Per capita gross domestic product	-0.4	2.1	1.6	1.4	0.2	-0.2	0.3	0.0	-0.3
Gross domestic product, by sector									
Agriculture, livestock, hunting, forestry and fishing	1.3	0.4	-0.7	7.7	-3.1	-2.6	0.1	0.1	3.2
Mining	1.0	6.5	5.3	0.4	-4.7	11.7	5.5	4.0	1.9
Manufacturing	1.7	8.0	6.6	3.7	4.1	4.0	2.9	2.3	0.7
Electricity, gas and water	17.1	4.2	6.1	2.7	-2.3	4.6	7.3	3.1	2.9
Construction	2.7	6.2	8.5	-1.8	-3.4	9.6	6.7	4.2	-13.6
Wholesale and retail commerce, restaurants and hotels	0.4	2.9	4.0	2.0	3.6	1.9	1.5	1.2	1.4
Transport, storage and communications	1.9	7.7	4.2	9.5	6.1	4.3	5.0	2.5	2.5
Financial institutions, insurance, real estate and business services	2.2	4.4	3.8	3.0	3.0	-0.8	2.8	2.4	5.0
Community, social and personal services	2.4	3.4	1.2	1.0	1.1	-0.3	-1.0	0.7	1.1
Gross domestic product, by type of expenditure									
Consumption	1.6	3.0	2.4	3.4	3.7	3.2	1.8	1.9	1.8
General government	2.8	2.8	2.5	0.4	0.9	4.6	1.5	4.1	-2.7
Private	1.5	3.0	2.4	3.7	3.9	3.1	1.8	1.7	2.2
Gross domestic investment	-22.1	6.5	22.8	-4.0	2.7	5.1	-7.0	10.3	-3.8
Exports (goods and services)	8.7	30.2	6.2	7.1	16.8	-0.2	5.9	3.8	6.6
Imports (goods and services)	-6.1	16.8	9.2	2.7	14.5	4.2	1.7	4.8	3.4
				Percentages of GDP					
Investment and saving [c]									
Gross domestic investment	15.2	15.1	17.6	16.4	16.9	16.7	16.7	16.9	15.8
National saving	13.5	14.2	16.8	14.5	13.6	15.6	13.9	11.8	11.9
External saving	1.6	0.9	0.8	1.9	3.3	1.1	2.8	5.1	3.9
				Millions of dollars					
Balance of payments									
Current account balance	-169	-98	-91	-239	-431	-150	-405	-764	-612
Merchandise trade balance	-1 242	-1 143	-1 306	-1 356	-1 740	-1 933	-1 865	-2 276	-2 619
Exports, f.o.b.	1 787	2 437	2 460	2 534	2 963	2 892	3 020	3 153	3 330
Imports, f.o.b.	3 030	3 580	3 765	3 890	4 703	4 824	4 885	5 428	5 949
Services trade balance	-90	-152	-149	-183	-235	-250	-240	-180	-109
Income balance	-90	-163	-163	-282	-253	-266	-323	-422	-460
Net current transfers	1 254	1 361	1 527	1 582	1 797	2 298	2 023	2 114	2 576
Capital and financial balance [d]	334	460	394	447	385	-27	282	1 080	572
Net foreign direct investment	-7	59	1 103	162	178	289	496	154	459
Financial capital [e]	341	401	-709	285	207	-316	-214	926	113
Overall balance	165	363	303	208	-46	-178	-124	316	-40
Variation in reserve assets [f]	-165	-363	-303	-208	46	178	124	-316	40
Other external-sector indicators									
Real effective exchange rate (index: 2000=100) [g]	106.5	104.0	101.9	100.4	100.0	99.6	99.6	101.1	101.0
Terms of trade for goods (index: 2000=100)	97.1	95.0	95.8	99.6	100.0	102.5	101.6	97.7	96.8
Net resource transfer (percentage of GDP)	2.4	2.7	1.9	1.3	1.0	-2.1	-0.3	4.4	0.7
Gross external public debt (millions of dollars)	2 517	2 689	2 646	2 789	2 831	3 148	3 987	4 717	4 778
Gross external public debt (percentage of GDP)	24.4	24.2	22.0	22.4	21.6	22.8	27.9	31.6	30.3
Net profits and interest (percentage of exports) [h]	0.0	0.0	1.0	3.5	1.6	2.0	2.3	2.1	1.9
				Average annual rates					
Employment									
Labour force participation rate [i]	51.3	50.9	53.5	52.6	52.2	53.3	51.2	53.4	51.7
Open unemployment rate [j]	7.7	8.0	7.5	7.0	6.7	7.0	6.2	6.9	6.8
Visible underemployment rate [k]	...	...	3.2	3.5	3.4	3.4	4.1	4.5	4.5

Table 1 (concluded)

	1996	1997	1998	1999	2000	2001	2002	2003	2004 [a]
					Annual averages				
Prices									
Variation in consumer prices (December-December)	7.4	1.9	4.2	-1.0	4.3	1.4	2.8	2.6	5.3
Variation in real minimum wage	-3.6	-4.3	3.3	2.4	-2.2	-3.6	-1.8	2.1	-1.4
Nominal deposit rate [l]	...	...	...	...	6.5	5.5	3.4	3.4	3.3
Nominal lending rate [m]	...	...	...	...	10.7	9.6	7.1	6.6	6.3
					Percentages of GDP				
Central government									
Current income	12.8	11.5	11.5	11.2	11.3	11.6	12.2	12.9	13.0
Current expenditure	11.7	10.5	10.8	11.1	11.8	11.5	11.4	12.2	12.2
Current balance	1.0	1.0	0.8	0.1	-0.4	0.1	0.9	0.7	0.8
Net capital expenditure	3.2	2.6	2.9	2.4	2.7	4.1	4.3	3.9	2.3
Primary balance	-0.2	0.2	-0.7	-0.9	-0.9	-2.3	-1.6	-0.8	0.9
Overall balance	-1.8	-1.1	-2.0	-2.1	-2.3	-3.6	-3.1	-2.7	-1.1
Public debt	37.8	36.2	33.3	26.0	27.4	31.2	36.1	38.0	38.3
Domestic	13.4	12.0	11.2	7.9	9.6	11.9	11.6	11.4	11.9
External	24.4	24.2	22.0	18.1	17.8	19.4	24.5	26.6	26.4
Interest payments (percentage of current income)	12.1	11.9	11.3	11.0	12.1	10.8	12.8	15.1	15.6
Money and credit [n]									
Domestic credit [o]	33.7	36.0	37.9	39.7	40.4	42.6	38.5	38.2	39.7
To the public sector	-0.5	-0.9	-1.6	-1.7	-1.2	0.2	0.4	-0.8	0.2
To the private sector	34.3	36.9	39.5	41.4	41.7	42.4	38.1	39.0	39.5
Liquidity (M3)	41.0	42.0	44.3	44.7	45.1	43.9	41.9	40.1	38.4

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.
[a] Preliminary figures. [b] Based on figures in local currency at constant 1990 prices. [c] Based on figures in local currency expressed in dollars at current prices. [d] Includes errors and omissions. [e] Refers to the capital and financial balance (including errors and omissions), minus net foreign direct investment. [f] A minus sign (-) denotes an increase in reserves. [g] Annual average, weighted by the value of merchandise exports and imports. [h] Refers to net investment income as a percentage of exports of goods and services as shown on the balance of payments. [i] Economically active population as a percentage of the working-age population; nationwide total. [j] Unemployment rate as a percentage of the economically active population; nationwide total. [k] Underemployment rate as a percentage of the economically active population; urban total. [l] Reference rate for deposits of up to 180 days in the financial system. [m] Reference rate for 1-year loans in the financial system. [n] The monetary figures are annual averages. [o] Refers to net credit extended to the public and private sectors by commercial banks and other financial and banking institutions.

slowdown in manufacturing. The 12-month moving average of the IVOPI industrial output index was also down, by 0.8%.

With declines in gross domestic investment and public consumption, the main economic stimulus in 2004 came from the 2.2% rise in private consumption. Consumption in this sector was spurred by the upswing in transfers from abroad, most of which came in the form of remittances from emigrants. Total supply was bolstered by a 3.4% increase in imports of goods and services.

The agricultural sector achieved a growth rate of over 3% after having turned in a very sluggish performance during the preceding four years. The crop-farming subsector exhibited a 2.4% increase in activity following a 2.5% slump in 2003, and the livestock subsector grew by 4.5%.

Manufacturing output made little progress (0.7%), largely because of shrinking demand in the United States for maquila products, which made up over 50% of the country's merchandise exports. Production fared better in non-maquila industries. Food output (28.1% of total manufacturing production) increased by 4.1%, while production of machinery and metal products rose by 2%, thanks to the momentum provided by the output of machinery and of transport and other equipment as well as, to a lesser extent, metal products. The biggest drop (-11.8%) was in the output of petroleum products and was associated both with sluggish economic activity and with the high cost of inputs.

A 13.6% downswing in the construction sector followed three years of steady growth as the country worked to rebuild in the aftermath of the 2001 earthquakes. The 9% drop in cement production —the sharpest decrease in 20 years— was reflected in a 17.7% reduction in apparent consumption. Net electric power generation showed only a slight increase over the previous year, thus attesting to the economy's weak performance in 2004.

Table 2
EL SALVADOR: MAIN QUARTERLY INDICATORS

	2003				2004 [a]				2005 [a]	
	I	II	III	IV	I	II	III	IV	I	II
Gross domestic product (variation from same quarter of preceding year) [b]	1.1	1.9	2.2	2.5	1.8	1.5	1.4	1.5	1.6	...
Merchandise exports, f.o.b. (millions of dollars)	801	762	801	764	815	518	819	894	821	...
Merchandise imports, c.i. f. (millions of dollars)	1 412	1 417	1 474	1 452	1 462	1 061	1 534	1 739	1 542	...
International reserves (millions of dollars)	1 800	1 687	1 814	1 943	1 937	1 837	1 919	1 927	1 739	...
Real effective exchange rate (index: 2000=100) [c]	100.2	101.2	101.4	101.5	101.4	100.4	100.4	101.7	101.7	102.0 [d]
Consumer prices (12-month percentage variation)	2.4	1.5	2.2	2.6	3.9	4.6	5.3	5.3	4.7	4.3
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 [e]	3.3	3.4	3.4	3.4	3.4	3.4	3.3	3.3	3.2	3.4
Lending rate [f]	6.6	6.5	6.6	6.6	6.6	6.2	6.3	6.1	6.9	6.8
Domestic credit (variation from same quarter of preceding year) [g]	0.9	5.8	7.7	8.9	8.5	12.7	10.8	6.3	7.7	...
Non-performing loans as a percentage of total credit [h]	3.5	3.3	3.2	2.8	2.7	2.6	2.7	2.4	2.5	2.1

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.
[a] Preliminary figures. [b] Based on figures in local currency at constant 1990 prices. [c] Quarterly average, weighted by the value of merchandise exports and imports. [d] Data to May. [e] Reference rate for deposits of up to 180 days in the financial system. [f] Reference rate for 1-year loans in the financial system. [g] Refers to net credit extended to the public and private sectors by commercial banks and other financial and banking institutions. [h] Refers to total credit extended by the banking system.

In January 2005 the government launched a project to construct the "dry canal" road links that are to connect Puerto Cortés, on the Honduran Atlantic coast, to the Pacific coast of El Salvador. This project is expected to serve as a catalyst for economic growth. With an investment of about US$ 170 million, the project will also include the construction of the Port of Cutuco, modernization of the Port of Acajutla, construction of a high-speed four-lane highway, and development of basic and hotel infrastructure. The project is slated to come fully on stream within three and a half years.

(b) Prices, wages and employment

Mostly because of rising international oil prices, which underlie about 70% of the inflation rate, the December-to-December consumer price index yielded a rate of 5.4%. This was much higher than any other rate registered since 1997, but was still one of the lowest figures in Central America. The sectors showing the largest increases were transport, furniture and household goods. Although in June 2005 the annual inflation rate began to decline (4.3%), the reduction has been so gradual that the official target of 3% may be hard to achieve. Rising fuel prices continue to exert upward pressure on production costs and consumer spending.

Despite the growing numbers of employed people paying into the social security system in 2004, the national unemployment rate fell by just 0.1 of a percentage point to 6.8%. This was chiefly due to the loss of some 8,000 jobs in the maquila sector. Underemployment, meanwhile, has been on the rise and now affects 34.6% of the working population.

With no increase in nominal minimum wages, agricultural workers' purchasing power declined by 4.3%. In industry, the real minimum wage was down by 1.4%, and in commerce and services it was 0.5% lower. Nonetheless, the nationwide household poverty rate fell from 36.1% in 2003 to 34.6% in 2004, while the national extreme poverty rate was reduced from 14.4% to 12.6%. In both cases, the biggest decreases were seen in rural areas and were partly attributable to increased family remittances.

(c) The external sector

In 2004, El Salvador was faced with climbing international oil prices and growing competition from Asia on world markets. Its exports of goods rallied by 5.6%, however, thanks to rising external sales of non-traditional products. Increased inflows of remittances remained a key factor in buoying private consumption and contributed to the decrease of over one percentage point in the current account deficit.

In fact, family remittances were up by 21% over the previous year, amounting to US$ 2,547,600,000 and covering 93.4% of the aggregate trade deficit. One factor contributing to the strong performance of remittances was the decline in unemployment among Hispanic workers in the United States seen in the last few months of 2004. The United States extended the Temporary Protected Status (TPS) designation granted to nationals of El Salvador who entered the United States illegally before the 2001 earthquakes, thereby making the Salvadoran economy less vulnerable to a potential contraction in remittances. During the first half of 2005, remittances totalled US$ 1.379 billion, for a year-on-year increase of 14.3%.

The country's export activities were clearly not trouble-free in 2004. Its terms of trade deteriorated, and stronger competition from Asia triggered a 2.8% drop in maquila exports. Thus, for the first time ever, the maquila sector was clearly out of step with economic growth in the United States. On the other hand, non-traditional exports were up 19.9%, mainly thanks to higher exports of outerwear, plastic products, cotton yarns and fruit juices. The small increase in traditional exports (1.8%) was attributable to increased coffee exports. Exports of goods to other Central American countries were up by 10.2%, and merchandise exports to the rest of the world rose by 3.9%.

Between January and June 2005, exports totalled US$ 1.74 billion (10% more than in the first half of 2004); exports of coffee and non-traditional products were higher, while maquila exports edged up by a mere 0.6%.

The expansion of merchandise imports (9.6%) was mainly due to higher unit values rather than to an increase in the volume of shipments. Purchases of intermediate goods rose by 14.3%, those of consumer goods by 12.4%, and those of capital goods by 5.7%. The result was a US$ 2,619,200,000 deficit on the merchandise trade account, which was 15.1% more than in 2003. This 9.6% year-on-year increase in imports for the first half of 2005 caused the trade deficit to widen by 9.2% relative to its level in the comparable period of 2004.

Inbound tourism increased by 14% in 2004, and the country's foreign-exchange revenues from this source were 13% higher than they had been in 2003. The financial account showed a positive balance of US$ 426.5 million, or just one third of the 2003 level. This result was made possible by the fact that the decline in assets and liabilities under "other investment" was outweighed by FDI, which amounted to 2.9% of GDP thanks to the sale of State-owned shares in the telecommunications company and increased foreign investment in the banking sector and construction.

Lastly, in 2004 and early 2005, the main rating agencies maintained their risk ratings for the country's long-term foreign-currency debt. Moody's Investors Service continued to assign the country an investment-grade rating, while Fitch Ratings and Standard & Poor's left their ratings just under that scale. This has put the country in a more favourable position for obtaining international loans.

Guatemala

1. General trends

In 2004, a more buoyant Guatemalan economy posted growth of 2.7%, after expanding by around 2% in the previous three years. For the first time since 2001, per capita GDP increased slightly. GDP growth was driven by external demand (6.6%), although the terms of trade worsened because of higher prices for petroleum and other raw materials. There was a fresh rise in family remittances, which accounted for a record 9.5% of GDP, while tourism revenues also climbed. As a result of this and of short-term capital inflows, the quetzal appreciated considerably from April 2004 onwards.

The new government authorities had to take on the 2003 fiscal deficit, as well as the consequences of the Constitutional Court's decision to suspend both the tax on commercial and farming enterprises (IEMA) and the fuel distribution tax. The government therefore drastically cut public spending, since the changes to the tax regime presented to Congress were only partially approved and did not generate as much income as projected. The government deficit narrowed from 2.3% of GDP to 1.0% of GDP, with significant cuts in current expenditure (especially capital expenditure).

High prices for petroleum and other raw materials pushed up the variation in consumer prices from 5.9% to 9.2% between December 2003 and December 2004. Modest growth meant there were no significant changes in employment. Average real wages and salaries fell by 2.4% during what was the fourth consecutive year of virtual stagnation.

The balance-of-payments current account deficit was quite hefty at 4.4% of GDP, and the country's chronic trade deficit for goods and services was very high. Although the external public debt was 10.9% higher than in 2003, debt burden indicators remained moderate.

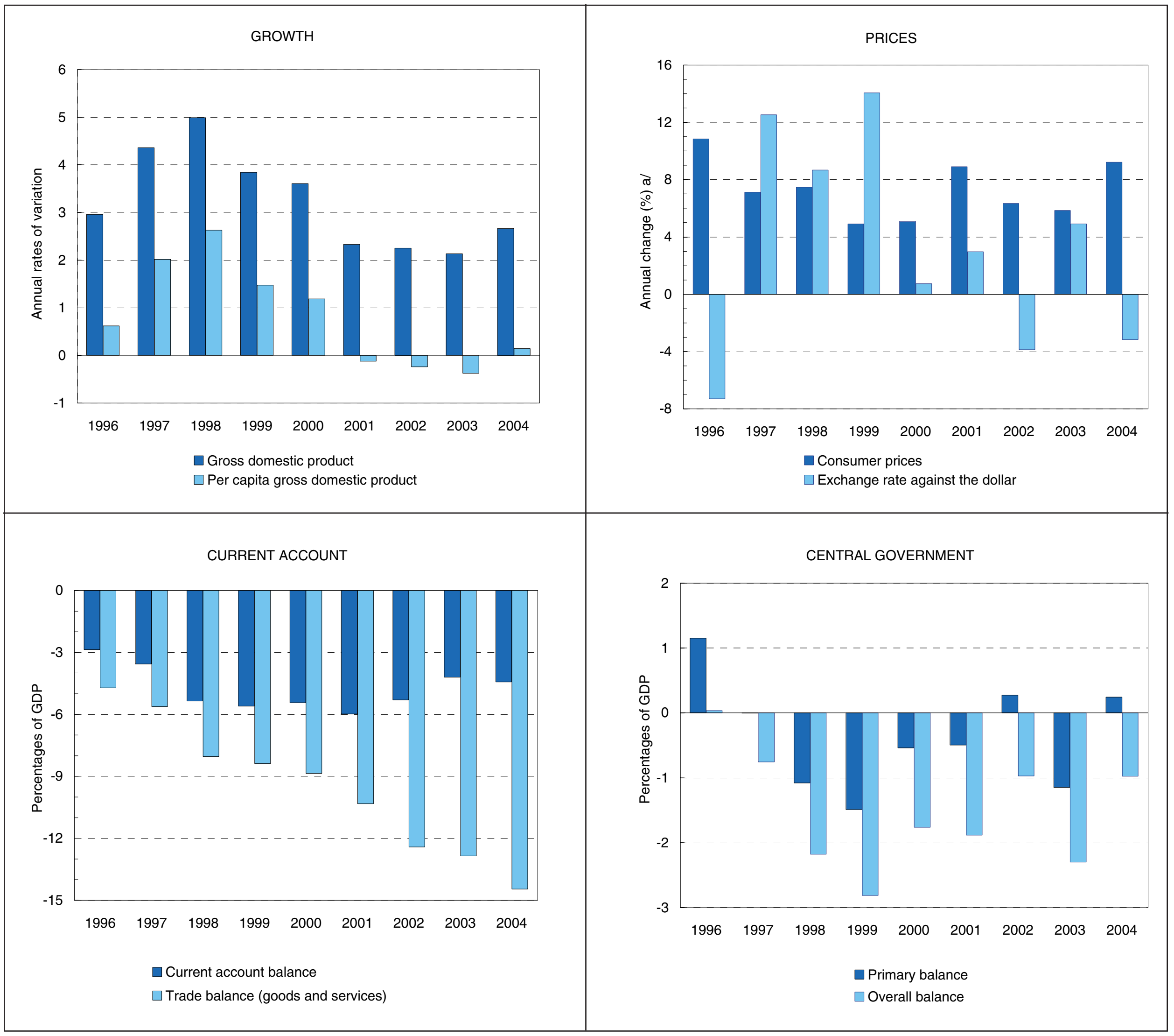
In the latter months of 2004 the government launched an economic and social recovery programme known as "*Vamos Guatemala*", which comprises a set of specific and measurable projects aimed at generating a propitious climate for production investment and creating tangible benefits for Guatemalan households.

In 2005, GDP is expected to rise by 3.2%. This should be facilitated by the consolidation of the new government and the *Vamos Guatemala* programme. The driving force behind growth is predicted to be construction (following the sharp decline in 2004) and increased buoyancy in the manufacturing industry. In contrast, growth is expected to falter in agriculture and commercial activities.

The authorities have expressed an intention to gradually introduce a system of explicit targets, as part of convergence towards a single benchmark interest rate for short-term monetary stabilization operations. Projections point to inflation of between 4% and 6% for 2005, although this target is likely to be overreached as it was in 2004. The fiscal deficit is expected to stand at 1.8% of GDP, which suggests both a looser stance on public spending and a slightly wider current account deficit than in 2004 (4.3% of GDP).

At the beginning of 2005, the government held negotiations for a new special drawing rights agreement with the International Monetary Fund (IMF), but did not ultimately formalize the accord, partly due to the positive performance of international reserves and smooth access to external financing. IMF will continue to monitor the economic targets set by the authorities and provide technical cooperation for the banking and tax systems, monetary policy and economic statistics.

Figure 1
GUATEMALA: MAIN ECONOMIC INDICATORS



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

2. Economic policy

The central bank sought to tackle the rise in international petroleum prices and the resulting impact on inflation and exchange rate appreciation, all without marring the recovery of economic activity. Fiscal policy was the instrument of choice for achieving these objectives. Although the real appreciation of the quetzal had not been halted by the end of the year, the authorities did manage to avoid sudden exchange-rate adjustments. Inflation remained in single-digit figures despite high prices for petroleum and other raw materials almost all year long.

(a) Fiscal policy

The government authorities had to grapple with the deterioration in the fiscal accounts seen in 2003 and the Constitutional Court's decision to overturn two taxes: first, the tax on commercial and farming enterprises (IEMA), which was partially suspended in a ruling of 3 February 2004, then the tax on fuel distribution, which was suspended on 16 December 2004.

Public spending was therefore slashed at the beginning of 2004. Congress was then presented with six tax reform proposals aimed at raising the tax burden to 12%. Four of the proposals were adopted mid-year, including a temporary tax to support the peace agreements (IETAP) and changes to income tax. At the end of the year, the Council of Ministers for Economic Integration (COMIECO) temporarily established a renewable three-month extraordinary tariff on fuel to offset the suspension of the fuel distribution tax.

The temporary tax to support the peace agreements (IETAP) and the income tax reforms failed to offset the fall in income following the suspension of IEMA. Total tax revenue remained constant thanks almost exclusively to higher VAT revenues as a result of the gradual economic recovery during the year and the measures adopted by the tax authorities to reduce evasion, although the income tax take still needs to be improved.

In 2004, the tax burden remained at the same level as in 2003 (10.3%), although lower than the 10.6% recorded in 2002. Indirect taxes grew by 0.2 percentage points, thereby compensating a similar fall in direct taxation. The narrowing of the deficit from 2.3% of GDP in 2003 to 1.0% in 2004 was entirely attributable to cuts in expenditure.

Indeed, total government expenditure dropped from 13.4% of GDP in 2003 to 12.0% in 2004, with a 0.7 percentage point decline in both current and capital expenditure. All headings of current expenditure were lower than in 2003, except interest on the external debt in the wake of international interest rake hikes and higher public debt.

Real current income declined by 1.5%, with a 7.3% fall in non-tax revenues (including transfers). The best performance among tax revenues was turned in by VAT (3.3%). Current expenditure dropped by 8.9% in real terms, owing mainly to smaller outlays on goods and services and a decline in current transfers. Capital expenditure was also down in real terms, by 15.6%, given the late adoption of the public investment programme. The government still faces the challenge of increasing tax revenues to meet its commitments under the peace agreements and to pay for overdue social investments.[1]

(b) Monetary policy

Among the factors that contributed to the economy's increased monetization were the central bank's purchases of foreign exchange on the market, in an attempt to slow the mounting appreciation of the quetzal during 2004 and up to April 2005.

In order to ease the expansion of the money supply, the central bank engaged actively in open-market operations, which in 2004 represented 1.4 billion quetzals more than the previous year. This was strongly offset by an increase in the government's deposits in the central bank, which stood at 8.385 billion quetzals at the end of 2004 (2.164 billion quetzals more than in 2003).

The monetary authority also raised interest rates on 28-day certificates of deposit in March, April and June, which produced a cumulative increase of 112.5 basis points. In October, the authorities responded to continued inflationary pressure by raising the interest rate on 91-day instruments by 25 basis points. This pushed up the average weighted interest rate on the total stock of open-market operations from 5.7% at the beginning of the year to 6.1% at the year's end. The result was that monetary aggregates showed little real variation, with M1 contracting by 2.0% and M2 by 1.1%. Domestic credit to the private sector went up by 6.7%, while domestic credit to the public sector dropped by 53%.

(c) Exchange-rate policy

The central bank has pursued a flexible exchange-rate policy based on occasional interventions in the foreign-exchange market to reduce volatility and purchase foreign exchange needed by the bank and the government. Unlike in 2003, when the quetzal depreciated by 3% in real terms, a real appreciation was observed in 2004 from April onwards.

Other determining factors included a large inflow of financial resources into the economy —mainly in the form of family remittances, short-term capital and other, unrecorded inflows— and Guatemala's wider interest-rate

[1] See the message sent by Secretary-General of the United Nations, Kofi Annan, on the occasion of the ceremony marking the closure of the United Nations Mission for the Verification of Human Rights and of Compliance with the Commitments of the Comprehensive Agreement on Human Rights in Guatemala (MINUGUA), Press Release SG/SM/9595/CA/27, 16 November 2004.

Table 1
GUATEMALA: MAIN ECONOMIC INDICATORS

	1996	1997	1998	1999	2000	2001	2002	2003	2004 [a]
	Annual growth rates [b]								
Gross domestic product	3.0	4.4	5.0	3.8	3.6	2.3	2.3	2.1	2.7
Per capita gross domestic product	0.6	2.0	2.6	1.5	1.2	-0.1	-0.2	-0.4	0.1
Gross domestic product, by sector									
Agriculture, livestock, hunting, forestry and fishing	2.6	2.9	3.7	2.1	2.6	1.2	1.8	3.1	3.7
Mining	23.4	24.6	21.0	-1.9	-8.5	0.8	9.8	4.1	-8.2
Manufacturing	1.9	2.7	3.6	2.5	1.9	1.1	0.8	1.0	2.3
Electricity, gas and water	6.0	14.7	5.8	11.0	17.4	-3.0	9.1	4.4	6.0
Construction	3.1	10.0	9.3	7.8	-18.3	12.2	-15.3	-3.3	-19.6
Wholesale and retail commerce, restaurants and hotels	2.7	3.7	5.3	3.2	4.1	2.7	2.8	1.9	3.2
Transport, storage and communications	3.6	5.9	7.5	6.8	7.6	6.8	5.7	4.8	9.2
Financial institutions, insurance, real estate and business services	4.4	4.7	5.9	4.6	3.1	0.3	2.2	2.2	2.5
Community, social and personal services	2.4	4.7	4.1	4.7	4.6	3.5	1.2	-0.2	-2.8
Gross domestic product, by type of expenditure									
Consumption	2.5	4.2	5.1	3.7	4.2	4.0	3.0	2.9	2.3
General government	0.0	6.2	9.7	5.2	10.4	5.4	-2.1	-0.6	-10.1
Private	2.8	4.0	4.6	3.6	3.5	3.8	3.7	3.3	3.7
Gross domestic investment	-15.0	20.1	36.3	-0.4	2.5	6.4	14.3	4.0	7.0
Exports (goods and services)	8.7	8.1	2.4	4.6	3.8	-4.0	-6.7	-0.2	6.6
Imports (goods and services)	-6.9	19.5	24.5	0.7	6.0	6.9	6.6	5.3	7.3
	Percentages of GDP								
Investment and saving [c]									
Gross domestic investment	12.7	13.7	17.4	17.4	17.8	17.8	19.1	18.0	17.5
National saving	9.8	10.1	12.0	11.8	12.4	11.8	13.8	13.8	13.1
External saving	2.9	3.6	5.4	5.6	5.4	6.0	5.3	4.2	4.4
	Millions of dollars								
Balance of payments									
Current account balance	-452	-634	-1 039	-1 026	-1 049	-1 253	-1 235	-1 039	-1 188
Merchandise trade balance	-643	-940	-1 409	-1 445	-1 660	-2 282	-2 972	-3 116	-3 760
Exports, f.o.b.	2 237	2 603	2 847	2 781	3 082	2 860	2 819	3 060	3 430
Imports, f.o.b.	2 880	3 543	4 256	4 226	4 742	5 142	5 791	6 176	7 189
Services trade balance	-101	-62	-152	-91	-48	117	79	-68	-115
Income balance	-230	-239	-184	-205	-209	-84	-318	-318	-319
Net current transfers	523	607	705	715	868	997	1 976	2 462	3 006
Capital and financial balance [d]	666	863	1 275	901	1 703	1 727	1 257	1 589	1 797
Net foreign direct investment	77	84	673	155	230	456	111	131	155
Financial capital [e]	589	779	602	746	1 474	1 271	1 146	1 458	1 642
Overall balance	214	230	235	-125	654	474	22	550	609
Variation in reserve assets [f]	-199	-258	-263	125	-654	-474	-22	-550	-609
Other financing [g]	-15	28	28	0	0	0	0	0	0
Other external-sector indicators									
Real effective exchange rate (index: 2000=100) [h]	94.8	88.3	88.1	98.7	100.0	95.7	88.5	88.2	85.6
Terms of trade for goods (index: 2000=100)	92.7	97.9	115.3	101.9	100.0	96.7	95.8	93.0	92.1
Net resource transfer (percentage of GDP)	2.7	3.7	5.8	3.8	7.7	7.8	4.0	5.1	5.5
Gross external public debt (millions of dollars)	2 075	2 135	2 368	2 631	2 644	2 925	3 119	3 467	3 844
Gross external public debt (percentage of GDP)	13.1	12.0	12.2	14.4	13.7	13.9	13.4	14.0	14.3
Net profits and interest (percentage of exports) [i]	4.6	5.1	3.7	4.3	5.8	4.4	5.7	6.6	5.2
	Average annual rates								
Employment									
Labour force participation rate [j]	...	...	...	...	...	…	60.8	...	...
Open unemployment rate [k]	5.2	5.1	3.8	...	...	…	3.1	3.4	3.1

Table 1 (concluded)

	1996	1997	1998	1999	2000	2001	2002	2003	2004 [a]
				Annual percentages					
Prices									
Variation in consumer prices (December-December)	10.9	7.1	7.5	4.9	5.1	8.9	6.3	5.9	9.2
Variation in nominal exchange rate (December-December)	-7.3	12.5	8.7	14.1	0.7	3.0	-3.9	4.9	-3.2
Variation in average real wage	9.7	2.8	3.6	5.8	3.8	0.5	-0.9	0.5	-2.4
Nominal deposit rate [l]	...	5.8	5.4	7.9	10.2	8.8	7.1	5.2	4.5
Nominal lending rate [m]	...	18.7	16.5	19.4	20.9	19.0	16.9	15.0	13.8
				Percentages of GDP					
Central government									
Current income	9.4	9.9	10.3	11.0	11.0	11.0	11.4	11.1	11.0
Current expenditure	6.7	6.7	7.9	8.6	9.1	9.2	8.6	8.9	8.2
Current balance	2.7	3.2	2.3	2.4	1.9	1.8	2.8	2.1	2.8
Net capital expenditure	2.7	3.9	4.5	5.2	3.7	3.7	3.8	4.5	3.8
Primary balance	1.2	0.0	-1.1	-1.5	-0.5	-0.5	0.3	-1.1	0.2
Overall balance	0.0	-0.8	-2.2	-2.8	-1.8	-1.9	-1.0	-2.3	-1.0
Public debt	13.5	14.0	14.6	17.5	16.9	18.0	16.4	18.5	19.1
Domestic	5.3	5.4	5.0	5.8	5.8	5.6	4.5	5.6	6.0
External	8.2	8.5	9.6	11.8	11.2	12.4	11.9	12.9	13.1
Interest payments (percentage of current income)	11.8	7.6	10.7	12.0	11.1	12.6	10.9	10.4	11.1
Money and credit [n]									
Domestic credit [o]	19.2	20.1	20.0	20.5	19.8	19.6	18.7	18.5	19.2
To the public sector	1.4	2.4	2.3	1.0	0.8	1.1	0.4	0.3	0.7
To the private sector	17.8	17.7	17.7	19.6	19.0	18.5	18.3	18.2	18.6
Liquidity (M3)	...	...	...	...	...	...	26.6	27.5	28.2
Currency in circulation and local-currency deposits (M2)	21.0	22.4	23.0	23.1	23.8	25.1	25.1	25.4	25.3
Foreign-currency deposits	...	...	...	...	...	...	1.5	2.1	2.9

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.
[a] Preliminary figures. [b] Based on figures in local currency at constant 1958 prices. [c] Based on figures in local currency expressed in dollars at current prices. [d] Includes errors and omissions. [e] Refers to the capital and financial balance (including errors and omissions), minus net foreign direct investment. [f] A minus sign (-) denotes an increase in reserves. [g] Includes the use of IMF credit and loans and exceptional financing. [h] Annual average, weighted by the value of merchandise exports and imports. [i] Refers to net investment income as a percentage of exports of goods and services as shown on the balance of payments. [j] Economically active population as a percentage of the working-age population; nationwide total. [k] Unemployment rate as a percentage of the economically active population; nationwide total. [l] Average rate for deposits in the banking system. [m] Average rate for loans in the banking system. [n] The monetary figures are annual averages. [o] Refers to net credit extended to the public and private sectors by commercial banks and other financial and banking institutions.

spread with respect to its main trading partners. In order to avoid a sudden adjustment in the exchange rate, in 2004 the central bank bought US$ 449 million in foreign exchange on the market, authorized the issuance of dollar-denominated certificates of deposit and coordinated bond issues with the Ministry of Public Finance.

The government helped to contain the money supply by increasing its deposits in the central bank. Even so, official figures from the end of 2004 show that the quetzal appreciated by 7.5% over the value recorded at the end of 2003.

(d) Other policies

The Free Trade Agreement between Central America and the United States (CAFTA) was approved by the Guatemalan Congress in March 2005 and subsequently enacted by the government.[2] There has been some controversy over the likely impact of the Agreement once it comes fully into effect. Trade liberalization is not a recent phenomenon in Guatemala, as Central America has been making progress on integration instruments for over forty years.[3] In 2000 Guatemala concluded free trade agreements with Mexico

2 See Economic Commission for Latin America and the Caribbean (ECLAC), *El tratado de libre comercio, Centroamérica-Estados Unidos* (LC/MEX/R.854), Subregional Headquarters in Mexico, Mexico City, March, 2004.

3 Secretariat for Central American Economic Integration (SIECA) [on line] <http://www.sieca.org.gt/SIECA.htm>.

Table 2
GUATEMALA: MAIN QUARTERLY INDICATORS

	2003				2004 [a]				2005 [a]	
	I	II	III	IV	I	II	III	IV	I	II
Merchandise exports, f.o.b. (millions of dollars)	1 078	1 151	1 172	1 059	1 174	867	1 344	1 262	1 293	...
Merchandise imports, c.i. f. (millions of dollars)	1 978	1 991	2 016	2 141	2 194	1 584	2 358	2 549	2 344	...
International reserves (millions of dollars)	2 361	2 483	2 897	2 833	2 862	2 872	2 896	3 426	3 563	...
Real effective exchange rate (index: 2000=100) [b]	87.0	88.2	88.2	89.3	88.6	85.9	84.6	83.3	81.3	79.9 [c]
Consumer prices (12-month percentage variation)	5.8	5.2	5.7	5.9	6.1	7.4	8.0	9.2	9.5	8.8
Average nominal exchange rate (quetzals per dollar)	7.84	7.91	7.94	8.07	8.10	7.99	7.90	7.79	7.71	7.61
Nominal interest rates (annualized percentages)										
Deposit rate [d]	6.1	5.4	4.9	4.6	4.4	4.4	4.5	4.5	4.6	13.1 [c]
Lending rate [e]	15.8	15.2	14.6	14.2	13.9	13.9	13.8	13.6	13.5	4.6 [c]
Domestic credit (variation from same quarter of preceding year) [f]	2.8	4.0	9.6	11.8	15.4	11.1	9.3	14.4	14.1	18.1 [g]
Non-performing loans as a percentage of total credit [h]	10.4	9.6	7.8	7.5	7.0	7.0	7.5	5.9	6.9	6.5 [c]

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.
[a] Preliminary figures. [b] Quarterly average, weighted by the value of merchandise exports and imports. [c] Data to May. [d] Average rate for deposits in the banking system. [e] Average rate for loans by the banking system. [f] Refers to net credit extended to the public and private sectors by commercial banks and other financial and banking institutions. [g] Data for April. [h] Refers to total credit extended by the banking system.

and then the Dominican Republic, and has concluded partial scope agreements with the Bolivarian Republic of Venezuela, Colombia, Cuba and Panama. Negotiations are currently under way for a free trade agreement with Taiwan Province of China and a partial scope agreement with Belize.

In recent years, significant progress has been made towards improving regulation and supervision of the financial system with the implementation of the risk-based capital adequacy standards established in the Basle Accord. At the end of 2004, the banking system's portfolio of loans that were non-performing or in arrears (not including the portfolios of banks in which the authorities have intervened) showed a slight improvement, representing 6.8% of total loans. In November 2004, dead assets represented 8.2% of total assets in the banking system. Of these, 40% corresponded to non-performing or arrears portfolios, mainly in two banks, whereas 19 other institutions reduced their non-performing portfolio to some extent.

3. The main variables

(a) Economic activity[4]

GDP grew by 2.7% on the strength of external demand (6.6%), since domestic demand expanded by only 3.0%. The sharp declines in public consumption and public investment (down by an average of 13.5%) were offset by the improved performance of private consumption and investment (averaging 4.6%). In the last four years, the economy has been driven by private consumption —which in turn is buoyed by considerable income from family remittances.

4 Estimates for the System of National Accounts (SNA) are currently being reviewed. The current version - SNA2 (constant 1958 quetzals) will be replaced by SNA4 (constant 2001 quetzals). Among other things, the methodological changes will affect the calculation of GDP levels.

Export performance was affected by the appreciation of the quetzal, but in recent years has also been influenced by other factors such as high transport costs, burdensome financing of export activity and a lack of appropriate tax incentives.[5]

The expansion of domestic demand (3.2%) was driven by private investment (8.8%), while public investment contracted considerably (24.0%). Particularly buoyant headings included machinery and equipment, while investment in construction declined. Total consumption climbed by 2.3% on the strength of private consumption (3.7%), as public consumption dropped considerably (10.1%).

In terms of the various sectors, agriculture (3.4%) was more buoyant than the previous year thanks to increased production of bananas, cardamom, sugarcane and vegetables. The manufacturing industry (2.1%) was also up on 2003, as a result of recovery in the United States and Central American markets. The textile industry posted the strongest expansion (21.4%).

Basic services (7.8%) swelled on the strength of transport, storage and communications. The telecommunications sector turned in a very robust performance associated with an increase of almost 50,000 new telephone lines. Construction activities, on the other hand, slumped (15.7%) owing to a sharp decline in public construction (29.8%), though this was partly offset by growth in private construction (8.8%). Other services expanded by only 1.6%.

(b) Prices, wages and employment

At the end of 2004, the cumulative 12-month variation in the consumer price index was 9.2%, compared with 5.9% in 2003. This exceeded the central bank's annual target of 6%, owing in part to higher international prices for petroleum and petroleum products. According to the central bank, 2.28 percentage points of the 9.2% inflation rate corresponded to imported inflation and 6.95 percentage points, to domestically generated inflation. The bank also estimated that excess imported inflation, attributable to petroleum prices, was 2.34 percentage points. In 2004, food and beverages posted the largest variation (12.7%), while clothing and footwear recorded the smallest (3.5%).

In 2004, the open unemployment rate was 3.1%, compared with 3.4% in 2003. However, the fall in the rate of open unemployment was accompanied by a reduction in the labour force participation rate from 60.9% in 2003 to 56.1% in 2004. The equivalent unemployment rate (including visible underemployment) went from 32% to 29% of the economically active population (EAP) in the same period. In July 2004 an increase in the minimum wage came into effect in agriculture (21%) and other sectors (16%). In real terms, this meant that, in 2004, the minimum wage averaged out at a level similar to that recorded the previous year.

(c) The external sector

In 2004, the trade deficit for goods and services rose for the eighth year in a row, reaching US$ 3.875 billion. The value of merchandise exports posted the highest rate of growth (12.1%) since 1997 thanks to an upturn in prices, although this was insufficient to offset the considerable rise in the value of merchandise imports (16.2%) and the goods trade deficit therefore broadened once again. The non-factor services balance also deteriorated, bringing the negative balance for goods and services to 14.4% of GDP.

The value of merchandise exports (including maquila value added) was US$ 3.43 billion, with a variation of 12.1%. Exports to the rest of Central America and non-traditional sales were more buoyant than in 2003.

Non-traditional exports grew strongly for the third consecutive year (with an annual variation of 15.7%), outpacing traditional sales for the first time. Particularly good performances were recorded in clothing (30%), natural rubber (56%), vegetables (52%) and chemicals (19%), while shrimp, fish and lobster dropped by half.

Traditional exports, on the other hand, picked up by only 3.9%, following three years of decline. This slight upturn was mainly attributable to higher external sales of coffee (10.6%) on account of better prices (as the volume of sales actually fell 13.6%). Higher prices also enabled an upturn of 1.0% in exports of sugar and banana, whose export volumes fell by 0.3 and 6.4%, respectively. Cardamom exports dropped once again (6.5%) due to lower prices (with no change in export volume).

Merchandise imports climbed by 16.2% in 2004, thereby continuing the strong expansion in external purchases observed since 1997. Imports of intermediate goods rose by 18.2%, with particularly strong growth rates in petroleum and fuels (19.8%), which brought the net balance of petroleum trade to stand at US$ 909 million. Imports of consumer goods expanded by 13.3%, with consumer durables (20.2%) more than doubling the rate for consumer non-durables. Imports of capital goods, meanwhile, climbed by 16.3%.

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5 Asociación Gremial de Exportadores de Guatemala (AGEXPRONT), *Modelo de desarrollo para Guatemala, quinquenio 2003-2007. Una propuesta para la eliminación de la pobreza*, October, 2002.

The non-factor services account benefited from foreign exchange generated by tourism, which brought in revenues of US$ 777 million (almost as much as total income from traditional exports) with 1.18 million tourist arrivals in 2004. Despite the rise in the number of visitors, the average spending per tourist dropped for the third year running, to US$ 657.

The income balance remained close to its 2003 level. Net payments of profits and interest maintained the same level as in the three previous years (US$ 320 million).

The balance of current transfers stood at US$ 3 billion, over 80% of which corresponded to family remittances. As a result, the balance-of-payments current account deficit was US$ 1.188 billion, which was financed by hefty income on the capital and financial accounts —mostly in the form of short-term capital— to give an overall balance of US$ 609 million.

Honduras

1. General trends

The upturn in the world economy had a positive impact on production in Honduras, where the growth rate increased from 3.5% to 5.0% between 2003 and 2004. The macroeconomic climate was stable, but some indicators deteriorated and showed no sign of improvement throughout the first half of 2005. Inflation rose to 9.2%, thus ending the downward trend that had lasted for several years. The labour situation continued to worsen and unemployment rose to 5.9%. The current account deficit widened to the equivalent of 5.2% of GDP, while public finances strengthened significantly.

In addition to the buoyancy of the international economic environment, other factors helped to boost expectations, among them the signing of an agreement with the International Monetary Fund (IMF), which gave a powerful endorsement to economic policy. Furthermore, the donor countries made important financial commitments under the Poverty Reduction Strategy (PRS) and Honduras was included in the initiative known as the Millennium Challenge Account, a fund created by the Government of the United States. Lastly, the negotiations of the Dominican Republic-Central America-United States Free Trade Agreement (CAFTA-DR) were successfully concluded.

The monetary programme for 2005 is consistent with the targets established in the agreement with IMF and the goal of improving the macroeconomic climate. Growth is expected to fluctuate between 4% and 4.5% of GDP, and inflation between 6.5% and 7.5%. The central government deficit and the external deficit should decrease to the equivalent of 3% and 2.7% of GDP, respectively. The lower growth projection is attributable to the slowdown in world economic growth and the ambitious inflation target established by the Central Bank of Honduras. In view of the sharp rise in international oil prices in the first half-year, achieving this target will depend on the adoption of a tighter monetary policy than that applied in 2004. The indicators for the first quarter have already revealed a slowdown in economic activity, especially in activity geared to the domestic market.

Further uncertainty surrounds the current process of modernization of the monetary policy and how economic agents will react. The forthcoming elections in November also represent a risk in the fiscal sphere. On the positive side, in April, the country reached completion point under the Heavily Indebted Poor Countries (HIPC) Initiative. This, together with the recent initiative of the Group of Eight, could result in a reduction of almost 50% in external debt.

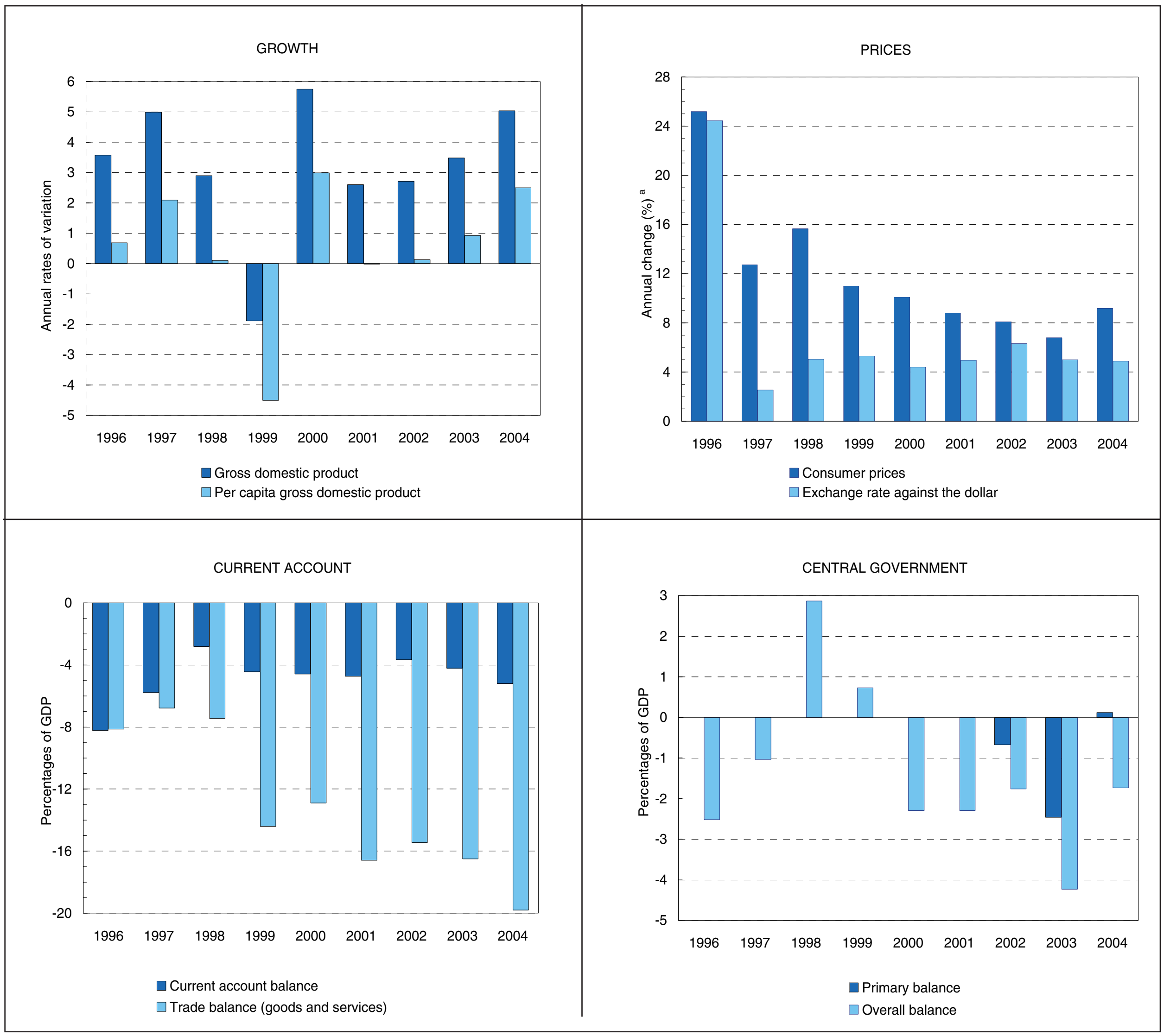
2. Economic policy

In 2004, the main objectives of macroeconomic policy were fiscal adjustment, financial system reforms, reduction of inflation and stabilization of the exchange rate.

(a) Fiscal policy

In keeping with the three fiscal reforms introduced in the previous biennium, the objective was to reduce

Figure 1
HONDURAS: MAIN ECONOMIC INDICATORS



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

the central government deficit to the equivalent of 3.4% of GDP. This objective was achieved, but the real adjustment was smaller than it seemed, since the 2003 deficit was inflated by the effects of legislation enacted to strengthen the financial position of agricultural producers. The payments resulting from the implementation of this legislation will be made over a ten-year period, but the cost, equivalent to 1.2% of GDP, was recorded as part of the deficit for 2003.

Revenue was up by 8.9% in real terms, owing to the increase in current revenue (9.5%), while tax revenue expanded by 10.4% as a result of the reforms. Direct taxes increased by 24.8%, owing to the taxes on property and net assets, which almost doubled. Income tax collection improved by 19.6%. Income from indirect taxation, however, grew by only 5.8%. This included revenue from taxes on petroleum products, which increased by 11.8%, and the contribution of taxes on foreign trade (9.7%).

Expenditure contracted by 3.1%. Current expenditure declined by 5.4%, while capital expenditure increased by 4.8%. Wages stagnated, in contrast to their strong growth in previous years. The wage bill diminished from 10.5%

of GDP in 2003 to 10% in 2004, in keeping with the target set by IMF. Purchases of goods and services fell by 11.5% and transfers, by 15.8%. Interest payments also decreased by 2.6% owing to forgiveness of interest on external debt granted before Honduras reached completion point.

It should be noted that, following a biennium of negative results, current savings turned positive again in 2004, rising to 1.4% of GDP. The central government deficit was financed with external resources intended for supplementing the budget, while the consolidated public sector, including the central bank, posted a deficit equivalent to 3% of GDP, which represented an improvement of 1.9 percentage points. This was influenced by the positive outturn of the four largest public enterprises, which recorded a positive operating balance equivalent to 2.6% of GDP. The central bank, however, recorded a deficit of over 1% of GDP.

Social policy was implemented as part of the Poverty Reduction Strategy, under which, social spending was raised by 0.6% of GDP to stand at 8.4% of GDP. Social investment was channelled through the Honduran Social Investment Fund and the Family Allowance Programme.

External public debt increased by 8.5% and stood at US$ 5.082 billion, or 68.4% of GDP. Domestic debt declined by 14.8%, after doubling in 2003, owing to a short-term loan to the government, the repayment of which reduced the balance by 0.7% of GDP.

(b) Monetary and exchange-rate policy

The central bank's goals were to lower the rate of inflation to 6.5%-7% and to build up international reserves by US$ 75 million. The instruments deployed for these purposes were open-market operations and foreign exchange auctions. In contrast to the previous year, fiscal consolidation was achieved as programmed, which enabled the central bank to adopt a looser stance. By mid-year, however, the rise in international oil prices put an end to the decline in inflation and the central bank adopted measures to mitigate the effects of this new development. In addition, the accumulation of net international reserves totalling US$ 504 million forced the central bank to issue monetary absorption certificates (CAM), which exceeded the 2003 placements by 5.072 billion lempiras, representing a 30% increase in real terms. By contrast, the net issuance of dollar-denominated absorption certificates was only 10.9 million lempiras.

The money supply expanded by 1.4% in real terms, due basically to a 3.5% contraction of current account deposits. Currency in circulation outside the banking system, however, increased by 8.5%. The money supply in local currency (M2) also swelled, by 8.5%, owing in part to time deposits in local currency (12%). The broad money aggregate (M3) increased by 9.2%, owing to the expansionary effect of foreign currency deposits (11.1%).

Interest rates followed a downward trend, but this was reversed in the second half of the year. Credit activity increased by 15.7%, four points above the expansion recorded in 2003. Thanks to a further strengthening of the financial system, non-performing loans were reduced from 8.7% in the previous year to 6.4%. The loan-loss coverage of the non-performing portfolio doubled over the same period, while the ratio of capital to risk-weighted assets increased from 13% to 14.5%. Lastly, total assets increased from 74.3% to 77.9% of GDP.

After focusing on the approval of its three fiscal reforms in the previous biennium, in 2004 and 2005 the government turned its attention to the financial system. The reforms implemented in 2004 include new legislation on the financial system and amendments to laws governing the functioning of the Central Bank of Honduras, the National Commission on Banks and Insurance and the Deposit Insurance Fund. The current year, 2005, saw the entry into force of a new monetary policy system designed to communicate the central bank's position more clearly to agents. The scheduled changes refer both to operational targets and to central bank instruments.

Net international reserves have continued to increase in 2005; the same is true of remittances, which exceed the 30% growth rate recorded in the previous year. Credit to the private sector has continued to expand at a rate close to 12%.

The objective of the exchange-rate policy in 2004 was to maintain exchange-rate stability through the public foreign-exchange auction system. The benchmark exchange rate reached 18.6 lempiras per United Stated dollar, which represents a nominal depreciation of 5%, while the real adjusted exchange rate, based on the consumer price indices of Honduras and the United States, remained practically unchanged.

(c) Trade policy

The most prominent event of 2004 was the signing of the Dominican Republic- Central America-United States Free Trade Agreement (CAFTA-DR) in May. Ratification began when El Salvador approved the Agreement in December 2004, followed by Honduras and Guatemala in the first quarter of 2005. Central American integration continued to move forward towards customs union on various fronts, including harmonization of more than 90% of the tariff fractions of the common external tariff, increased harmonization of the tax systems and improvements to the relevant legal framework. An important advance in this context was the facilitation of transit for individuals and goods at integrated border crossings.

Table 1
HONDURAS: MAIN ECONOMIC INDICATORS

	1996	1997	1998	1999	2000	2001	2002	2003	2004 [a]
				Annual growth rates [b]					
Gross domestic product	3.6	5.0	2.9	-1.9	5.7	2.6	2.7	3.5	5.0
Per capita gross domestic product	0.7	2.1	0.1	-4.5	3.0	0.0	0.1	0.9	2.5
Gross domestic product, by sector									
Agriculture, livestock, hunting, forestry and fishing	2.5	4.2	-1.9	-8.5	11.7	-0.5	4.9	2.6	7.1
Mining	7.3	4.9	3.7	5.4	1.7	-0.8	4.2	3.2	-0.8
Manufacturing	4.6	6.1	3.4	2.6	5.5	5.2	3.8	3.7	4.2
Electricity, gas and water	15.4	7.6	4.9	2.1	10.6	-1.8	5.6	10.1	5.6
Construction	-11.4	-3.0	5.3	10.5	1.5	-5.2	-14.2	13.8	-4.7
Wholesale and retail commerce, restaurants and hotels	4.5	3.5	3.1	0.7	3.7	3.0	2.9	3.1	4.7
Transport, storage and communications	4.4	4.4	2.7	1.7	5.0	5.3	3.5	3.7	4.0
Financial institutions, insurance, real estate and business services	4.3	7.8	7.2	0.8	2.6	3.4	2.8	2.7	3.8
Community, social and personal services	0.7	5.3	3.3	-0.9	10.5	11.0	6.9	1.4	7.0
Gross domestic product, by type of expenditure									
Consumption	5.4	2.5	5.7	0.4	7.9	5.3	4.8	3.1	4.8
General government	5.3	-1.0	15.4	9.8	15.7	12.1	0.5	0.8	5.6
Private	5.5	2.9	4.5	-0.9	6.8	4.3	5.5	3.5	4.6
Gross domestic investment	-6.3	8.4	1.9	8.1	-2.8	-3.8	-5.8	7.7	11.4
Exports (goods and services)	8.1	1.3	1.6	-11.2	7.4	3.2	4.9	5.3	8.9
Imports (goods and services)	2.4	-1.4	7.5	4.3	3.8	4.0	2.4	7.3	12.5
				Percentages of GDP					
Investment and saving [c]									
Gross domestic investment	31.1	32.2	30.9	34.7	30.7	29.6	25.6	26.9	30.4
National saving	22.9	26.4	28.1	30.2	26.1	24.8	22.0	22.7	25.2
External saving	8.2	5.8	2.8	4.4	4.6	4.7	3.7	4.2	5.2
				Millions of dollars					
Balance of payments									
Current account balance	-335	-272	-148	-241	-276	-303	-241	-292	-391
Merchandise trade balance	-287	-294	-323	-753	-658	-834	-829	-965	-1 267
Exports, f.o.b.	1 638	1 857	2 048	1 756	2 012	1 935	1 977	2 094	2 411
Imports, f.o.b.	1 926	2 150	2 371	2 510	2 670	2 769	2 806	3 059	3 678
Services trade balance	-45	-26	-70	-28	-119	-228	-187	-181	-224
Income balance	-231	-212	-204	-155	-147	-170	-193	-252	-279
Net current transfers	227	260	449	696	648	929	969	1 106	1 379
Capital and financial balance [d]	257	454	-8	53	119	302	304	65	759
Net foreign direct investment	91	122	99	237	282	193	176	247	293
Financial capital [e]	166	333	-107	-185	-163	109	129	-182	466
Overall balance	-79	182	-155	-188	-157	-1	64	-227	368
Variation in reserve assets [f]	13	-308	-230	-442	-32	-147	-214	88	-504
Other financing [g]	66	126	385	630	189	148	150	139	136
Other external-sector indicators									
Real effective exchange rate (index: 2000=100) [h]	130.0	119.0	108.8	104.5	100.0	97.1	96.9	98.6	100.0
Terms of trade for goods (index: 2000=100)	145.4	125.5	108.9	107.5	100.0	94.8	92.0	88.0	87.2
Net resource transfer (percentage of GDP)	2.3	7.8	3.3	9.7	2.7	4.4	4.0	-0.7	8.2
Total gross external debt (millions of dollars)	4 121	4 073	4 369	4 691	4 711	4 757	4 922	5 143	5 793
Total gross external debt (percentage of GDP)	101.0	86.4	83.0	86.5	78.2	74.3	74.8	74.0	76.9
Net profits and interest (percentage of exports) [i]	3.5	3.2	2.9	2.0	2.8	4.3	4.3	6.3	6.8
				Average annual rates					
Employment									
Labour force participation rate [j]	52.2	53.1	52.9	55.7	...	52.5	51.7	50.0	50.6
Open unemployment rate [k]	4.5	3.6	3.5	3.5	...	4.1	3.9	5.3	5.9
Visible underemployment rate [k]	2.4	3.0	2.1	2.7	...	4.4	3.9	6.4	6.9

Table 1 (concluded)

	1996	1997	1998	1999	2000	2001	2002	2003	2004 [a]
				Annual percentages					
Prices									
Variation in consumer prices (December-December)	25.2	12.7	15.7	11.0	10.1	8.8	8.1	6.8	9.2
Variation in nominal exchange rate (December-December)	24.5	2.5	5.1	5.3	4.4	5.0	6.3	5.0	4.9
Variation in real minimum wage	-4.0	6.3	1.8	-3.0	3.1	2.5	2.1	8.6	0.8
Nominal deposit rate [l]	...	21.3	18.6	19.4	15.9	14.5	13.7	11.5	11.1
Nominal lending rate [m]	...	32.1	30.6	30.2	26.8	23.8	22.7	20.8	19.9
				Percentages of GDP					
Non-financial public sector									
Current income	29.5	29.4	31.8	32.1	29.7	31.9	30.8	31.9	33.1
Current expenditure	22.8	22.8	22.9	22.6	24.4	27.1	26.6	29.0	27.8
Current balance	6.7	6.5	8.9	9.5	5.3	4.8	4.2	2.9	5.3
Net capital expenditure	8.6	7.2	6.3	8.6	6.6	6.1	6.1	7.3	7.3
Primary balance	...	...	...	...	...	...	-0.7	-2.5	0.1
Overall balance	-2.5	-1.0	2.9	0.7	-2.3	-2.3	-1.8	-4.2	-1.7
Public sector debt	90.3	80.9	75.0	78.8	66.1	64.0	65.8	69.5	68.4
Domestic	...	...	...	...	3.1	3.1	3.2	5.9	4.4
External	90.3	80.9	75.0	78.8	63.0	60.9	62.6	63.7	64.0
Interest payments (percentage of current income)	...	...	...	...	...	...	3.5	5.6	5.6
Money and credit [n]									
Domestic credit [o]	23.3	24.1	31.0	33.1	33.4	35.3	35.6	36.3	37.7
To the public sector	0.9	-0.1	-2.3	-4.8	-4.6	-3.5	-3.0	-2.3	-0.8
To the private sector	22.3	24.1	33.4	37.9	38.0	38.9	38.7	38.6	38.5
Liquidity (M3)	29.0	35.0	40.8	43.3	45.3	46.7	48.6	49.3	50.5
Currency in circulation and local-currency deposits (M2)	22.7	27.2	32.2	33.2	34.7	34.7	34.6	34.7	35.3
Foreign-currency deposits	6.3	7.8	8.6	10.1	10.6	12.0	14.0	14.6	15.2

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.
[a] Preliminary figures. [b] Based on figures in local currency at constant 1978 prices. [c] Based on figures in local currency expressed in dollars at current prices. [d] Includes errors and omissions. [e] Refers to the capital and financial balance (including errors and omissions), minus net foreign direct investment. [f] A minus sign (-) denotes an increase in reserves. [g] Includes the use of IMF credit and loans and exceptional financing. [h] Annual average, weighted by the value of merchandise exports and imports. [i] Refers to net investment income as a percentage of exports of goods and services as shown on the balance of payments. [j] Economically active population as a percentage of the working-age population; nationwide total. [k] Unemployment and underemployment rates as percentages of the economically active population; nationwide total. [l] Weighted average rate on time deposits. [m] Weighted average rate on loans. [n] The monetary figures are annual averages. [o] Refers to net credit extended to the public and private sectors by commercial banks and other financial and banking institutions.

3. Production, employment and prices

The monetary programme for 2004 was aimed at achieving economic growth of between 3.5% and 4%. However, the improvement in economic conditions boosted growth to 5% and, for the second consecutive year, investments were more buoyant than consumption.

(a) Economic activity

Overall demand grew by 6.9% in 2004, a half point ahead of domestic demand. The buoyancy of exports and imports was reflected in growth rates of 8.9% and 12.5%, respectively, while gross fixed capital formation almost doubled to stand at 15.7%. Since investment in construction showed a negative growth rate, the increase in aggregate investment corresponded to the machinery and equipment category. These were mainly private investments, since public investment was flat. Growth in consumption lagged behind the expansion of GDP.

Construction recorded a contraction of 4.7%, partly due to the sharp rise in the cost of materials such as cement and steel, which triggered a 0.8% decline in mining and quarrying activity.

Table 2
HONDURAS: MAIN QUARTERLY INDICATORS

	2003				2004 [a]				2005 [a]	
	I	II	III	IV	I	II	III	IV	I	II
Merchandise exports, f.o.b. (millions of dollars) [b]	369	348	310	316	408	293	367	345	476	...
Merchandise imports, c.i. f. (millions of dollars)	756	779	835	898	925	624	985	1 076	1 014	...
International reserves (millions of dollars)	1 450	1 454	1 395	1 430	1 501	1 625	1 695	1 970	2 068	...
Real effective exchange rate (index: 2000=100) [c]	97.5	98.5	98.8	99.5	100.0	99.7	99.6	100.9	101.0	100.5 [d]
Consumer prices (12-month percentage variation)	8.7	7.2	7.3	6.8	7.3	8.3	8.4	9.2	9.5	9.0
Average nominal exchange rate (lempiras per dollar)	17.04	17.22	17.46	17.67	17.86	18.10	18.33	18.54	18.71	18.84
Nominal interest rates (annualized percentages)										
Deposit rate [e]	12.2	11.5	11.2	11.1	11.3	11.2	11.0	10.9	11.0	18.9 [f]
Lending rate [g]	21.5	20.9	20.5	20.2	20.1	20.0	19.7	19.6	19.3	11.0 [f]
Interbank interest rate	7.3	7.3	8.0	8.7	8.3	7.5	7.5	7.7	7.5	7.5
Domestic credit (variation from same quarter of preceding year) [h]	10.4	14.7	15.9	18.4	18.4	19.0	16.9	15.7	14.9	...
Non-performing loans as a percentage of total credit [i]	11.9	13.5	10.9	9.6	9.7	9.4	8.6	6.9	6.9	7.2 [f]

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.
[a] Preliminary figures. [b] Does not include maquila activities. [c] Quarterly average, weighted by the value of merchandise exports and imports. [d] Data to May. [e] Weighted average rate on time deposits. [f] Data for April. [g] Weighted average rate on loans. [h] Refers to net credit extended to the public and private sectors by commercial banks and other financial and banking institutions. [i] Refers to total credit extended by the banking system.

The manufacturing industry expanded by 4.2%, half a percentage point more than in 2003. The most dynamic branch was the textiles and garment industry (9.2%), thanks to the upturn in maquila activity. Food, beverages and tobacco grew by 4.1%, whereas other subsectors showed lower rates of expansion.

The agricultural sector experienced a 7.1% upturn, thanks largely to the influence of traditional export crops. Banana production expanded by 19%, fifteen points more than in 2003. Following a 7.6% contraction, coffee production climbed by 11% and sugar cane was up by 10%, also recovering from a downturn in 2003. Crops for domestic consumption showed diverging trends, however: paddy rice and banana showed marked increases, whereas bean and corn production diminished.

Electricity, gas and water production expanded by 5.6%, while the transport, storage and communications sector grew at a slower rate (4.0%), as did commerce, restaurants and hotels (4.7%). The sector of financial institutions, insurance, real state and business services increased by 3.8%, while community, social and personal services were up by 7%. In sectoral terms, public administration and defence recorded strong growth (11.9%), reflecting the government's decision to prioritize security.

For the second consecutive year, the value added of maquila showed a double digit increase, this time of 17%. The country became the third largest exporter of made-up garments to the United States, surpassed only by China and Mexico, while the number of workers in the industry increased from 123,000 to 131,000.

The agricultural production index in the first quarter of 2005 was 4.3%, almost three points less than in 2004, while the industrial production index recorded a decline of almost 7%. Licensed construction continued to shrink (25.9%), giving rise to a slowdown in economic activity in 2005.

(b) Prices, wages and employment

Inflation, based on the consumer price index, showed a 9.2% variation up to December 2004, compared with 6.8% in 2003, owing to the rise in international oil prices and adverse weather conditions. The annual average inflation rate increased much less, since it stood at 8.1% in 2004, compared with 7.7% in 2003.

The rise in oil prices had an impact on costs of housing, water, electricity, gas and other fuels (10.3%) and transport (14.8%). There was also an escalation in the cost of education services (12.4%), which pushed up inflation further. Other categories recorded lower than average increases, in particular, communications, which increased only slightly (2.9%). Cumulative inflation to

April 2005 amounted to 3.7%, while the year-on-year variation was 9.4%.

The wholesale price index showed a sharper deterioration, moving from 4.7% in 2003 to 12.7% in 2004. The steepest rise occurred in national products (13.8%), while the variation in import prices was lower (9.9%).

Nominal minimum wages were raised by 9.7% on average, but, since the adjustment took effect in April, the real average minimum wage (deflated by average annual CPI variation) showed a slight decrease of 0.76%.

The labour market situation continued to deteriorate, notwithstanding the considerable expansion in economic activity. The national open unemployment rate increased from 5.1% in 2003 to 5.9% in 2004. In Tegucigalpa, the rate remained high at around 11%, while in San Pedro Sula, it moved from 6.7% to 8.4% in the same period. Underemployment also worsened, since the rate rose from 33.1% to 36.4%.

(c) The external sector

Robust external demand was reflected in a 13.5% increase in exports, but imports increased even further (18.7%). The current-account balance-of-payments deficit widened to 5.2% of GDP, while the terms of trade continued to deteriorate. The financial account recorded net income of US$ 730 million, partly due to the strong inflow of foreign direct investment.

Merchandise exports recorded their best performance (15.1%) since 1995. This trend included all the major categories, but the strongest increase came from traditional exports, which, after three years of decline, soared by 38%. The export value of bananas swelled by 57%, reflecting a favourable trend in both price and volume, following a 23% contraction in 2003. A similar pattern was observed for coffee exports, which shot up by 37.4%, as well as for sugar, silver and lead exports, which posted two-digit increases.

Non-traditional exports grew by 3.7%, half the rate recorded in the previous year. Pineapple and soaps and detergents, which expanded by one third, were the only two categories to perform strongly, while exports of other non-traditional exports stagnated or grew very slightly despite the increase in export volumes.

Booming economic activity and, in particular, the strong expansion of investments translated into a major increase in merchandise imports (20%). Consumer goods expanded by 5.8%, like in 2003, and the same occurred with imports of raw materials and intermediate goods, which were even more buoyant (17.8%). In this context, the oil bill increased by a fourth, while capital goods reversed their downward trend as they rocked by 54.2%, following a decline of 3.6% in 2003.

Merchandise exports were up by 21.2% in the first four months of 2005, eight points more than a year earlier. Export values climbed by 85% for bananas, 63% for tilapia and 31% for coffee. At the same time, merchandise imports rose by 13.2%, twelve points less than in 2004. Barring fuel purchases, which showed a 30% increase due to the high international price for oil, imports grew by only 10%. If this trend continues, the outcome may be a reduction in the external deficit in 2005.

The services trade deficit widened by US$ 40 million in 2004, despite a 13% increase in income from tourism. This, together with the widening of the merchandise deficit, was reflected in an increase in the aggregate trade deficit from US$ 1.145 billion to US$ 1.490 billion. Like other components of the current account, the income balance showed a deterioration (US$ 25 million). The only component to record a surplus was current transfers, thanks to family remittances, which rose by 31.9% to stand at US$ 1.135 billion or 15% of GDP.

The financial account recorded net income of US$ 730 million, over 10 times more than in 2003. Foreign direct investment totalled US$ 293 million, thanks to projects in the energy, telecommunications and maquila sectors. Net long-term capital inflows amounted to US$ 687 million, compared with just US$ 140 million in 2003. Loans to the private sector stood at US$ 137 million, loans to the public sector, represented US$ 279 million and loans to banks, amounted to US$ 66 million. Short-term inflows were positive (US$ 43 million) in 2004, compared with the negative figure recorded in 2003 (-US$ 80 million).

Mexico

1. General trends

In 2004, the Mexican economy grew by 4.4%, which was the highest rate since 2000 and translated into a considerable upturn in per capita GDP, following three years of sluggish performance. Aggregate demand swelled by 6% as a result of increased buoyancy in domestic and external demand. Exports were boosted by an upswing in manufacturing production in the United States, while consumption was strengthened by a rise in employment and credit and increased remittances. The improved economic outlook revived investment following a three-year downtrend. The increased pace of production activity was reflected in imports, resulting in a widening of the trade deficit. Higher revenues from petroleum exports and current transfers from abroad (in excess of US$ 17 billion) helped to reduce the balance-of-payments current account deficit to 1.1% of GDP, its lowest level since 1996.

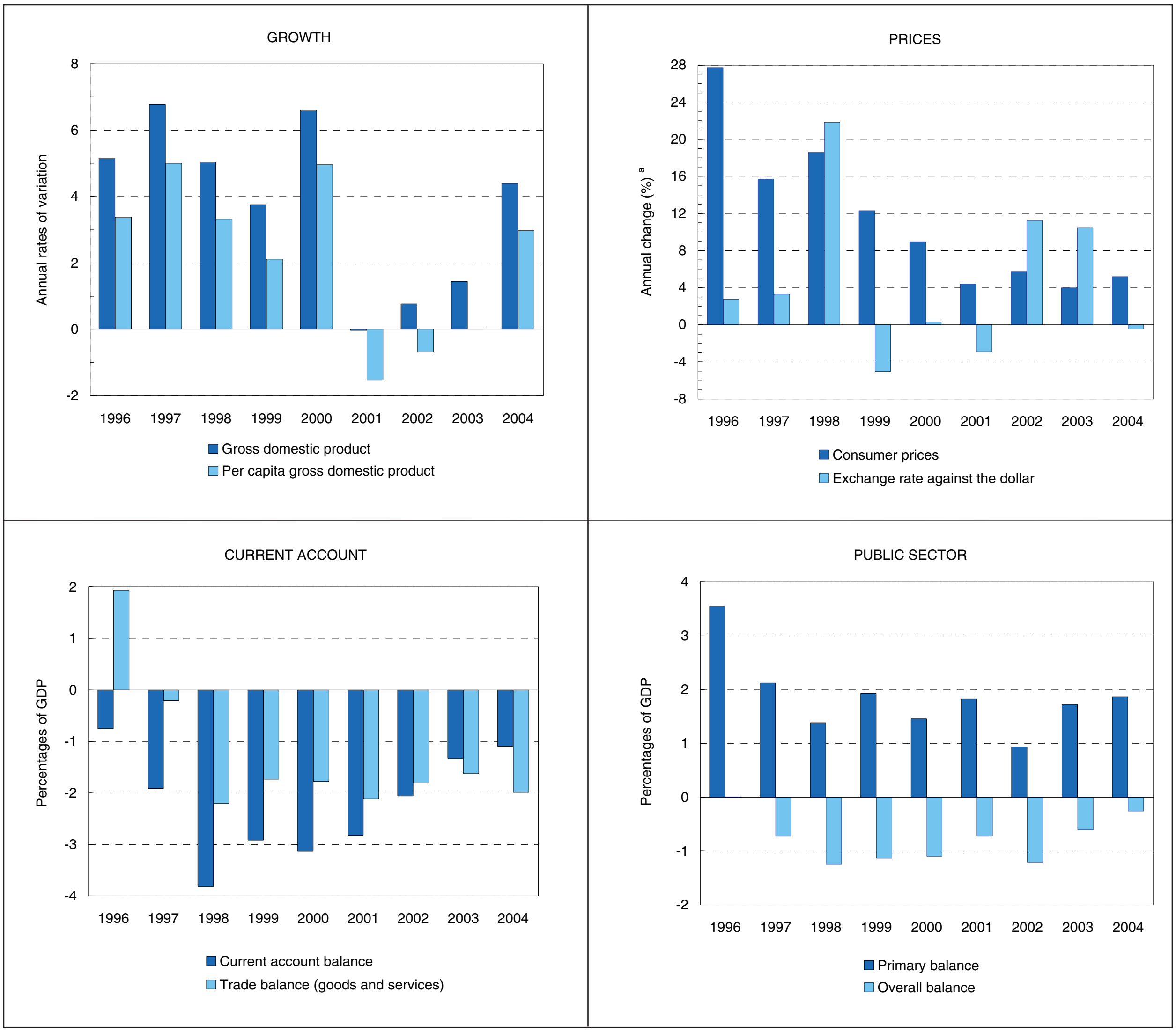
Economic policy continued to be guided by the principles of fiscal discipline and monetary stringency in the context of a floating exchange rate. Inflation exceeded the government's target, as it reached 5.19%, owing to adverse weather conditions affecting agriculture, increased rates for public services and high international prices for certain raw materials and petroleum. Oil revenues strengthened public finances and made it possible to increase expenditure and achieve the fiscal deficit target of 0.26% of GDP.

After falling in the first few months of 2004, interest rates mirrored the uptick observed in international rates. The benchmark interest rate, which is the rate on 28-day treasury bills (CETES), rose from 4.95% in the final week of January 2004 to 8.5% in December, encouraging foreign portfolio investment and contributing to a 2.6% real appreciation of the Mexican peso against the dollar.

Production was buoyant across all the sectors, which pushed up formal employment by 1.3% following three years of job losses, although this was a fairly subdued response to economic growth. Much of the labour supply was absorbed by informal employment, and the open unemployment rate rose from 3.2% in 2003 to 3.8% in 2004. Unit labour costs dropped again, continuing the trend first observed in 2002.

In the first quarter of 2005, the Mexican economy grew by 2.4%. This was less than the 3.9% recorded for the year-earlier period, reflecting the slowdown in the United States. In 2005, GDP is expected to grow by 3.6% and inflation will come in at around 3.9%.

Figure 1
MEXICO: MAIN ECONOMIC INDICATORS



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

2. Economic policy

The core objective of economic policy was again to reduce inflation to levels similar to those in the United States.

(a) Fiscal policy

Budgetary revenues were 10% higher than the estimates formulated by the government at the beginning of the year, thanks to a 14.5% real increase in oil earnings. This revenue came to represent 36.1% of budgetary income, which was the highest figure recorded since 1987 and facilitated achievement of the fiscal target.

Non-petroleum tax revenue edged up by 0.8% in real terms. There were increases of 7.1% in receipts from value-added tax (VAT), 4.7% in taxes on imports and 1%

in the special tax on production and services, while income tax receipts decreased by 2.2%. In terms of GDP, non-petroleum tax revenue stood at 9.4%, which was four tenths of a percentage point lower than the three previous years. The income of non-petroleum enterprises and agencies rose by 1.8% in real terms, to 4.1% of GDP, as a result of increases in electricity rates and sales of the Federal Electricity Commission (CFE), plus higher contributions paid to the social security institutions, namely the Mexican Social Security Institute (IMSS) and the Social Service Institute for State Workers (ISSTE).

The level of non-recurrent government income permitted an in increase public spending (4.2% in real terms and 10.1% more than estimated) without endangering compliance with the fiscal target. Expenditure represented 23.5% of GDP, four tenths of a percentage point less than in 2003. In real terms, programmable spending rose by 3.9% as a result of lower outlays for personal services (including the voluntary separation programme for civil servants) and a 79% increase in capital expenditure. There were rises in transfers to states for social infrastructure development, infrastructure investment by Petróleos Mexicanos (PEMEX) and resources in the oil revenue stabilization fund.[1] Investment in PEMEX and CFE projects through the mechanism known as Projects with a Deferred Impact on Public Expenditure Recording (PIDIREGAS) rose to 18.3% in real terms, which helped to maintain the buoyancy of public investment, although less than in the previous biennium.

The public sector's financing requirements, which encompass all of its activities regardless of whether they are implemented by public or private entities, were equivalent to 1.85% of GDP, or 2.52% excluding non-recurrent public sector income that affects those requirements.

The unconsolidated net public-sector debt stood at 35% of GDP, which was 2.9 percentage points less than in 2003, thanks to a reduction in all the components (domestic and external debt plus additional items) except PIDIREGAS debt, which represented 5.24% of GDP (0.45 tenths of a percentage point more than in 2003).

(b) Monetary policy

As in previous years, the main aim of monetary policy was to keep inflation within a range of one percentage point on either side of the target of 3%. The principal instrument of monetary policy is the "corto", which is employed to influence nominal interest rates indirectly by setting a target for commercial banks' daily current-account balances in the central bank.

To offset the inflationary effects of international price increases on a number of raw materials, as well as potential pressure from aggregate demand, the central bank raised the corto several times, from 25 million pesos in January to 69 million in December. In addition, at the end of the year it required financial institutions to create a monetary regulation deposit of 50 billion pesos (about US$ 4.386 billion) as an additional measure to tighten liquidity.

The tight monetary policy pushed up interest rates. The interest rate on 28-day treasury bills (CETES), which had fallen to 4.69% in the last week of January 2004, climbed to 8.61% in the last week of December. In real terms, the average annual yield on CETES was 1.8%, despite which the real yield on bank bills was negative by 2%. In any event, the tight monetary stance did not affect the upswing in gross fixed capital formation over the year.

The money supply swelled by 8.75% in real terms. Mexico has been gradually remonetizing its economy since the 1995 crisis, and the monetary base expanded from 3.61% of GDP to 3.72%. The broadest monetary aggregate (M4, which includes all private-sector financial savings) grew by 7.98% in real terms to represent 48.8% of GDP.

Thanks to an upturn in bank credit, the domestic financing of the non-financial private sector rose by 9.6% in real terms, compared with 0.4% in 2003. Commercial bank credit for consumer and mortgage loans were significant components of this trend (up 42.2% and 24.9%, respectively), while business lending by commercial banks also picked up (18%). Total corporate credit from bank and non-bank institutions declined, however, by 0.4%, compared with a 1.8% decrease recorded in 2003. Non-bank financial intermediaries continued to expand their operations (18.6%). Prominent among these were institutions known as limited purpose financial companies (SOFOLES), which specialize in mortgage lending, and whose share of total SOFOLE and commercial bank mortgage lending now stands at 45%.

(c) Exchange-rate policy

Generally speaking, there was a strong supply of United States dollars in the economy in 2004, owing to a high level of remittances, FDI and buoyant hydrocarbons exports. The foreign-exchange market experienced short-lived periods of sharp volatility in the course of the year,

[1] Congress ruled that part of the PEMEX tax burden for 2004 would be directly invested in capital infrastructure, i.e., operations linked to gas extraction, exploration, refining and petrochemicals.

Table 1
MEXICO: MAIN ECONOMIC INDICATORS

	1996	1997	1998	1999	2000	2001	2002	2003	2004 [a]
			Annual growth rates [b]						
Gross domestic product	5.2	6.8	5.0	3.8	6.6	0.0	0.8	1.4	4.4
Per capita gross domestic product	3.4	5.0	3.3	2.1	5.0	-1.5	-0.7	0.0	3.0
Gross domestic product, by sector									
Agriculture, livestock, hunting, forestry and fishing	3.8	0.2	3.0	1.5	0.4	5.9	-0.9	4.1	4.0
Mining	8.1	4.5	2.7	-2.1	3.8	1.5	0.4	3.7	2.5
Manufacturing	10.8	9.9	7.4	4.2	6.9	-3.8	-0.7	-1.3	3.8
Electricity, gas and water	4.6	5.2	1.9	7.9	1.0	12.0	1.0	1.6	2.3
Construction	9.8	9.3	4.2	5.0	4.2	-5.7	2.1	3.3	5.3
Wholesale and retail commerce, restaurants and hotels	4.8	10.7	5.6	3.1	12.2	-1.2	0.0	1.6	4.9
Transport, storage and communications	8.0	9.9	6.7	7.8	9.1	3.8	1.8	5.0	9.7
Financial institutions, insurance, real estate and business services	0.6	3.7	4.6	3.6	5.5	4.5	4.2	3.9	4.6
Community, social and personal services	1.0	3.3	2.9	2.1	2.9	-0.3	0.9	-0.6	1.7
Gross domestic product, by type of expenditure									
Consumption	1.8	6.0	5.0	4.4	7.4	1.9	1.4	2.1	4.7
General government	-0.7	2.9	2.3	4.7	2.4	-2.0	-0.3	0.8	-1.2
Private	2.2	6.5	5.4	4.3	8.2	2.5	1.6	2.3	5.5
Gross domestic investment	25.7	24.8	10.5	4.0	11.5	-3.4	-1.4	-4.0	1.8
Exports (goods and services)	18.2	10.7	12.1	12.4	16.4	-3.8	1.6	2.7	11.5
Imports (goods and services)	22.9	22.7	16.6	14.1	21.5	-1.6	1.5	0.7	10.2
			Percentages of GDP						
Investment and saving [c]									
Gross domestic investment	23.1	25.9	24.3	23.5	23.7	20.9	20.6	20.6	21.8
National saving	22.4	24.0	20.5	20.6	20.6	18.1	18.6	19.2	20.7
External saving	0.8	1.9	3.8	2.9	3.1	2.8	2.1	1.3	1.1
			Millions of dollars						
Balance of payments									
Current account balance	-2 500	-7 666	-16 073	-13 999	-18 188	-17 579	-13 347	-8 453	-7 394
Merchandise trade balance	6 533	623	-7 915	-5 584	-8 003	-9 617	-7 633	-5 779	-8 811
Exports, f.o.b.	96 002	110 431	117 459	136 391	166 455	158 780	161 046	164 766	187 999
Imports, f.o.b.	89 469	109 808	125 374	141 975	174 458	168 396	168 679	170 546	196 810
Services trade balance	-94	-1 433	-1 350	-2 737	-2 323	-3 558	-4 048	-4 601	-4 649
Income balance	-13 473	-12 106	-12 820	-11 992	-14 856	-13 743	-11 934	-11 931	-10 977
Net current transfers	4 534	5 250	6 012	6 313	6 994	9 338	10 268	13 858	17 044
Capital and financial balance [d]	4 448	28 126	12 572	18 249	25 314	24 904	20 436	17 891	11 452
Net foreign direct investment	9 186	12 831	11 897	13 055	16 075	23 317	14 396	9 879	13 112
Financial capital [e]	-4 738	15 295	675	5 194	9 239	1 587	6 041	8 011	-1 660
Overall balance	1 948	20 460	-3 501	4 250	7 126	7 325	7 090	9 438	4 058
Variation in reserve assets [f]	-1 805	-10 513	-2 118	-596	-2 862	-7 325	-7 090	-9 438	-4 058
Other financing [g]	-144	-9 948	5 619	-3 654	-4 265	0	0	0	0
Other external-sector indicators									
Real effective exchange rate (index: 2000=100) [h]	138.5	119.9	119.0	108.8	100.0	93.4	92.9	104.5	109.5
Terms of trade for goods (index: 2000=100)	90.8	89.5	90.6	99.3	100.0	97.4	97.9	98.8	101.6
Net resource transfer (percentage of GDP)	-2.8	1.5	1.3	0.5	1.1	1.8	1.3	0.9	0.1
Total gross external debt (billions of dollars)	157.2	149.0	160.3	166.4	148.7	144.5	134.7	132.0	130.5
Total gross external debt (percentage of GDP)	47.3	37.2	38.1	34.6	25.6	23.2	20.8	20.7	19.3
Net profits and interest (percentage of exports) [i]	3.8	3.1	4.1	2.4	4.0	3.7	2.3	2.4	2.3
			Average annual rates						
Employment									
Labour force participation rate [j]	55.4	56.2	56.5	55.8	56.3	55.6	55.1	55.6	56.4
Open unemployment rate [k]	5.5	3.7	3.2	2.5	2.2	2.5	2.7	3.3	3.8
Visible underemployment rate [k]	16.0	14.8	12.2	11.3	11.7	11.1	10.0	10.5	11.6

Table 1 (concluded)

	1996	1997	1998	1999	2000	2001	2002	2003	2004 [a]
	Annual percentages								
Prices									
Variation in consumer prices (December-December)	27.7	15.7	18.6	12.3	9.0	4.4	5.7	4.0	5.2
Variation in the national producer price index (December-December)	25.3	10.5	17.5	12.5	6.4	1.3	9.2	6.8	8.0
Variation in nominal exchange rate (December-December)	2.8	3.3	21.8	-5.0	0.3	-2.9	11.2	10.4	-0.5
Variation in average real wage	-9.9	-0.6	2.8	1.5	6.0	6.7	1.9	1.3	0.1
Nominal deposit rate [l]	...	20.0	22.4	20.9	14.6	11.0	6.2	5.2	5.4
Nominal lending rate [m]	...	22.1	26.4	23.7	16.9	12.8	8.2	6.9	7.2
	Percentages of GDP								
Public sector									
Budgetary revenues	23.0	23.1	20.4	20.8	21.6	21.8	22.2	23.2	23.2
Programmable current spending	12.0	12.8	12.4	12.5	13.0	13.3	13.8	14.6	13.7
Primary balance	3.6	2.1	1.4	1.9	1.5	1.8	0.9	1.7	1.9
Overall balance	0.0	-0.7	-1.2	-1.1	-1.1	-0.7	-1.2	-0.6	-0.3
Net public debt [n]	38.2	31.1	33.5	30.1	27.0	25.8	27.5	27.6	26.1
Domestic	7.6	8.6	9.8	11.0	12.3	13.1	14.5	14.7	14.4
External	30.6	22.5	23.7	19.1	14.7	12.6	13.0	12.9	11.7
Money and credit [o]									
Domestic credit [p]	...	38.3	39.9	37.2	37.0	37.5	36.6	36.6	35.5
To the public sector	...	15.9	16.6	17.2	19.1	20.0	19.2	19.5	19.2
To the private sector	...	22.4	23.3	20.0	17.9	17.5	17.4	17.1	16.3
Liquidity (M3)	35.1	36.3	38.1	40.2	40.1	44.0	46.3	47.1	48.0
Currency in circulation and local-currency deposits (M2)	33.8	35.1	36.8	38.8	38.7	42.6	44.6	45.6	46.6
Foreign-currency deposits	1.3	1.3	1.3	1.4	1.4	1.5	1.6	1.4	1.4

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.
[a] Preliminary figures. [b] Based on figures in local currency at constant 1993 prices. [c] Based on figures in local currency expressed in dollars at current prices. [d] Includes errors and omissions. [e] Refers to the capital and financial balance (including errors and omissions), minus net foreign direct investment. [f] A minus sign (-) denotes an increase in reserves. [g] Includes the use of IMF credit and loans and exceptional financing. [h] Annual average, weighted by the value of merchandise exports and imports. [i] Refers to net investment income as a percentage of exports of goods and services as shown on the balance of payments. [j] Economically active population as a percentage of the working-age population, urban areas. [k] Unemployment and underemployment rates as percentages of the economically active population, urban areas. [l] Cost of term deposits in local currency in the multibanking system. [m] Lending rate published by IMF. [n] Refers to (consolidated) net debt reported by the Banco de México. [o] The monetary figures are annual averages. [p] Refers to net credit extended to the public and private sectors by commercial banks and other financial and banking institutions.

mainly as a result of international interest-rate hikes (particularly in the United States) and expectations of further increases. The rise in domestic rates helped to stabilize the price of the peso in relation to the dollar, which resulted in an average nominal depreciation of 4.4% and a slight real appreciation of 2.6%.

Net international reserves swelled by US$ 4.058 billion to reach US$ 61.493 billion at the end of 2004, despite the central bank's continued use of the mechanism it has employed since May 2003 to slow the build-up of international reserves, by auctioning a fixed amount of dollars daily. In 2004, US$ 6.712 billion were sold in this way.

3. Production, employment and prices

(a) Economic activity

The manufacturing sector expanded by 3.8%, as a result of strong growth in base metals (6%); non-metal mineral products (5.2%); metal products, machinery and equipment (up by 5.1% following three years of decline); and chemicals and petroleum products (3.8%). To a lesser extent, production also improved in the segments of paper

Table 2
MEXICO: MAIN QUARTERLY INDICATORS

	2003				2004 [a]				2005 [a]	
	I	II	III	IV	I	II	III	IV	I	II
Gross domestic product (variation from same quarter of preceding year) [b]	2.5	0.1	1.0	2.1	3.9	4.1	4.6	4.9	2.4	...
Merchandise exports, f.o.b. (millions of dollars)	39 051	40 245	41 543	43 927	43 193	32 662	47 874	49 543	46 827	...
Merchandise imports, f.o.b. (millions of dollars)	39 189	41 891	42 972	46 493	43 718	33 083	50 013	54 918	48 772	...
International reserves (millions of dollars)	51 096	52 899	51 418	56 086	58 406	58 407	56 887	61 496	61 363	60 655
Real effective exchange rate (index: 2000=100) [c]	104.0	101.7	104.0	108.6	106.5	110.5	111.0	109.9	108.9	107.8 [d]
Urban unemployment rate	2.8	3.0	3.8	3.5	3.9	3.7	4.1	3.5	3.9	4.0
Consumer prices (12-month percentage variation)	5.6	4.3	4.0	4.0	4.2	4.4	5.1	5.2	4.4	4.3
Average nominal exchange rate (pesos per dollar)	10.81	10.46	10.70	11.18	10.98	11.38	11.45	11.33	11.18	10.96
Average real wage (variation from same quarter of preceding year)	1.1	1.0	2.2	1.2	1.4	0.5	-0.2	-1.3	-0.2	...
Nominal interest rates (annualized percentages)										
Deposit rate [e]	6.9	5.4	3.9	4.3	4.5	5.0	5.6	6.5	7.2	7.9
Lending rate [f]	9.8	6.9	5.1	5.9	6.0	6.7	7.5	8.6	9.4	10.0 [d]
Interbank interest rate	9.7	6.8	5.1	5.8	5.9	6.7	7.5	8.5	9.4	10.0
Sovereign bond spread (basis points)	291	237	212	199	183	215	188	166	180	168
Stock price index (in dollars, December 2000=100)	87	105	111	123	148	141	149	183	178	198
Domestic credit (variation from same quarter of preceding year) [g]	12.8	8.7	10.7	6.1	8.0	8.4	5.2	8.6	7.0	9.4 [h]
Non-performing loans as a percentage of total credit [i]	4.6	4.2	3.7	3.2	3.2	3.0	2.7	2.5	2.4	...

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.
[a] Preliminary figures. [b] Based on figures in local currency at constant 1993 prices. [c] Quarterly average, weighted by the value of merchandise exports and imports. [d] Data to May. [e] Cost of term deposits in local currency in the multibanking system. [f] Lending rate published by IMF. [g] Refers to net credit extended to the public and private sectors by commercial banks and other financial and banking institutions. [h] Data for April. [i] Refers to total credit extended by the multibanking system.

(1.9%); textiles and clothing (1.6%); timber (0.6%); and other manufacturing industries (2.6%).

Construction continued to grow (5.3%), partly thanks to housing projects that have benefited from the upturn in credit (particularly non-bank loans). Construction also received a boost from water, irrigation and sanitation projects and petroleum extraction and petrochemical operations, while construction activity in the electricity and transport sectors declined. There was also an improvement in the performance of the mining industry (2.5%) and the generation of electricity, gas and water (2.3%), although the latter waned in the last quarter of 2004.

Automobile production contracted for a fourth consecutive year (1.1%). The sector's exports also dropped 5.9% due the problems faced by United States companies in terms of foreign competition, mainly from Asia and Europe. Domestic vehicle sales, on the other hand, were boosted by the availability of financing from banks and motor vehicle distributors, rising by 12.1% (the highest rate in four years).

Agriculture grew by 4%, the highest rate since the 7.3% recorded in 1990. In the first half of the year, agricultural production benefited from favourable weather conditions, while excessive rainfall during the rest of the year marred the supply of certain fruit and vegetables on the domestic market. In the livestock sector, beef, pork and poultry production, eggs and milk all performed well.

Services, which represent 65% of GDP, expanded by 4.8%. The increase was headed by transport, storage and communications (9.7%); followed by commerce, restaurants and hotels (4.9%); financial services, insurance and real estate (4.6%); and community, social and personal services (1.7%).

Private consumption, which accounts for 73% of GDP, climbed by 5.5%, which was 2.5 times higher than the average for the previous three years. This, in turn, bolstered demand. Another factor in the upswing was a real increase of 18.5% in bank and non-bank household credit, mainly in the form of consumer loans. Bank loans (which represent 59% of consumer credit) were up 39.1% in real terms while non-bank credit rose by 7.9%.

Following two years of decline and one of meagre growth, fixed gross capital formation increased by 7.5% (the highest rate since 1999) to stand at 19.8% of GDP. The main driving force behind this was private investment, after three years of contraction. In particular, investment in machinery and equipment expanded by 9.7% and both private and public construction remained buoyant. Growth in total public investment slowed for the second year in a row, although it still posted a significant rate of 3.6%. The bulk of public investment (87%) went to construction.

(b) Prices, wages and employment

The increase in the consumer price index (5.19%) was mainly due to higher prices of raw materials (especially foods) and price adjustments for public transport at the beginning of the year and for certain fruits and vegetables in the second half of the year.

Non-core inflation stood at 8.2%, as a result of increases for goods with administered and negotiated prices (7.51%), particularly domestic gas, electricity, agricultural products including tomatoes, poultry, beef and eggs (10.11%) and education (7.5%). Core inflation was 3.8% (0.14 percentage points above the 2003 level). This was attributable to increases in processed food prices, which were, in turn, partly offset by slower rises in the price of services.

The formal labour market was slow to respond to the upturn in output. The number of jobs registered with the Mexican Social Security Institute (IMSS) increased by only 1.3%, indicating that the average number of jobs in 2004 was 1% lower than in 2000. Employment in the manufacturing sector dipped by 2.6%, while it rose by 4.7% in the maquila export sector following three years of decline.

The open unemployment rate climbed from 3.25% to 3.75% in 2004, while permanent employment edged up by a mere 1.2% after falling for three straight years. This suggests that the informal sector continues to absorb considerable proportions of the labour force, given that around 1.2 million people are estimated to join the workforce each year. The economically active population currently numbers 41.1 million people, of whom over a quarter (11.5 million) are thought to work informally (mainly in the tertiary sector). The National Institute of Statistics, Geography and Informatics (INEGI) estimates that informal activity accounts for around 13% of output.

Productivity per worker rose in the main production sectors: by 6.3% in manufacturing; 2.4% in the maquila industry; and by 7.9% in commerce. Real wages remained flat in manufacturing, fell by 0.2% in the maquila sector and climbed 2.7% in commerce. Continuing the trend observed since 2002, this meant that unit labour costs dropped in all sectors: 5.8% in manufacturing, 2.6% in maquila activity and 4.8% in commerce.

(c) The external sector

The balance-of-payments current-account deficit stood at US$ 7.394 billion, or 1.1% of GDP. A prominent feature was the upswing in external demand, which bumped up both petroleum and non-petroleum exports. Yet the merchandise trade balance was negative, since imports increased following a virtual standstill. This deficit was offset by a strong rise in remittances.

Following three years of inertia, the total value of merchandise exports climbed to US$ 188 billion, which surpassed the level reached in 2000 for the first time. The value of petroleum exports climbed by 27%, mainly thanks to higher prices (US$ 31.02 per barrel —the highest in 23 years), since the volume sold was only 1.7% more than the previous year.

Non-petroleum exports amounted to over US$ 164 billion. Almost all the subsectors recorded increases except exports of passenger cars, which declined by 5.7%. Mining and quarrying exports swelled by 82%. Particularly notable were the increases in exports of crude copper (148%) and agricultural products, which were up 13%, mainly thanks to increased sales of fresh vegetables, melon, watermelon, other fresh fruit and livestock.

Manufacturing exports (84% of the total) climbed by 12% to almost US$ 158 billion. Good performances were recorded in sales of metal products, machinery and equipment (12%) —which accounted for 63% of manufacturing exports— and petrochemical products (69%), steel (45%), metal mining (39%) and petroleum products (21%). The textile sector posted an upturn of 2% following three years of decline, and the exports of the timber industry were up 11%. Food, beverages and tobacco continued to expand (12%).

Despite this, Mexico's exports continued to lose competitiveness and market share in the United States, the country's main export destination. The value of total United States imports grew by 17% in the year, with China's market share expanding from 12.1% in 2003 to 13.4% in 2004, while Mexico's shrank from 11.0% to 10.6%.

The growth of exports and domestic spending fuelled imports, which represented almost US$ 197 billion (14% more than in 2003). As a result, the merchandise trade deficit widened by more than 50%, to stand at US$ 8.811 billion. There were major increases in the three main categories of imports: consumer goods (18%), intermediate goods (16%) and capital goods (12%). The recovery of maquila exports bolstered imports of intermediate goods (which represent 76% of imports), which rose by 15%. Purchases of capital goods (11% of imports) expanded following three consecutive years of decline. Prominent among imports of consumer goods were television sets, electrical and electronic appliances, gasoline and automobiles.

Imports of agricultural goods rose at a slower rate than the previous year (7.9%, compared to 9.1% in 2003). The fastest-growing were sorghum (6.1%) and soybean (3.7%), while imports of beef cattle continued to slide (47%).

Mexico's imports from China have increased considerably since 1996. Chinese imports rose from 1.1% of Mexico's total imports in 1996 to 13% in 2004, while imports from the United States dropped from 75.5% to 56.2% in that period. Chinese imports have hurt production in several industries, and they are often alleged to be associated with smuggling and unfair trade practices.

Current transfers from abroad climbed by 25% to stand at over US$ 17 billion. This was equivalent to 2.6% of GDP, which was double the income from tourism or 80% of hydrocarbon exports, representing a similar amount to foreign direct investment income. These transfers fuelled consumption in many households, particularly in rural areas.

The financial account recorded income of US$ 13.692 billion, which was 24% more than in 2003. There was an increase in flows of FDI and portfolio investment, while external debt declined (both in the public and private sectors) and assets held abroad by Mexican residents expanded. Income from foreign direct investment amounted to US$ 16.602 billion, 48% of which corresponded to new investments, 15% to reinvestment of profits and 37% to accounts with the parent company. Within total FDI, 25% corresponded to the purchase of Mexican-owned Bancomer shares by the Spanish group BBVA, for US$ 4.2 billion. The manufacturing sector absorbed 52% of FDI; financial services, 29.9%; transport and communications, 7.8%; and commerce, 5.6%. The main investors were the United States (48%); Spain (34.7%); Switzerland (7.2%), Canada (2.1%); Germany (2.1%) and the Netherlands (1.5%).

Portfolio investment surged from US$ 779 million in 2003 to US$ 2.671 billion in 2004, in response to attractive returns on the money market, which brought in a total of US$ 5.193 billion. This revenue offset an outflow of US$ 2.522 billion from the equity market. Mexican-held assets abroad, in the form of bank balances and direct investment, swelled by US$ 4.588 billion.

Nicaragua

1. General trends

In 2004 the Nicaraguan economy continued the recovery begun in 2003, after two years of lacklustre growth. Progress was made towards consolidating overall macroeconomic stability in the framework of the three-year programme signed with the International Monetary Fund (IMF) in 2002. Real GDP increased by 5.1% and per capita GDP, by 2.5%, following two years of decline. This performance was driven by buoyant exports and an expansion of domestic demand engendered by higher investment (especially in the public sector).

The open unemployment rate dropped from 7.7% to 6.5%. Real average income grew by only 0.3%, however, due to an uptick in inflation (which reached 9.3%) caused mainly by rising international prices for petroleum and a number of industrial commodities.

Although the fiscal deficit narrowed, increased financial resources made it possible to step up public spending on investment and poverty reduction efforts, as well as to lower the level of indebtedness to the financial sector (particularly the central bank). Monetary policy was fairly expansionary. In order to contain inflationary pressure, and given the high rate of exchange-rate pass-through to prices, the authorities reduced the devaluation rate from 6% to 5%. Bank deposits and credit levels surged, while real interest rates continued to trend downwards.

In the external sector, the balance-of-payments current-account deficit narrowed slightly, which combined with higher capital inflows to swell international reserves.

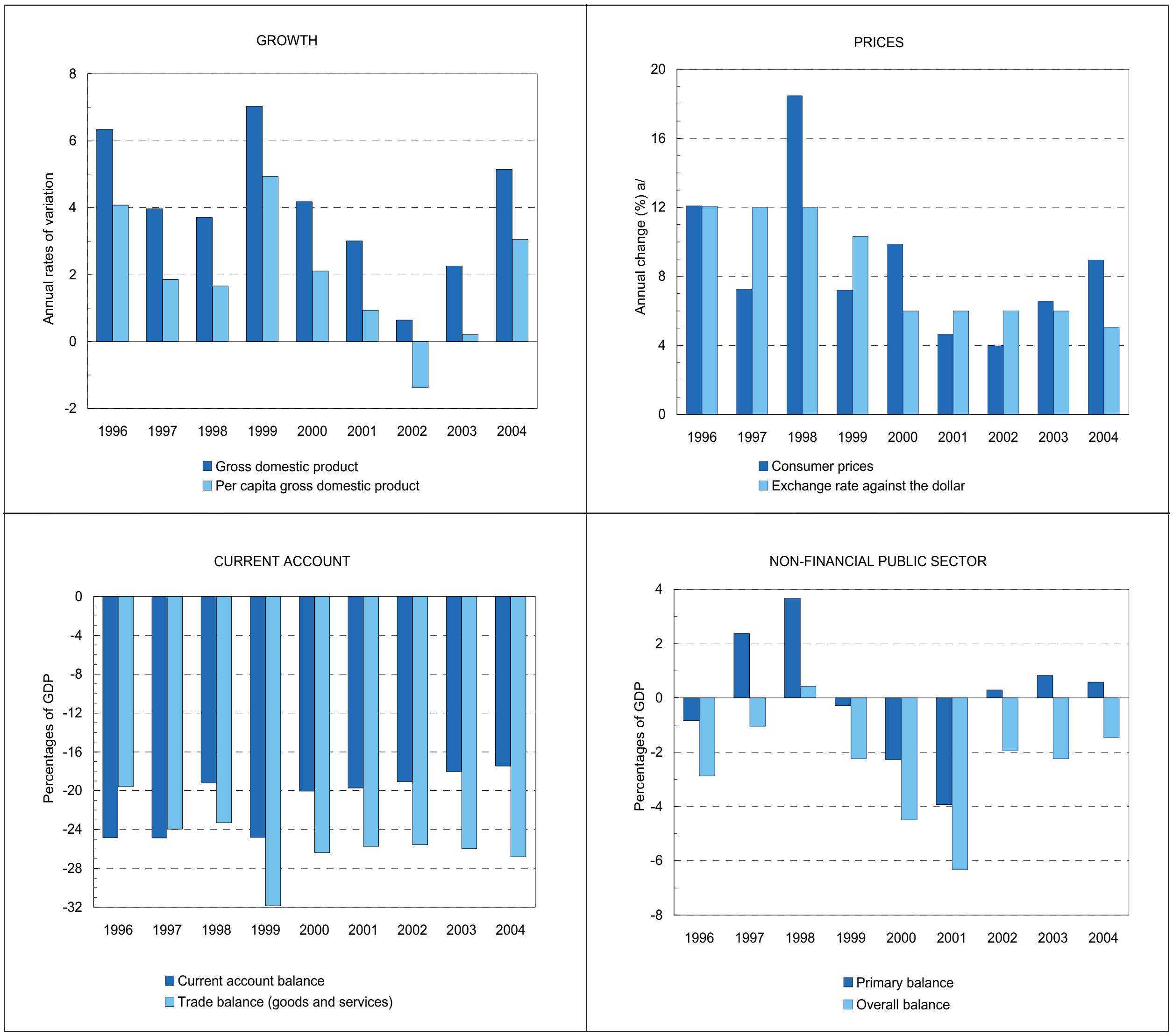
In March, Nicaragua reached completion point under the Heavily Indebted Poor Countries (HIPC) Initiative. This enabled the cancellation of 18% of the balance of the country's external public debt, which thus stood at US$ 5.391 billion at the end of the year (the lowest level in 20 years).

ECLAC projects real GDP growth of between 3.5% and 4% in 2005, while inflation is expected to come in at 8.5%-9%. The devaluation rate will probably remain at 5%. In a pre-electoral year, the fiscal deficit is likely to widen slightly, while the balance-of-payments current-account deficit will narrow to 17% of GDP.

2. Economic policy

In the context of a deteriorating political climate and serious governance problems, intensified electioneering could affect economic performance in 2005. Much will depend on the outcome of political disputes that have hampered the approval of the 2005 budget and prevented the presentation of a proposal to negotiate a new economic programme with the International Monetary Fund (IMF), particularly as regards delayed structural reforms. In these circumstances, a number of international financial institutions and donor countries have warned that the provision of resources will be contingent upon the continuity of the IMF programme. A sharp drop in income from those sources would require a major fiscal and monetary adjustment, which would reduce liquidity, push up interest rates and have a recessionary impact.

Figure 1
NICARAGUA: MAIN ECONOMIC INDICATORS



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

In 2004, the government's economic programme aimed to stimulate growth in a context of macroeconomic stability, by deploying a prudent and more transparent fiscal policy, gradually reducing the domestic debt stock and building up international reserves.

Nicaragua's achievements in terms of growth and macroeconomic stability stood in contrast with its limited progress in structural reform, due to lack of parliamentary support for the initiatives of the executive branch. This prevented the adoption of important legislative proposals, such as the extension of legal protection to officials of the superintendency of banks and other financial institutions and a fiscal responsibility act. As regards pension system reform, the authorities suspended the introduction of a system based on privately administered personal retirement-savings accounts until the fiscal implications have been clearly worked out.

(a) Fiscal policy

The outcome of Nicaragua's fiscal policy will be a key determinant of its macroeconomic performance in 2005.

The country's IMF programme has not been reviewed since October 2004, with one of the main obstacles being the National Assembly's decision to raise the budgetary expenditure ceiling for 2005. Following the approval of tax reforms in June, however, the central government deficit should be close to the previous year's figure.

In 2004, the central government deficit narrowed without sacrificing spending on public investment or on Nicaragua's poverty reduction strategy. This was achieved mainly thanks to higher tax receipts (generated by the reforms implemented in 2002 and 2003), improved tax administration and a reduction in public debt servicing. An increase in international assistance in the form of grants and soft loans, as well as non-recurrent income from the sale of shares in the Nicaraguan Telecommunications Company (ENITEL), also helped to narrow the fiscal deficit. The management of public finances, especially the reduction in net government borrowing from the central bank, thus facilitated the fulfilment of monetary policy targets.

The central government's current revenues expanded by 20.5% and the tax burden rose to 16.3% of GDP (which was higher than the 15.7% recorded the previous year). This was in addition to grants, which remained at 3.3% of GDP. Consequently, total revenue rose from 19.5% of GDP in 2003 to 20.1% in 2004. The fastest-growing revenue items were income tax, value added tax and customs duties.

Total expenditure remained constant at 22.3% of GDP. This reflected two factors. The first was a dip in current expenditure from 14.1% of GDP to 12.9%, which was mainly because of a drop in interest payments, from 3.1% to 2.0% of GDP, following the cancellation of a large part of the external debt. The second was the reduction in interest rates paid on central bank paper issued to control the monetary base and bail out the banking system during the crisis of 2000-2001. Despite strongly rising capital expenditure (24.3%), the fiscal deficit therefore shrank from 6.1% of GDP in 2003 to 5.4% in 2004 (not including grants). The improvement is smaller (from 2.8% of GDP to 2.2%), however, when grants are factored in. Notably, the government transferred the equivalent of 4.4% of GDP to the central bank, but external financing rose again to stand at 6.1% of GDP.

In 2004, the external public debt fell to US$ 5.391 billion, which was 18% lower than the balance at the end of 2003. By the end of 2004, Nicaragua had negotiated debt relief for US$ 3.826 billion in the framework of the HIPC Initiative, and US$ 3.652 billion had been written off out of a total of US$ 6.328 billion in scheduled relief.

(b) Monetary policy

In 2005, monetary policy will be directed towards keeping prices stable, improving the central bank's financial position and building up international reserves. Monetary policy was slightly expansionary in 2004. The main aims were to ensure that international reserves remained at a level conducive to the maintenance of exchange-rate stability as an anchor against inflation, and to reduce the central bank's domestic debt in order to improve its operating balance and increase liquidity in the banking sector, thus narrowing interest-rate spreads.

The fiscal adjustment swelled net international reserves through transfers of resources from the government to the central bank. This was in addition to access to external resources to finance the overall balance-of-payments deficit. As international reserves expanded, the central bank's domestic debt continued to shrink, which reduced its liabilities and lowered the cost of refinancing. The injection of liquidity also helped to bring down real interest rates.

Liquidity climbed by 18%, which exceeded the 15.8% growth rate of nominal GDP. This shifted the pattern of credit to the private sector, which picked up by 30%. Almost 60% of new loans consisted of consumer credits. Business loans and personal and credit card lending were up, and the remainder went mainly to the mortgage sector (19%).

(c) Exchange-rate policy

In 2005, the authorities will continue to apply daily mini-devaluations of the local currency consistent with a pre-announced annual rate, or crawling-peg system. In 2004, the central bank lowered the devaluation rate from 6% to 5% on the grounds that slower annual devaluation would help to ease inflationary pressures, given the strong link between inflation and the annual rate of devaluation. However, this measure did not affect the real exchange rate, which remained practically constant.

(d) Other policies

As regards structural reform, significant developments in 2005 were the adoption of the Tax Code, the submission of a financial administration bill to the executive branch, and the presentation of a final proposal for reforming the pensions system. In addition, the rules governing financial activity were changed with a view to strengthening bank supervision and bolstering the deposit guarantee fund (FOGADE).

Trade policy continued to be directed towards increasing economic openness in 2004. Nicaragua approved the entry of the Dominican Republic into the free trade agreement between Central America and the United States and participated in efforts to expedite the trade integration process in Central America.

Table 1

NICARAGUA: MAIN ECONOMIC INDICATORS

	1996	1997	1998	1999	2000	2001	2002	2003	2004 [a]
	Annual growth rates [b]								
Gross domestic product	6.3	4.0	3.7	7.0	4.2	3.0	0.6	2.3	5.1
Per capita gross domestic product	4.1	1.9	1.7	4.9	2.1	0.9	-1.4	0.2	3.1
Gross domestic product, by sector									
Agriculture, livestock, hunting, forestry and fishing	9.4	-0.6	-0.4	6.5	12.6	2.1	-0.6	2.9	6.0
Mining	22.6	16.1	36.2	19.1	-14.9	4.8	13.0	-8.4	19.7
Manufacturing	7.6	7.6	-0.3	5.0	6.0	6.6	1.6	2.5	6.6
Electricity, gas and water	3.8	4.9	11.0	0.1	-0.2	0.1	19.8	5.2	5.1
Construction	-1.4	-8.6	-1.4	39.1	0.3	0.2	-14.5	3.9	10.7
Wholesale and retail commerce, restaurants and hotels	8.1	5.6	7.2	10.3	4.0	3.9	-2.0	2.5	5.9
Transport, storage and communications	9.0	3.9	6.5	9.2	2.0	0.4	4.3	3.1	3.2
Financial institutions, insurance, real estate and business services	4.1	6.3	8.4	7.6	3.9	1.6	5.9	4.3	8.4
Community, social and personal services	-0.5	3.8	2.6	4.7	-2.6	0.5	11.8	1.9	1.6
Gross domestic product, by type of expenditure									
Consumption	3.4	3.7	4.7	4.5	3.8	2.4	8.4	3.7	3.3
General government	1.8	-4.1	4.4	8.2	3.7	-4.5	-1.9	3.0	2.8
Private	3.6	4.6	4.7	4.1	3.8	3.2	9.5	3.7	3.3
Gross domestic investment	21.3	23.6	4.3	31.2	-13.1	-6.0	-16.1	-5.5	9.8
Exports (goods and services)	16.2	14.4	5.8	12.3	12.5	10.8	-6.5	7.9	15.8
Imports (goods and services)	12.9	22.1	7.2	20.7	-5.3	0.1	1.4	4.4	9.4
	Percentages of GDP								
Investment and saving [c]									
Gross domestic investment	25.8	31.2	31.0	39.6	33.4	31.0	26.1	26.1	28.4
National saving	0.9	6.3	11.8	14.8	13.3	11.2	7.0	8.0	11.0
External saving	24.8	24.8	19.2	24.8	20.0	19.7	19.1	18.1	17.5
	Millions of dollars								
Balance of payments									
Current account balance	-825	-841	-687	-928	-792	-797	-767	-749	-795
Merchandise trade balance	-527	-728	-749	-1 071	-921	-910	-918	-972	-1 112
Exports, f.o.b.	595	745	761	749	881	708	681	749	910
Imports, f.o.b.	1 122	1 473	1 510	1 820	1 802	1 617	1 599	1 720	2 022
Services trade balance	-124	-83	-84	-120	-122	-129	-112	-106	-110
Income balance	-324	-265	-185	-197	-202	-240	-200	-191	-192
Net current transfers	150	235	331	460	453	483	462	519	619
Capital and financial balance [d]	77	548	285	533	336	525	575	575	717
Net foreign direct investment	120	203	218	337	267	150	204	201	250
Financial capital [e]	-43	344	66	196	69	375	371	373	467
Overall balance	-748	-293	-402	-395	-456	-272	-192	-175	-78
Variation in reserve assets [f]	-53	-173	30	-157	17	119	-72	-52	-161
Other financing [g]	801	466	372	552	439	153	264	226	239
Other external-sector indicators									
Real effective exchange rate (index: 2000=100) [h]	99.8	101.2	101.3	101.9	100.0	101.1	103.1	107.2	109.1
Terms of trade for goods (index: 2000=100)	84.4	82.0	79.6	95.3	100.0	88.4	87.0	84.1	82.5
Net resource transfer (percentage of GDP)	16.7	22.1	13.2	23.7	14.5	10.8	15.9	14.7	16.8
Gross external public debt (millions of dollars)	6 094	6 001	6 287	6 549	6 660	6 374	6 363	6 596	5 391
Gross external public debt (percentage of GDP)	183.5	177.4	176.0	175.0	168.5	157.8	158.0	159.0	118.3
Net profits and interest (percentage of exports) [i]	6.2	5.9	6.2	6.5	6.3	8.3	7.9	7.6	6.7
	Average annual rates								
Employment									
Labour force participation rate [j]	48.9	...	...	...	...	…	57.5	...	...
Open unemployment rate [k]	16.0	14.3	13.2	10.7	8.3	11.3	11.6	10.2	9.3
	Annual percentages								
Prices									
Variation in consumer prices (December-December)	12.1	7.3	18.5	7.2	9.9	4.7	4.0	6.6	8.9
Variation in nominal exchange rate (December-December)	12.1	12.0	12.0	10.3	6.0	6.0	6.0	6.0	5.0
Variation in average real wage	-3.8	3.7	4.0	4.0	0.0	1.0	3.5	1.9	-2.2
Nominal deposit rate [l]	...	...	...	...	...	11.6	7.8	5.6	4.7
Nominal lending rate [m]	...	...	...	...	...	18.6	18.4	15.5	13.5

Table 1 (concluded)

	1996	1997	1998	1999	2000	2001	2002	2003	2004 [a]
	Percentages of GDP								
Non-financial public sector									
Current income	18.6	20.2	22.2	20.7	19.4	19.1	21.2	22.6	23.3
Current expenditure	15.3	15.6	16.3	15.5	16.6	18.7	20.7	22.0	21.3
Current balance	3.1	4.5	5.8	5.1	2.8	0.3	0.5	0.6	2.0
Net capital expenditure	11.7	8.8	7.6	12.7	11.8	10.5	5.6	6.6	7.1
Primary balance	-0.8	2.4	3.7	-0.3	-2.3	-3.9	0.3	0.8	0.6
Overall balance	-2.9	-1.0	0.4	-2.2	-4.5	-6.3	-1.9	-2.2	-1.5
Public sector debt	144.4	207.9	198.3	187.5	177.5	180.5	193.9	193.4	147.6
Domestic	15.0	85.5	72.9	67.4	63.2	66.8	81.3	79.2	69.9
External	129.4	122.4	125.4	120.2	114.3	113.7	112.6	114.1	77.7
Interest payments (percentage of current income)	11.0	16.9	14.7	9.4	11.4	12.6	10.6	13.6	8.8
Money and credit [n]									
Domestic credit [o]	14.6	18.6	21.7	26.0	29.3	24.3	19.3	21.3	23.8
To the public sector	-2.1	-0.2	-0.8	-1.3	-0.7	-0.5	-0.5	-0.3	0.8
To the private sector	16.7	18.8	22.5	27.3	30.0	24.8	19.8	21.5	23.0
Liquidity (M3)	25.6	34.7	37.7	39.5	37.3	38.2	40.0	41.3	42.1
Currency in circulation and local-currency deposits (M2)	10.2	13.4	13.3	14.5	12.8	12.7	12.1	13.2	14.1
Foreign-currency deposits	15.5	21.3	24.4	24.9	24.5	25.5	27.9	28.1	28.0

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.
[a] Preliminary figures. [b] Based on figures in local currency at constant 1994 prices. [c] Based on figures in local currency expressed in dollars at current prices. [d] Includes errors and omissions. [e] Refers to the capital and financial balance (including errors and omissions), minus net foreign direct investment. [f] A minus sign (-) denotes an increase in reserves. [g] Includes the use of IMF credit and loans and exceptional financing. [h] Annual average, weighted by the value of merchandise exports and imports. [i] Refers to net investment income as a percentage of exports of goods and services as shown on the balance of payments. [j] Economically active population as a percentage of the working-age population; nationwide total. [k] Unemployment rate as a percentage of the economically active population, urban total. Up to 1999 the figures refer to the nationwide total. [l] Weighted average rate on 30-day deposits. [m] Weighted average rate on short-term loans. [n] The monetary figures are end-of-period balances. [o] Refers to net credit extended to the public and private sectors by commercial banks and other financial and banking institutions.

3. The main variables

(a) Economic activity

In 2004, real GDP growth was 5.1%, more than doubling the 2.3% recorded in 2003. The upswing in GDP growth contributed to an increase in real per capita GDP, which was up 2.5%.

The strong economic expansion was attributable to several factors. These included the revival of the world economy, especially the recovery in the United States and the countries of the Central American Common Market (CACM). This boosted external demand for Nicaraguan goods and services, which in turn stimulated production of agricultural and industrial products for export, such as coffee, sugar, sesame, seafood, meat, beef on the hoof, food and beverages, textiles and clothes, footwear and chemicals. The tourist sector also performed well.

Domestic demand picked up (4.4%) thanks to the upturn in investment (particularly in the public sector) and a rise in private consumption. Gross fixed capital formation in the public sector increased, thanks to implementation of projects related to infrastructure, education and health. The rise in private investment was used for trade and property, telecommunications and industry. Simultaneous increases in real available income, family remittances and credit availability contributed to the expansion of private consumption.

The main branches of economic activity —agriculture, manufacturing, construction, commerce and financial services, which, combined, represent 70% of GDP— expanded at rates that exceeded average growth for the economy as a whole. The monthly index of economic activity continued to show an upward trend in March 2005. In the first quarter of 2005, the index rose by 5.7%,

Table 2
NICARAGUA: MAIN QUARTERLY INDICATORS

	2003				2004 [a]				2005 [a]	
	I	II	III	IV	I	II	III	IV	I	II
Merchandise exports, f.o.b. (millions of dollars)	152	152	148	152	187	129	188	184	219	...
Merchandise imports, c.i.f. (millions of dollars)	456	443	464	524	506	393	531	624	613	...
International reserves (millions of dollars)	436	508	489	502	571	613	601	668	640	...
Real effective exchange rate (index: 2000=100) [b]	104.6	106.8	107.9	109.6	108.7	108.0	109.2	110.4	111.7	108.6 [c]
Consumer prices (12-month percentage variation)	5.1	5.3	4.7	6.6	8.4	7.7	9.0	8.9	8.4	9.7
Average real wage (variation from same quarter of preceding year)	14.8	15.0	15.2	15.4	15.6	15.8	16.0	16.2	16.2	16.3
Average nominal exchange rate (córdobas per dollar)	3.53	1.45	1.75	0.96	-1.64	-1.48	-2.34	-3.03	-1.03	...
Nominal interest rates (annualized percentages)										
Deposit rate [d]	6.6	6.1	4.9	4.6	4.8	4.9	4.8	4.4	3.9	3.9
Lending rate [e]	17.1	16.1	14.5	14.5	14.6	12.9	13.4	13.1	13.0	12.9
Domestic credit (variation from same quarter of preceding year) [f]	17.3	12.2	28.7	29.3	27.8	34.4	27.2	34.2	...	...
Non-performing loans as a percentage of total credit [g]	3.5	3.9	3.3	2.7	2.6	2.5	2.5	2.1	2.2	2.3 [h]

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.
[a] Preliminary figures. [b] Quarterly average, weighted by the value of merchandise exports and imports. [c] Data to May. [d] Weighted average rate on 30-day deposits. [e] Weighted average rate on short-term loans. [f] Refers to net credit extended to the public and private sectors by commercial banks and other financial and banking institutions. [g] Refers to total credit extended by the banking system. [h] Data for April.

which was more than the 4.6% recorded for the year-earlier period. This was mainly due to the buoyancy of the sectors mentioned above, which, together, contributed 5.5 percentage points to the annual average increase in the index.

(b) Prices, wages and employment

Inflation, which is calculated on the basis of the consumer price index (CPI), rose from 6.5% in 2003 to 9.3% in 2004. This acceleration reflected short-term factors such as a rise in prices for fuel, transport and certain agricultural goods, especially basic grains.

In May 2005, cumulative inflation stood at 5.4%, which was higher than the 5.1% recorded in May 2004. Year-on-year inflation rose from 8.5% to 9.6%. This increase was mostly due to high international prices for main raw materials (especially petroleum).

The country's economic growth has helped to boost the level of employment. According to the household survey conducted to measure urban and rural employment in November 2004, open unemployment dropped from 7.7% to 6.5%. Between November 2003 and November 2004, the employed population expanded by 56,000 and the number of unemployed declined by almost 22,000. Some of these positive findings appear to be associated with the low growth rate of the economically active population, however. An increase in the minimum wage, public-sector pay adjustments and lower wages in the private sector translated into a modest upturn in the real average wage (0.3%).

In June 2004, an 8.8% increase in the official minimum wage was approved for most sectors of the economy. Wages for civil servants were raised by 10%.

(c) The external sector

In 2004, the larger trade gap resulted in a current-account deficit of US$ 795 million, which was an increase of almost 6%. As a proportion of GDP, however, the deficit narrowed slightly from 18.1% to 17.5%. This was attributable to a considerable upswing in income from the maquila industry and tourism, and a sharp rise in current transfers, especially family remittances, which were equivalent to 11.4% of GDP and 36.7% of the deficit on the trade and income accounts. Increased official and private capital inflows (including foreign direct investment), together with disbursements made to offset the balance-of-payments deficit, were sufficient to finance the current-account deficit. Moreover, this led to a build-up of US$ 451 million in net international reserves held by the central bank, which nevertheless remain somewhat low.

FDI amounted to US$ 250 million, which was 24.2% up on 2003. However, this represented only 5.5% of GDP and 31.4% of the current-account deficit. Most of this investment went to commerce, tourism, telecommunications and construction, whose activities benefit from incentives under legislation adopted to promote tourism and exports (these sectors traditionally involve lower costs and investment risks and offer higher profitability and relatively short capital recovery periods).

The merchandise trade deficit remained very high, at 24.4% of GDP. Exports, including net exports from the free zones, grew by 21.5%, while imports rose by 17.5%.

Merchandise exports (f.o.b.), including US$ 490.7 million from firms in the free-trade zones, stood at US$ 1,246,300,000, or 27.3% of GDP. This considerable upswing was mainly thanks to external sales of traditional products including coffee, sugar, sesame, seafood, meat and beef on the hoof. In the industrial category, the fastest growing exports were food and chemicals. Exports by companies operating under the free-zone regime, which deal mainly in textiles and clothing, maintained the brisk rate of growth seen in recent years. In addition, the number of firms in the free zones increased, and they created more jobs. This was thanks to rising demand in the United States market and the fact that a number of companies, attracted by lower labour costs, relocated their operations from Guatemala and El Salvador to Nicaragua. Value added in the maquila industry rose to US$ 144 million (an increase of 8.4%).

The rise in merchandise imports (c.i.f.), which reached a value of US$ 2,212,200,000, or 48.6% of GDP, was largely due to the upswing in the economy and steadily expanding consumption. The fastest growing imports were raw materials and intermediate goods (21%), primarily thanks to increased purchases of petroleum, fuel and lubricants (29.7%). Imports of raw materials for industry and construction also climbed. Imports of capital goods expanded by 12.6% on the strength of higher investment in construction and services, especially in health, energy and telecommunications. Consumer goods imports showed considerable growth (16.1%), sustained mainly by higher family remittances and more readily available credit. Food products (particularly rice and maize), along with medicines and pharmaceutical products, were also imported to make up for domestic market shortages.

In March, the cumulative balance-of payments current-account deficit for 2005 increased considerably (60%), mainly due to a widening trade deficit (25.5%). A steep rise in exports (17%) was outpaced by the expansion in imports (21.3%), which was mainly attributable to purchases of petroleum and petroleum products.

Panama

1. General trends

Panama's economy grew 6.2% in 2004, on the back of buoyant external demand and a fiscal stimulus to domestic demand. Inflation remained low and the rate of unemployment eased back. The State's financial position weakened and the external deficit broadened to 8.5% of GDP.

Both the sectors traditionally associated with external demand —the Panama Canal, the Colón Free Zone and the international banking centre— and other international service sectors (ports, tourism, telecommunications and rail transport) played a part in the strong expansion of output. The outgoing government had deployed fiscal policy instruments to boost the economy during the electoral process of 2004, which worsened the State's financial position. The new government taking office in September therefore abandoned the fiscal deficit target of under 2% of GDP.

The incoming government's election by a large margin made for very optimistic economic projections, on the strength of which it gained approval in February 2005 for a fiscal reform, despite stiff opposition to a number of the adjustment measures this involved. Other major government projects in 2005 include a reform of the social security system, the conclusion of free trade negotiations with the United States and a referendum on the widening of the Panama Canal.

In 2005, the sectors that have traditionally driven the Panamanian economy continued to be fuelled by external demand, making a growth rate of around 4.5% likely for the year. The rate of inflation will register a larger variation, and the fiscal deficit could narrow from the equivalent of 5% of GDP to 3.6%. Domestic demand is also likely to dip, as a result of the fiscal adjustment and a slowing in construction, at least until work begins on widening the Panama Canal and upgrading sanitation in the Bay of Panama, which is scheduled to commence in 2006. Sectors linked to international trade remained buoyant and GDP increased by 6.5% in the first quarter of 2005.

2. Economic policy

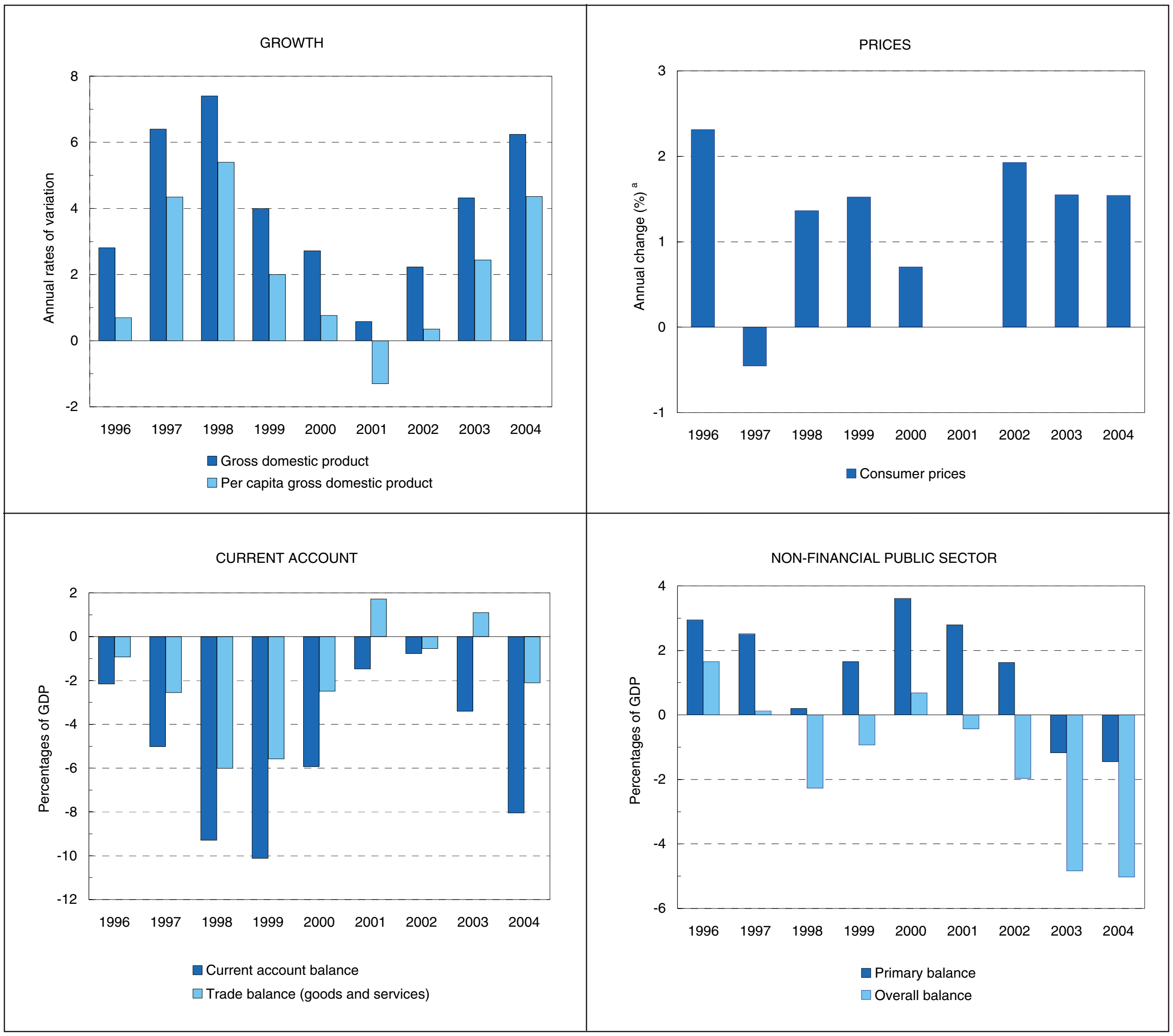
In 2004 the main objective of economic policy was to provide stimulus to the economy through fiscal policy. The new government opted instead to concentrate on fiscal rehabilitation. Other key areas of economic policy were efficient public debt management and the continuation of trade liberalization through the conclusion of free trade agreements.

(a) Fiscal policy

Since fiscal policy had been successful in stimulating economic reactivation in 2003, it continued to be deployed for this purpose into 2004. To that end, the government used proceeds from the sales of assets reverted from the Canal area and drew on resources from part of the Development Trust Fund and profits earned in public debt buy-back operations, channelling some of these monies into temporary incentives for the construction sector. Lastly, only part of the announced containment in budgeted expenditure (totalling US$ 360 million) was made effective.

The new government's priorities were to consolidate the fiscal position and improve transparency. As part of this, it was decided to change the methodology used to

Figure 1
PANAMA: MAIN ECONOMIC INDICATORS



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

compile the fiscal accounts to a more orthodox model. The new method of calculation does not include the anticipated dividends of the National Bank of Panama, the financial results of the Panama Canal Authority, or the savings made through public debt buy-back operations. In the new accounts, the non-financial public sector deficit came in at US$ 691 million, or the equivalent of 5.0% of GDP, compared to 2.8% using the previous methodology. The new government also inherited almost US$ 500 million in accounts payable. This floating debt was quickly whittled down, however, and in March 2005 stood at only US$ 35 million.

The central government deficit widened to 3.8% of GDP in 2003 and 5.6% in 2004. This was due to the fact that revenues rose only 1.8% in real terms while expenditures jumped by 12.6%. The buoyancy of economic activity boosted tax income by 6.8%. Revenues from direct taxes were up 7.6% and from indirect taxes, 5.2%. Non-tax revenues, by contrast, dropped by 2.8%. Tax income from the Panama Canal was 31% higher than the previous year, but dividends from other public enterprises declined by 58%.

Current spending was up by 12.7%, chiefly due to an increase in transfers (31%) and purchases of goods and services (15.3%). Interest payments on the debt, which accounts for a fifth of spending, rose by 5.5%, while capital expenditures expanded 11.7%. The central government's current savings deficit widened from US$ 118 million to US$ 330 million.

Data from the first four months of 2005 show an increase of 19% in current income, which augurs well for the fiscal position. The cut in fuel tax, a temporary measure implemented to absorb part of the increase in the international price of petroleum, will erode fiscal income, however.

The government continued to take an active approach to public debt management, focusing particularly on domestic debt, with a view to strengthening the domestic capital market. Consolidated domestic debt —not including the Social Security Fund (CSS)— rose by 40%, moving from 10.1% of GDP in 2003 to 13.3% in 2004. External public debt rose from 50.6% to 52.6% of GDP over this period.

The balance on the public debt increased by US$ 716 million, which represented an increase of 11%. During the year Panama issued global bonds for US$ 250 million maturing in 2034, re-opened its 2023 global bond for a further US$ 326 million and issued a global bond maturing in 2015 for US$ 600 million. This last issue was aimed at taking advantage of the prevailing favourable market conditions in order to pre-finance the 2005 budget.

(b) The International Banking Centre and credit policy

In contrast to the previous biennium, the International Banking Centre turned in a good performance in 2004. Favourable external conditions, particularly the robust growth seen in the South American economies, helped to revive external operations. This was accompanied by the Panamanian economy's increasing rate of expansion starting in the second semester of 2003.

The total assets of the International Banking Centre rose 7%, from US$ 32.305 billion in 2003 to US$ 34.604 billion in 2004. The assets held in the national banking system expanded by 10%, while the assets in international licence banks shrank by 8%. Net profits climbed 19.8%, the liquidity in the system was equivalent to 30% of deposits and the ratio of capital to risk-weighted assets was 17.8%. The non-performing portfolio decreased from 2.5% in 2003 to 1.7% and the portfolio in arrears represents 1.8% of the total. Lastly, time and savings deposits went up 11% after contracting for two years in a row.

Total credit extended by the national banking system expanded strongly (11.4%). Domestic credit to the private sector rose 9.2% and to the public sector, 60%. Panama's interest rate trends ran contrary to international tendencies in 2004. The drop in nominal lending rates was most pronounced in mortgage lending (the benchmark rate dropped by 100 basis points) and in corporate credits (where it dropped 50 basis points). Deposit rates remained largely unchanged.

The authorities also continued the drive to consolidate a modern legal framework for bank regulation and supervision, in order to ensure the stability of the banking system and, in particular, to combat money laundering and terrorism and prevent the regional spread of these illegal activities. In relation to this last point, the superintendency engaged in cross-border inspections, in what is becoming a more common practice within the Central American Isthmus. The banking sector is now preparing for new standards due to come into force imminently to comply with the New Basel Capital Accord (Basel II).

(c) Trade policy

Trade policy continued to be directed at deepening Panama's integration into the world economy through trade liberalization. In 2004 negotiations were begun with Singapore and with the United States, which is Panama's largest trading partner. The talks with Singapore were concluded in the first semester of 2005, but those with the United States stalled over certain problems to which solutions satisfactory to both parties have yet to be found. In the first quarter of 2005 an agreement was reached with Mexico on the reciprocal promotion and protection of investment and a partial accord was arrived at with Colombia extending tariff preferences for a number of goods.

3. The main variables

(a) Economic activity

The growth rate of 6.2% was the highest recorded since 1998. In contrast to the preceding biennium, when the domestic component drove overall demand, in 2004 external demand resumed its traditional role as the main engine of growth. Gross domestic investment climbed 15%, largely thanks to the expansion of construction, although

Table 1

PANAMA: MAIN ECONOMIC INDICATORS

	1996	1997	1998	1999	2000	2001	2002	2003	2004 [a]
				Annual growth rates [b]					
Gross domestic product	2.8	6.4	7.4	4.0	2.7	0.6	2.2	4.3	6.2
Per capita gross domestic product	0.7	4.3	5.4	2.0	0.8	-1.3	0.4	2.4	4.4
Gross domestic product, by sector									
Agriculture, livestock, hunting, forestry and fishing	1.1	4.5	6.0	1.0	9.8	6.5	3.3	4.6	2.4
Mining	-16.3	80.8	26.1	23.9	-10.6	-4.1	18.7	25.2	33.7
Manufacturing	-1.3	3.3	2.2	1.1	-7.2	-6.3	-2.6	-1.6	2.6
Electricity, gas and water	17.7	6.2	-2.5	12.0	9.3	-4.7	6.9	1.7	8.8
Construction	-4.1	6.7	11.9	36.0	1.3	-21.8	-7.1	32.5	16.0
Wholesale and retail commerce, restaurants and hotels	-1.0	12.1	6.8	-3.9	3.8	3.7	-0.9	0.9	10.6
Transport, storage and communications	2.5	10.0	14.6	6.7	12.5	2.5	2.0	13.6	11.6
Financial institutions, insurance, real estate and business services	8.2	5.2	7.8	5.8	5.9	-0.5	-0.2	0.2	3.4
Community, social and personal services	2.6	3.1	4.2	3.7	-0.4	3.9	4.5	1.9	3.1
Gross domestic product, by type of expenditure									
Consumption	7.9	6.8	16.1	0.6	0.2	3.9	7.3	0.9	4.1
General government	3.4	-0.6	4.7	1.5	1.8	8.1	9.1	3.1	1.5
Private	9.1	8.5	18.5	0.4	-0.1	3.1	6.9	0.4	4.7
Gross domestic investment	6.1	4.2	10.9	3.5	-9.2	-24.2	-5.4	19.0	15.2
Exports (goods and services)	-9.4	7.4	-0.9	-12.4	18.5	0.3	-2.5	-0.9	16.8
Imports (goods and services)	-4.1	7.0	7.8	-14.7	10.3	-4.3	0.7	-1.6	17.5
				Percentages of GDP					
Investment and saving [c]									
Gross domestic investment	26.7	25.7	27.2	25.8	24.1	17.6	15.8	19.1	16.3
National saving	24.6	20.7	17.9	15.7	18.2	16.2	15.0	15.7	7.9
External saving	2.2	5.0	9.3	10.1	5.9	1.5	0.8	3.4	8.4
				Millions of dollars					
Balance of payments									
Current account balance	-201	-507	-1 016	-1 159	-689	-174	-96	-437	-1 104
Merchandise trade balance	-644	-685	-1 296	-1 340	-1 143	-696	-1 035	-1 113	-1 585
Exports, f.o.b.	5 823	6 670	6 332	5 288	5 839	5 992	5 315	5 049	5 886
Imports, f.o.b.	6 467	7 355	7 627	6 628	6 981	6 689	6 350	6 162	7 471
Services trade balance	558	428	638	701	854	899	968	1 254	1 295
Income balance	-249	-400	-517	-691	-577	-602	-272	-820	-1 042
Net current transfers	135	151	159	171	177	226	244	241	228
Capital and financial balance [d]	467	850	911	1 350	613	818	242	284	709
Net foreign direct investment	416	1 299	1 203	864	700	405	99	792	1 012
Financial capital [e]	52	-449	-292	485	-87	413	143	-507	-303
Overall balance	267	343	-105	191	-77	644	146	-153	-395
Variation in reserve assets [f]	-298	-611	20	-185	108	-633	-138	163	396
Other financing [g]	31	268	85	-7	-32	-11	-8	-10	-1
Other external-sector indicators									
Real effective exchange rate (index: 2000=100) [h]	100.6	102.5	100.1	100.7	100.0	103.0	102.1	105.0	110.2
Terms of trade for goods (index: 2000=100)	105.5	103.9	104.7	104.6	100.0	102.7	101.6	97.2	95.3
Net resource transfer (percentage of GDP)	2.7	7.1	4.4	5.7	0.0	1.7	-0.3	-4.2	-2.4
Gross external public debt (millions of dollars)	5 069	5 051	5 180	5 412	5 604	6 263	6 349	6 504	7 219
Gross external public debt (percentage of GDP)	54.4	50.1	47.4	47.2	48.2	53.0	51.7	50.6	52.6
Net profits and interest (percentage of exports) [i]	5.5	6.1	7.8	10.1	7.4	7.3	2.6	9.4	11.1
				Average annual rates					
Employment									
Labour force participation rate [j]	60.6	61.5	62.2	62.8	59.9	60.5	62.6	62.8	63.3
Unemployment rate [k]	14.3	13.4	13.6	11.8	13.5	14.0	13.5	13.1	11.8

Table 1 (concluded)

	1996	1997	1998	1999	2000	2001	2002	2003	2004 [a]
				Annual percentages					
Prices									
Variation in consumer prices (December-December)	2.3	-0.5	1.4	1.5	0.7	0.0	1.9	1.5	1.5
Variation in real minimum wage	4.3	-1.3	2.7	3.4	3.8	7.0	-1.2	0.7	0.9
Nominal deposit rate [l]	...	...	...	...	...	6.8	5.0	4.0	2.2
Nominal lending rate [m]	...	...	...	...	...	10.6	9.2	8.9	8.2
				Percentages of GDP					
Non-financial public sector									
Current income	24.4	23.9	23.0	23.8	25.3	24.8	23.2	21.9	21.6
Current expenditure	19.6	20.8	20.7	21.0	22.1	22.7	22.9	23.0	23.2
Current balance	4.8	3.1	2.3	2.8	3.2	2.1	0.3	-1.1	-1.6
Net capital expenditure	3.1	3.7	5.1	3.8	2.5	2.5	2.3	3.8	3.5
Primary balance	2.9	2.5	0.2	1.7	3.6	2.8	1.6	-1.2	-1.5
Overall balance	1.7	0.1	-2.3	-0.9	0.7	-0.4	-2.0	-4.8	-5.0
Public sector debt	73.5	67.1	64.8	67.2	66.5	71.1	69.4	67.3	72.6
Domestic	19.1	17.0	15.9	18.6	18.3	18.1	17.7	16.8	20.1
External	54.4	50.1	48.9	48.6	48.2	53.0	51.7	50.6	52.6
Interest payments (percentage of total income)	5.3	9.6	10.4	10.6	11.3	12.6	14.9	16.4	16.4
Money and credit									
Domestic credit [n]	65.8	67.9	75.8	86.4	95.3	99.1	92.8	86.2	82.4
To the public sector	1.3	0.7	1.1	1.0	1.4	1.2	1.4	2.9	2.8
To the private sector	64.5	67.2	74.7	85.4	93.9	98.0	91.4	83.3	79.6
Liquidity (M3) [o]	59.5	63.2	65.9	68.2	74.0	79.8	76.6	76.5	77.7

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.
[a] Preliminary figures. [b] As of 1997, based on figures in local currency at constant 1996 prices. [c] Based on figures in local currency expressed in dollars at current prices. [d] Includes errors and omissions. [e] Refers to the capital and financial balance (including errors and omissions), minus net foreign direct investment. [f] A minus sign (-) denotes an increase in reserves. [g] Includes the use of IMF credit and loans and exceptional financing. [h] Annual average, weighted by the value of merchandise exports and imports. [i] Refers to net investment income as a percentage of exports of goods and services as shown on the balance of payments. [j] Economically active population as a percentage of the working-age population; nationwide total. [k] Unemployment rate as a percentage of the economically active population; nationwide total. Includes hidden unemployment. [l] Six-month deposits in the local banking system. [m] One- to five-year loans for commercial activities in the local banking system. [n] Refers to net credit extended to the public and private sectors by commercial banks and other financial and banking institutions. [o] End-of-period figures.

growth in the machinery and equipment subsector, at over 11%, was far from negligible. Both public and private investment posted double-digit growth rates. Consumption rose by 4%, driven by private consumption.

Agriculture, livestock, forestry and fishing recorded an expansion of 2.4%. Production of fruit for export, including pineapples, melons and watermelons, increased particularly sharply (40%). Other crops such as coffee, maize and sugar cane also performed well, though rising at more moderate rates. Banana production fell back 1.1% as a result of phytosanitary problems. Production of rice went down by 35%. Output was up in the segments of beef livestock (2.7%), pork (6.9%) and poultry (12.7%). The fishing segment, meanwhile, expanded a mere 1.5%.

Mining and quarrying was the most dynamic sector, with a growth rate of 34%. Construction expanded by 16%, thanks to a large number of residential projects, port works and highway upgrading, the conclusion of the Centenary Bridge and the expansion of shopping centres.

After having contracted for four straight years, manufacturing posted an upturn of 2.6%. The production of inputs for construction reaped the benefits of that sector's expansion. The clothing and footwear segments contracted, as did fish processing and dairy products. In contrast to the downturn in the generation of thermal energy, hydroelectric energy performed exceptionally well, surging by 35% thanks, in part, to the Estí hydroelectric plant's entry into operation. The value added of water production rose 7.6%.

Transport, storage and communications posted an upswing of 11.6%. The transport system benefited from the buoyancy of international trade, with the output of the railway segment and ports expanding 39% and 23.2%, respectively, mainly thanks to increased movements of container freight. Also robust, albeit lower, growth rates were recorded in Panama Canal activities (7.1%) and air transport (8.4%). Telecommunications were up 13.2%, led by the mobile telephony segment.

Table 2
PANAMA: MAIN QUARTERLY INDICATORS

	2003				2004 [a]				2005 [a]	
	I	II	III	IV	I	II	III	IV	I	II
International reserves (millions of dollars)	1 405	1 310	1 101	1 011	974	792	469	631	1 039	...
Real effective exchange rate (index: 2000=100) [b]	101.7	105.3	105.6	107.3	109.0	109.4	109.9	112.4	113.1	112.7 [c]
Consumer prices (12-month percentage variation)	1.6	1.5	1.3	1.5	1.1	1.9	1.7	1.5	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 [d]	4.6	4.7	4.0	2.6	2.3	2.2	2.2	2.2	2.6	...
Lending rate [e]	8.8	8.8	8.7	9.2	8.4	8.0	8.0	8.5	8.5	...
Domestic credit (variation from same quarter of preceding year) [f]	-1.6	-3.0	0.0	-1.2	-0.3	3.1	3.0	5.2	6.6	7.2 [g]
Non-performing loans as a percentage of total credit [h]	3.1	2.9	2.7	2.5	2.6	1.9	1.9	1.7	...	...

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.
[a] Preliminary figures. [b] Quarterly average, weighted by the value of merchandise exports and imports. [c] Data to May. [d] Six-month deposits in the local banking system. [e] One-year loans for commercial activities in the local banking system. [f] Refers to net credit extended to the public and private sectors by commercial banks and other financial and banking institutions. [g] Data for April. [h] Refers to total credit extended by the multibanking system.

The encouraging performance of commerce (10.6%) was fuelled mainly by vigorous activity in the Colón Free Zone, which expanded 19%, since the national component of commerce increased by around 4%. Upturns in the economies of South American customers of the free zone were the main driver of this good performance. The hotel and restaurant sector grew by 8.2%, thanks to a 13% increase in tourist arrivals.

Financial intermediation dipped slightly (2.6%), reflecting a drop of 1% in the value added of banking activities and of 4% in insurance. In contrast, real estate, business and rental services climbed by 6.3%. Personal, community and social services expanded 3% and government services, 1.5%, both lower than the rate posted by the segments of other services (6.7%) and health (5.9%).

(b) Prices, wages and employment

The authorities prepared a new nationwide urban consumer price index, with a base year of October 2002, in order to reflect price variations more accurately. This indicator showed prices rising 1.5% in 2004. The sector to post the largest variation was transport (2.9%), owing to the rise in international petroleum prices. Food and beverages, health and education also saw price increases of over 1%. The other sectors registered decreases.

The wholesale price index was up by 4.4%, a large increase by Panamanian standards that was driven by a rise of 7.3% in import prices. Higher international market prices for petroleum and other raw materials were the main reasons for this uptrend.

Consumer inflation gathered pace in the first four months of 2005, with a rise of 3.3% over the year-earlier period. In contrast, the wholesale price index slackened its rate of increase to 1.7% in the first quarter.

Minimum wages are adjusted every two years, with 2004 falling between adjustment years. The rate of total unemployment dropped 1.3 points, from 13.1% in 2003 to 11.8%, thanks to the economic upswing. The drop in the unemployment rate was more pronounced in urban areas (2 percentage points). Total employment climbed 4.5%, raising the employment rate by 1.3 percentage points with respect to 2003.

(c) The external sector

Buoyant external demand provided a strong stimulus to the Panamanian economy and this was reflected in the activity of the Colón Free Zone. The current-account deficit widened from the equivalent of 3.6% of GDP in 2003 to 8.5%. The financial account returned a surplus of US$ 709 million, reflecting a large inflow of foreign direct investment (FDI).

The goods balance deteriorated again, with the deficit widening from US$ 1.112 billion in 2003 to US$ 1.585 billion in 2004. Goods exports, including those from the Colón Free Zone, increased in value by 16.6%, and imports by 21.2%. After a two-year decline, re-exports from the Colón Free Zone posted a strong upswing of 19.2%.

National exports expanded 10.6%. A number of export products recorded very high growth rates, including pineapples (199%) and melons (84%). Beef, lobster and other refrigerated fish also performed well (46%, 35% and 22%, respectively). The value of banana exports dropped by 4%, however, shrinking for a fifth consecutive year. Exports of shrimp were down by 5% and of sugar, by 18%. The export value of coffee declined by 11%, which was attributable to smaller volumes exported.

Goods imports expanded at an even stronger pace than exports, boosted by the upswing in economic activity. Imports to the Colón Free Zone rose 27.7%, after having shrunk for two years in a row. National imports climbed 14.9%, in view of larger imports of fuels, construction materials and capital goods.

The value of national exports was up by 37.4% in the first quarter of 2005, thanks to excellent sales of melon, watermelon, shrimp, sugar and coffee. Re-exports from the Colón Free Zone rose 10.1%. Movements of containers in port rose 23.1% and net tons through the Canal, 4%. Tourist arrivals were 23.1% higher than in the first quarter of 2004, and their expenditures rose 19.9%.

The services balance was the only current-account item to post an upturn in 2004, with a surplus that climbed from US$ 1.254 billion in 2003 to US$ 1.295 billion. The value of transport services rose 9%, partly because of higher prices in the Panama Canal's new rate structure and partly because of an increase in traffic volumes. Tourist income, which rose 11%, also contributed to the good performance of the services sector. Lastly, the banks saw their surplus decrease by about US$ 10 million.

The large sums paid in interest, together with outflows of profits, widened the deficit on the income balance to US$ 1.042 billion, while the surplus on the transfers balance narrowed slightly. Accordingly, the current-account deficit widened from US$ 437 million in 2003 to US$ 1.104 billion in 2004.

The strongest component of the financial account was FDI, which amounted to US$ 1.012 billion. This jump was the result of the reactivation of banking operations and an upturn in the activities of firms trading internationally through the Colón Free Zone. Another major contributing factor was the sale of Bellsouth Panama to the Spanish firm Telefónica Móviles for US$ 340 million.

The government's levels of net external indebtedness rose. Large movements, both inward and outward, of portfolio capital resulted in a portfolio investment deficit of US$ 170 million.

The Caribbean

Bahamas

1. General trends

In 2004, economic growth (2.8%) was higher than in the previous year (1.9%), despite the effects of hurricanes Jeanne and Frances, which hit the country in September and caused total damage estimated at 7% of GDP.

Tourism, transport, telecommunications and, to a lesser extent, fishing were among the sectors worst affected. Nevertheless, tourism made a rapid recovery, recording an unprecedented number of visitors in 2004. Construction, driven in part by the reconstruction and rehabilitation work, also made a significant contribution to economic growth.

The improvement in the economy, which brought the unemployment rate down from 10.8% in 2003 to 7% in 2004, also had a positive impact on tax receipts. This factor, together with rigorous control of public spending, reduced the fiscal deficit from 2.4% in fiscal year 2003 to 2.3% in 2004.[1]

The monetary policy stance was closely linked to fiscal goals. Accordingly, for most of the year the central bank deployed a tight policy based on direct controls of expansion in liquidity, which it cautiously loosened at the end of the year. This policy contributed in part to the reduction in the inflation rate.

The balance of payments returned a surplus, thanks to the increase in the positive balance on the capital and financial account which, excluding errors and omissions, was more than sufficient to compensate for the current account deficit. This deficit, in turn, was significantly lower than the year before (8% and 4% of GDP in 2003 and 2004, respectively).

The consequent accumulation of reserves in the financial system, together with the improved quality of the commercial banks' portfolios, prompted the monetary authorities to change their policy stance in 2005. They proceeded to lower the reference interest rates in order to stimulate economic activity. The government also plans a significant rise in public spending for fiscal year 2005.

2. Economic policy

(a) Fiscal policy

The central government fiscal deficit diminished as a result of the expansion of current income (equivalent to 16.9% and 18.1% of GDP in fiscal years 2003 and 2004, respectively) while public spending increased from 19.6% to 20.6% in 2004. This occurred despite the negative impact of hurricanes Jeanne and Frances on tax collection and the higher public spending occasioned by reconstruction activities.

The rise in tax collection (9.8%), especially taxes on commerce and international transactions, which account for 55% of the total, made a significant contribution to the increase in public revenues. Efforts to improve stamp tax collection, which was 55% higher than in the previous fiscal year, also contributed to this result.

As for disbursements, current expenditure rose by 18.1% and 18.6% of GDP in fiscal years 2003 and 2004, respectively, while capital spending increased from 1.5% to 2% of GDP over the same periods.

[1] Fiscal year 2004 runs from 1 June 2004 to 31 May 2005.

The fiscal deficit was financed mainly through local-currency loans. The government's obligations in Bahamas dollars, amounting to 86% of total debt, were up by 10% at the end of 2004. State enterprises are the main holders of public debt (40%), followed by private and institutional investors (28%), local commercial banks (24%) and the central bank (8%). Meanwhile, the government made payments on external debt principal, which reduced its external debt stock from US$ 603 million in 2003 to US$ 559 million in 2004, or from 11% to 9% of GDP.

The authorities estimate that the fiscal deficit will be equivalent to 2.8% of GDP in fiscal year 2005. Current spending is expected to increase by 5.5%, mainly as a result of payroll expenses and expenditure on social programmes for public-sector employees. The wage policy has been drawn up in response to demands that have resulted from labour negotiations between the government and the trade unions.

Capital spending will grow from 2% of GDP in fiscal year 2004 to 2.7% in 2005. Of the total planned capital expenditure, 33% is earmarked for the ministry of public works and services, and 10% for the ministry of education, in order to improve public education facilities.

(b) Monetary and exchange-rate policies

During the first eight months of the year the authorities maintained the tight monetary policy stance adopted in 2001, based on quantitative restrictions on commercial bank lending.

Increased inflows of foreign currency swelled international reserves and bank liquidity, and improved the quality of commercial bank portfolios. Accordingly, the central bank eased its monetary stance. Bank liquidity, measured by the level of voluntary reserves, grew by 47% in 2004.

Improved portfolio quality was reflected in a decline in loans arrears, with the non-performing portfolio narrowing from 5.3% of the total in 2003 to 4.9% in 2004. The share of bad loans in bank balances also diminished. Payment arrears declined as a proportion of secured private loans, from 10.4% in 2003 to 9.4% in 2004.

In September the authorities began to adopt a more flexible credit policy. The banks were allowed to resume lending operations, albeit on two conditions. First, the increase in their personal loans portfolio must not exceed the equivalent of 15% of net assets and, second, they must not extend loans whose servicing would exceed the range of 40% to 45% of the borrower's monthly income.

In accordance with the monetary policy shift, interest rates came down. The real weighted average interest rate on loans went down from 8.1% in 2003 to 6.8% in 2004 and the weighted average rate on deposits decreased by 0.25 percentage points. The banks took advantage of their improved portfolios to purchase government paper, thus bringing down the corresponding interest rate from 1.6% in 2003 to 0.3% in 2004 and lightening the burden of local-currency public-debt servicing.

Although the expansion of credit supply slowed after the passage of hurricanes Jeanne and Frances in the month of September, the figure for 2004 (5%) still exceeded that of the previous year (1%). Credit to the private sector rose by 6% (compared to 0.6% in 2003), with significant growth in personal loans, real estate mortgages and consumer credit (10.2%, 14.6% and 6.2%, respectively).

International reserves showed an unprecedented 38% year-on-year expansion at the end of 2004, which resulted in a coverage of non-petroleum imports of 21.7 weeks, compared to 16.6 in 2003.

These monetary trends strengthened in 2005. Credit to the private sector, especially to commercial establishments, grew rapidly. In addition, the continued expansion of liquidity in the economy (with reserves at US$ 800 million) and in the commercial banks has prompted a further loosening of monetary policy. The sale of public assets, such as state properties at Cable Beach, has helped to create this situation of abundant liquidity.

At the beginning of 2005 the discount rate for open-market operations went from 5.5% to 5.25%. The commercial banks lowered their prime lending rate from 6% to 5.5%, which should boost the activity of enterprises that finance their operations with such loans, including mortgage-lending and commercial establishments.

3. The main variables

(a) Economic activity

Economic activity improved in relation to the previous year and was based on growth in tourism, construction and financial services. The country is expected to maintain its growth trend in 2005 with a rate of 3.5%.

The number of visitors rose 8.9% to 5 million (an unprecedented figure, despite the damage caused by the

Table 1
BAHAMAS: MAIN ECONOMIC INDICATORS

	1996	1997	1998	1999	2000	2001	2002	2003	2004 [a]
	Annual growth rates [b]								
Gross domestic product	4.2	4.9	6.8	4.0	1.9	0.8	1.4	1.9	2.8
Per capita gross domestic product	2.6	3.4	5.3	2.5	0.4	-0.6	0.0	0.5	1.4
Gross domestic product, by sector									
Agriculture, livestock, hunting, forestry and fishing	8.7	0.1	-2.4	-6.8	8.8	-6.9	20.7	-3.5	3.8
Mining	-24.9	5.1	-1.2	-22.3	11.6	3.4	0.2	13.5	24.8
Manufacturing	11.4	8.8	-4.0	-0.6	7.4	13.0	2.2	-2.6	-1.7
Electricity, gas and water	0.3	7.5	11.3	2.4	0.2	11.3	3.6	7.9	2.5
Construction	7.2	32.0	21.2	8.3	13.3	-13.3	6.2	-0.9	0.8
Wholesale and retail commerce, restaurants and hotels	5.4	0.8	8.2	11.4	-3.4	4.9	-6.4	1.9	7.1
Transport, storage and communications	15.7	4.1	12.4	0.7	10.4	-5.3	7.2	-2.3	7.0
Financial institutions, insurance, real estate and business services	1.8	12.1	10.7	9.1	5.4	3.1	2.7	0.8	1.3
Community, social and personal services	-4.7	5.6	-0.6	-0.9	-7.4	-3.4	-0.5	9.3	6.1
Gross domestic product, by type of expenditure									
Consumption	6.4	6.0	8.6	5.1	1.3	4.4	-1.4	2.2	2.8
General government	7.0	6.3	-0.8	-1.8	-4.9	3.8	3.5	4.6	7.3
Private	6.3	6.0	10.5	6.3	2.3	4.5	-2.1	1.8	2.0
Gross domestic investment	15.1	28.7	19.9	-0.4	13.6	-7.4	-5.6	3.5	6.4
Exports (goods and services)	3.6	1.4	0.3	7.0	5.2	-5.7	4.0	0.9	2.2
Imports (goods and services)	10.2	21.0	12.1	6.1	10.4	-4.6	-3.6	2.6	6.3
Real sector indicators									
Tourist arrivals	5.5	1.1	-3.1	9.0	15.2	-0.5	5.2	4.3	8.9
Value of building starts	51.1	154.4	-64.3	-0.6	19.0	-8.0	55.0	-6.9	…
Value of building conmpletions	42.5	9.2	187.9	-7.4	-34.2	8.0	-5.9	-12.7	…
Electricity generation (MWh)	2.9	5.7	8.7	5.1	6.9	3.9	5.6	5.4	-8.0
	Millions of dollars								
Balance of payments									
Current account balance	-263	-472	-995	-672	-471	-645	-421	-448	-229
Merchandise trade balance	-1 014	-1 116	-1 374	-1 428	-1 371	-1 387	-1 327	-1 331	-1 339
Exports, f.o.b.	273	295	363	380	805	417	422	427	471
Imports, f.o.b.	1 287	1 411	1 737	1 808	2 176	1 804	1 749	1 757	1 810
Services trade balance	862	757	542	857	1 029	819	965	888	868
Income balance	-149	-153	-198	-138	-173	-186	-102	-54	-9
Net current transfers	37	39	34	37	43	110	42	49	251
Capital and financial balance [c]	256	529	1 115	737	410	615	482	559	413
Net foreign direct investment	88	210	146	144	250	101	153	165	274
Financial capital [d]	168	319	969	593	161	514	329	393	139
Overall balance	-8	57	119	65	-61	-30	61	111	184
Variation in reserve assets [e]	8	-57	-119	-65	61	30	-60	-110	-183
Other external-sector indicators									
Gross external public debt (millions of dollars)	286	335	323	338	349	328	309	362	343
Gross external public debt (percentage of GDP)	7.6	8.1	8.1	7.7	7.5	7.0	6.1	6.7	6.0
	Average annual rates								
Employment									
Open unemployment rate [f]	11.5	9.8	7.8	7.8	...	6.9	9.1	10.8	7.0
	Annual percentages								
Prices									
Variation in consumer prices (December-December)	1.1	0.8	1.9	1.4	1.0	2.9	1.9	2.3	1.2
Nominal deposit rate [g]	5.1	5.3	5.6	4.5	4.0	4.2	4.1	3.9	3.8
Nominal lending rate [g]	12.6	12.8	12.3	11.8	11.7	11.5	11.3	12.0	11.2
	Percentages of GDP								
Central government									
Current income	20.4	20.9	...	19.8	19.1	16.7	16.7	16.9	18.1
Current expenditure	19.1	19.4	...	17.4	16.9	17.5	17.8	18.1	18.6
Net capital expenditure	2.4	2.5	...	2.3	1.7	2.0	1.6	1.5	2.0
Overall balance [h]	-2.0	-1.8	...	-0.8	-0.3	-1.9	-2.7	-2.4	-2.3

Table 1 (concluded)

	1996	1997	1998	1999	2000	2001	2002	2003	2004 [a]
Money and credit									
Domestic credit	80.1	97.5	109.2	121.7	135.5	152.4	161.0	162.1	...
To the public sector	16.0	16.5	19.1	21.6	21.1	25.2	28.4	28.7	...
To the private sector	64.1	81.1	90.2	100.1	114.4	127.1	132.6	133.4	...
Liquidity (M3)	62.5	65.3	67.8	69.0	70.9	72.4	71.0	72.8	77.1
Currency in circulation and local-currency deposits (M2)	61.7	64.2	66.4	67.9	69.2	70.7	69.3	70.9	75.4
Foreign-currency deposits	0.8	1.1	1.4	1.1	1.7	1.8	1.7	1.8	1.7

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.
[a] Preliminary figures. [b] Based on figures in local currency at constant 1991 prices. [c] Includes errors and omissions. [d] Refers to the capital and financial balance (including errors and omissions), minus net foreign direct investment. [e] A minus sign (-) denotes an increase in reserves. [f] Unemployment rate as a percentage of the economically active population; nationwide total. [g] Weighted average. [h] Includes interest.

hurricanes), with 71% of the total being cruise passengers. The tourist sector benefited from a 1.5% rise in average hotel rates which, together with higher occupancy, boosted the sector's average income from 32% of GDP in 2003 to 33% in 2004.

In the first quarter of 2005, arrivals declined by 4.1% in relation to the same period of the previous year. In fact, arrivals were up 5% on Nassau/Paradise Island and down by 27% and 5% on Grand Bahama and Out Islands, respectively. In the case of Grand Bahama, the drop was the result of hurricane damage and the authorities viewed the situation as temporary. They expect a positive arrivals trend over the rest of the year, driven partly by foreign direct investment flows and increased air transport capacity.

The construction sector performed well thanks to inflows of foreign direct investment, increased liquidity in the economy, lower interest rates and the reconstruction work undertaken by the authorities after the hurricanes. Growth in construction was reflected in a 28% rise in the number of mortgages (95% of which were for residential building projects) and a 43% increase in their value.

Agriculture and fishing contracted, basically due to hurricane damage, although they were less affected than other areas of the economy. Fishing suffered a setback in terms of both volume and price (-5.5% and -10.2%, respectively). Lobster tails, which account for 72% of fishing production, were down 10%.

(b) Prices, wages and employment

The inflation rate, measured by the average retail price index, decreased with respect to the previous year, from 2.4% to 0.9%.

This was mainly due to a contraction in the largest component of the price index —housing (33% of the total)— and, to a lesser degree, to lower prices under the headings of recreation, entertainment and other services, and other goods and services.

In contrast, the components of health and medical services, foodstuffs and beverages, and transport and communications, which together account for 33% of the total price index, showed growth of 7%, 3% and 2%, respectively.

Reflecting trends in economic activity, the unemployment rate went down from 10.8% in 2003 to 7% in 2004, absorbing a 1.5% increase in the work force.

(c) The external sector

The balance of payments turned in a surplus of 3.2% of GDP (compared to 2% in 2003). The capital and financial account surplus (including errors and omissions) amounted to 9.7% of GDP in 2003 and 6.8% in 2004, and was more than sufficient to finance the current account deficit, which narrowed to half the level of the previous year.

The services account recorded a surplus of 15%, as a result of growth in tourism.

The trade deficit continues to represent almost a quarter of GDP, owing to an increase in imports and low growth in the export sector. This was partly because of the negative effects of the hurricanes on fishing exports. Import trends reflected the higher oil bill resulting from the rise in international fuel prices (29% in relation to the previous year).

Meanwhile, the deficit on the income balance narrowed from US$ 54 million in 2003 to US$ 9 million in 2004, thanks to a substantial drop in profit repatriation flows. Current transfers expanded as a result of increases in official assistance and remittances from workers resident abroad.

The capital and financial account surplus reflects flows of foreign direct investment to the tourist sector, which amounted to 3% of GDP in 2003 and 4.8% in 2004. Increases in equity investment, private borrowing and real estate sales also contributed to this result.

Barbados

1. General trends

In 2004, the economy picked up speed and by the end of the year had reached the highest growth rate in real terms since 1999 (4.5% compared with 3.7% in 2003). The rise in GDP was the result of the dynamic expansion of tourism, construction and commerce. Despite the high economic growth rate, stable macroeconomic conditions sufficed to bring down inflation (measured on the basis of annual averages) from 1.6% in 2003 to 1.4% in 2004.

By reducing expenditure, the government was able to narrow the fiscal deficit from 2.8% of GDP to 2.2%, in accordance with the sustainability target it had set. Monetary policy was altered to reduce fluctuations in the net international reserves of the banking system, thereby protecting the fixed exchange rate and facilitating lending for private-sector production activities. The overall balance-of-payments outturn was a deficit (-6.1% in 2004), due to an increase in imports, which weakened the current account position.

Economic activity is expected to grow by 3.2% in 2005, with the impetus coming from commerce, non-sugar agriculture, and fishing and tourism. Inflation is expected to be between 1.5% and 2% as a result of higher food prices.

The fiscal deficit should stand at 2.7% of GDP on account of lower tax receipts. As far as the balance of payments is concerned, the overall deficit is expected to narrow to approximately 1% of GDP thanks to a smaller current account deficit and a larger surplus in the financial account.

2. Economic policy

(a) Fiscal policy

The aim of fiscal policy in 2004 was to reduce the budget deficit with a view to achieving stable growth, following the countercyclical fiscal expansion that had been needed to stimulate the economy in previous years. The economic upturn contributed to the recovery in public finances in 2004, and the fiscal deficit shrank from 2.8% of GDP in 2003 to 2.2% in 2004, thus outperforming the budget target of 2.9%. The government considers a deficit of 2.5% of GDP to be sustainable in the medium- and long-term. In general, a much more manageable fiscal position appears to have been achieved.

The decline in fiscal revenues from 34.4% of GDP in 2003 to 33.7% in 2004 was attributable to the tax measures implemented. These included a cut in the rate applied to the first 24,200 Barbados dollars of taxable personal income and a 1.5% reduction in the corporate tax rate, which translated into a drop of 4% in receipts from direct taxes. Non-tax revenues and grants were up by 1.9% in 2004, which was almost identical to the increase recorded in 2003.

Table 1

BARBADOS: MAIN ECONOMIC INDICATORS

	1996	1997	1998	1999	2000	2001	2002	2003	2004 [a]
	Annual growth rates [b]								
Gross domestic product	3.2	4.6	6.2	0.5	2.4	-3.4	-0.5	3.7	4.5
Per capita gross domestic product	2.8	4.3	5.9	0.2	2.1	-3.7	-0.7	3.4	4.2
Gross domestic product, by sector									
Agriculture, livestock, hunting, forestry and fishing	17.7	-0.6	-13.3	9.5	3.7	-9.5	-4.2	-4.0	-5.9
Mining	0.0	-1.7	49.2	8.0	-8.4	-12.6	-6.6	-8.5	1.5
Manufacturing	-0.9	3.8	3.4	-2.4	-0.5	-8.2	0.2	-0.7	1.6
Electricity, gas and water	4.3	3.8	9.1	5.0	0.0	3.7	1.8	2.8	2.2
Construction	4.0	14.2	16.9	10.0	2.6	-4.4	3.1	16.1	3.5
Wholesale and retail commerce, restaurants and hotels	2.5	5.7	9.7	-4.6	4.7	-4.4	-0.7	5.4	6.9
Transport, storage and communications	2.6	3.8	5.8	4.3	0.9	0.6	-3.0	1.4	3.2
Community, social and personal services [c]	2.3	3.5	4.3	1.9	1.3	-1.2	0.0	2.3	5.1
	Millions of dollars								
Balance of payments									
Current account balance	70	-50	-63	-148	-145	-111	-192	-198	-319
Merchandise trade balance	-456	-599	-651	-714	-744	-681	-714	-816	-980
Exports, f.o.b.	287	289	270	275	286	271	241	250	278
Imports, f.o.b.	743	888	921	989	1 030	952	955	1 066	1 258
Services trade balance	540	550	591	571	603	570	538	632	672
Income balance	-52	-48	-56	-71	-82	-93	-102	-107	-107
Net current transfers	38	47	52	66	78	93	86	93	96
Capital and financial balance [d]	17	54	55	182	324	326	281	386	148
Net foreign direct investment	10	14	15	16	18	17	17	301	113
Financial capital [e]	7	40	40	166	306	309	264	85	35
Overall balance	86	4	-7	35	179	215	89	188	-170
Variation in reserve assets [f]	-61	5	7	-35	-180	-216	-89	-188	170
Other financing [g]	-25	-9	1	1	1	1	0	0	0
Other external-sector indicators									
Real effective exchange rate (index: 2000=100) [h]	102.5	98.1	100.6	101.0	100.0	98.4	100.1	103.4	107.9
Gross external public debt (millions of dollars)	481.0	428.0	453.0	492.0	605.0	539.0	755.0	737.0	792.0
Gross external public debt (percentage of GDP)	24.1	19.4	19.1	19.8	23.3	21.1	29.1	27.3	28.4
	Average annual rates								
Employment									
Labour force participation rate [i]	68.1	67.8	67.8	67.8	68.6	69.5	68.5	...	...
Open unemployment rate [j]	15.6	14.5	12.3	10.4	9.2	9.9	10.3	11.0	9.8
	Annual percentages								
Prices									
Variation in consumer prices									
(December-December)	...	...	...	...	3.8	-0.3	0.9	0.3	4.3
(annual average)	2.4	7.7	-1.2	1.6	2.4	2.8	0.2	1.6	1.4
Nominal deposit rate	...	...	...	...	...	...	...	...	3.0
Nominal lending rate	...	...	...	...	...	...	...	...	7.4
	Percentages of GDP								
Non-financial public sector									
Income	29.4	27.9	31.0	31.5	31.7	33.9	34.6	34.4	33.7
Expenditure	-30.2	-31.3	-32.1	-32.2	-33.0	-35.8	41.0	37.3	35.9
Overall balance	-0.8	-3.4	-1.1	-0.7	-1.3	-1.9	-6.4	-2.8	-2.2
Money and credit									
Domestic credit	62.5	62.9	63.8	67.1	69.0	71.2	75.1	73.0	74.8
To the public sector	14.5	15.9	14.1	12.6	12.7	13.3	15.7	17.6	19.4
To the private sector	48.0	47.0	49.7	54.5	56.3	57.8	59.4	55.4	55.4
Currency in circulation and local-currency deposits (M2)	...	...	...	...	...	...	99.5	100.7	110.7

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

[a] Preliminary figures. [b] Based on figures in local currency at constant 1974 prices. [c] Includes financial institutions, insurance, real estate and business services. [d] Includes errors and omissions. [e] Refers to the capital and financial balance (including errors and omissions), minus net foreign direct investment. [f] A minus sign (-) denotes an increase in reserves. [g] Includes the use of IMF credit and loans and exceptional financing. [h] Annual average, weighted by the value of merchandise exports and imports. [i] Economically active population as a percentage of the working-age population. [j] Unemployment rate as a percentage of the economically active population. Includes hidden unemployment.

Expenditure dipped slightly from 37% of GDP in 2003 to 36% in 2004, owing to the reduction in capital expenditure from 5% of GDP in 2003 to 3.8% in 2004. This reflected the completion of several large-scale projects.

The current expenditure aggregate and its headings remained at the same level as in the previous year (32% of GDP for wages, 11% for goods and services and 4% for interest). Transfers rose because the operating costs of the Queen Elizabeth Hospital, which is no longer administered directly by the central government, are now included in this category.

The fiscal deficit was financed mainly using national resources, which helped to mitigate the currency movements and exchange risks associated with international interest rates. Commercial banks contributed 143 million Barbados dollars (BDS$), while BDS$ 111.1 million were provided by the national insurance system. Principal payments amounted to BDS$ 81.8 million.

Public finances weakened during the first four months of 2005, and by the end of April had accumulated a deficit of around BDS$ 10 million. This stood in sharp contrast to the BDS$ 14 million surplus posted for the same period in 2004. Revenues climbed by 2.7%, owing to a considerable upswing in income from corporate tax, due to higher company profits. Expenditure rose in even higher proportions (7.5%), however, as a result of payments to the Barbados Tourism Authority, the Transport Board and the University of the West Indies.

According to projections, the overall fiscal deficit is set to swell to 2.7% of GDP in 2005. In particular, capital expenditure is expected to rise as a result of work to upgrade the Kensington Oval stadium for the 2007 Cricket World Cup and other projects. Barbados will continue to open its economy progressively, with the implementation of the Caribbean Community (CARICOM) Single Market and Economy (CSME), which will mean lower tax receipts and increased competition in manufacturing and agriculture.

(b) Monetary and exchange-rate policy

In 2004, monetary policy was aimed at stemming the loss of international reserves and reducing the pressure on the balance of payments in order to support the fixed exchange-rate system with the United States dollar and improve financial intermediation for production activities. With these aims in mind, the authorities' main policy instrument was the minimum interest rate on deposits, which they calibrated to encourage commercial banks to adjust their lending rates.

In keeping with the growing trend towards monetization of the economy, broad liquidity expanded by 7.4% to BDS$ 4.482 billion (almost 80% of GDP). Savings deposits shot up by 15.2%, while time deposits edged up by a more moderate 4.5%; both increases were in response to a rise in household income.

An upswing in credit was partly thanks to buoyant economic activity, but the main impetus came from public sector demand. Credit to the public sector increased by almost 19% to BDS$ 521 million (16% of GDP), while credit to the private sector slipped down to just under 47% of GDP. This sluggish growth (1.6% between 2001 and 2003) is a cause for concern, particularly as regards the relatively low level of loans to the tourism and agriculture sectors.

The banking system in Barbados has tipically displayed ready liquidity. This apparently reflects the limited number of projects generating demand for the funds available and presumably, the risk-aversion of the system in general. Judging by the considerable dip in the liquid reserves held by the commercial banks in central bank deposits, however, liquidity in the banking system decreased in 2004. As a result, the liquid asset ratio dropped 5.8 percentage points to 14.3%.[1]

There was also a notable slowdown in the growth rate of net international reserves of the banking system, which was 2.8% compared with the high figure of 21.9% recorded in 2003.

The growth of broad liquidity is expected to pick up in 2005, given that lower personal and corporate income tax rates will lead to an increase in deposits. Recent high demand for mortgage loans should trigger a pronounced expansion in credit, which would, in turn, help to reduce liquidity in the banking system. In addition, as well as the sustained climb in international interest rates, domestic rates are expected to rise.

[1] The liquid assets ratio is the amount of cash plus treasury notes held by commercial banks, divided by their total assets.

3. The main variables

(a) Economic activity

The Barbadian economy had slowed down in the wake of the events of 11 September 2001 and their effects on the tourism sector, the country's main engine of growth. Economic activity recovered in 2003 and gained strength to expand by 4.5% in 2004.

The expansion was driven by both the tradable and non-tradable sectors. Tourism climbed healthily for the second year in a row, with a 9.4% increase in value added (compared with 7% in 2003). Tourist activity benefited from an increase of almost 4% in long-stay arrivals thanks to the expansion of flight seating capacity. There was an increase in the number of visitors from the main tourist markets, and the effects of the hurricane that hit Grenada also resulted in higher number of tourists visiting Barbados. In other tradable goods sectors, manufactures grew by 1.6% following the slight contraction recorded in 2003. The decline in food production was offset by encouraging increases in output in the electronics, chemical and non-metallic minerals sectors.

The sector of financial and international business services, which has become increasingly significant over time, expanded during 2004. Between January and November, 327 new licences were issued to offshore enterprises providing services to international companies.

Agriculture is still prey to competitiveness problems, since productivity has stood still in relation to foreign competitors. This is combined with limited research, technological development and innovation, and the failure to attract a sufficient number of young and inventive farmers. With the area under sugar-cane cultivation continuing to shrink, sugar production fell by 5.1% during 2004, in a fourth consecutive year of decline. The non-sugar agriculture and fishing sectors also declined owing to a dip in milk and fish production.

The non-tradable sector reported buoyant activity and posted growth of 4.5%. Most services performed well, including transport, storage, communications, government services and construction. The 3.5% expansion in construction was attributable to new residential buildings and business premises, a major hotel and public projects such as the refurbishment of Grantley Adams International Airport. Strong demand for imports, fuelled a 7% increase in the value added of wholesale and retail trade.

(b) Prices, wages and employment

Inflation (measured by the average retail price index) retreated slightly to stand at 1.4% in 2004, compared with 1.6% in 2003. Increases in the cost of food, medical services and personal care were offset by reductions in the cost of housing, domestic service and household items. Imported inflation remained low thanks to government subsidies, that mitigated the effects of the rise in international oil prices.

Growth had a positive effect on employment. Average unemployment dropped 1.2 percentage points to 9.8% at the end of September 2004 (compared with 11% in 2003). Unemployment fell faster among women (2.2%) than among men (0.7%). Most new jobs were generated in general services, construction, finance and business services.

In 2005, inflation is expected to be 3.2% as a result of higher food prices, and sustained growth should maintain the level of unemployment below 10%.

(c) The external sector

The balance of payments deteriorated considerably in 2004. The overall balance moved from a surplus of 7.0% of GDP in 2003 to a deficit of 6.1% of GDP in 2004. Capital inflows failed to offset the rise in imports (18%), and the current account deficit widened by BDS$ 120 million to stand at an unprecedented 11.4% of GDP. Expenditure on imports of capital goods surged by over 26%, while imports of consumer goods and fuel posted more moderate, but nonetheless considerable, increases. Exports climbed by a significant 11%, but this only partly offset the rise in imports. Sugar exports rose by over 9%, owing to the positive effects of the appreciation of the euro against the United States dollar. Exports of electronic components recorded an increase for the first time since 1999.

Services grew, albeit at a lower rate than in 2003, as a result of higher tourist spending amidst record arrival figures. It is hoped that the competitiveness strategy adopted by the government in association with the private sector will continue to bear fruit in this area.

The capital and financial account surplus shrank considerably to stand at US$ 148 million in 2004, compared with US$ 386 million in 2003 (14.3% and 5.3% of GDP respectively). This result is linked to the lower level of incoming investment due to the completion of private projects, the lack of privatization income (unlike the situation in 2003), and an increase in national banking institutions investing outside the country. This last factor is the result of the Second-Tier Reserve programme, under which the central bank authorized certain banks to invest some of their reserves overseas, on condition that the funds are repatriated upon request.

As a result of the worsening balance-of-payments situation, net international reserves declined by some US$ 170.2 million, after increasing by US$ 188 million in 2003. This was the biggest drop since 1975.

In 2005, the balance of payments is expected to improve, with an overall budgeted deficit of US$ 73.1 million (0.8% of GDP). The current account position is also expected to improve, with the deficit decreasing by 6.5% to stand at 4.5% of GDP, on the back of continued growth in tourist spending and the consequent gains in the services account. At the same time, the financial account surplus is projected to swell with an upturn in private investment flows.

Belize

1. General trends

The economy of Belize grew more moderately than the previous year, slowing from 9% to 4.2%. Activity was boosted by a significant increase in tourism, buoyancy in construction and manufacturing, and productivity gains in the primary sector, while basic and non-tourist services showed a less satisfactory performance.

The expansion of economic activity and the implementation of tax measures resulted in an increase in tax collection. There was also a policy of restricting capital spending and reducing the central government deficit, in accordance with the fiscal targets set by the authorities.

The budget deficit was financed with external and domestic resources, thereby expanding the country's public debt from 89% of GDP in 2003 to 93% in 2004.

In contrast to fiscal policy, monetary policy was openly expansionary for most of the year. It was based on the expansion of net domestic credit, both public and private, which increased the liquidity in the financial system.

The external sector posted a deficit of US$ 31 million, owing to a decline in the capital and financial account surplus, which was thus insufficient to finance the current account deficit, and the economy's international reserves were eroded as a result. The capital and financial account result was due to a contraction of foreign direct investment flows.

In 2005 the authorities plan to keep policy tight in both the fiscal and monetary domains. This policy, which should bring the fiscal deficit down to 2.8% of GDP, is aimed at curbing growth in demand and avoiding a further deterioration in the country's external position, based on increases in taxes and in the commercial bank legal reserve requirements. The authorities consider that this should not affect the growth target of over 3% per year.

2. Economic policy

(a) Fiscal policy

The central government reduced its fiscal deficit from 6.5% of GDP in 2003 to 4.2% in 2004, thanks to a cutback in capital spending and the higher level of tax collection. The significant increase in official grants from the Chinese Province of Taiwan, up from 6 million Belize dollars in 2003 to 35 million Belize dollars in 2004, gave the authorities more room for manoeuvre. The deficit was financed from domestic resources, in particular commercial bank credit, and external resources. Consequently, the total external debt balance grew from 76% of GDP in 2003 to 79% in 2004.

Capital spending went from 4.5% of GDP in 2003 to 2.8% in 2004 in the case of capital II expenditure, and from 5% to 4.1% over the same period in the case of capital III expenditure.[1] The effect of this on the overall fiscal balance was partially offset by the government's expansionary stance on spending (19.9% and 22.1% of GDP in 2003 and 2004 respectively).

[1] In the fiscal accounts, capital spending is subdivided into capital II and capital III. The first of these items is financed from domestic resources and the second from external funds.

Table 1
BELIZE: MAIN ECONOMIC INDICATORS

	1996	1997	1998	1999	2000	2001	2002	2003	2004 [a]
	Annual growth rates [b]								
Gross domestic product	1.5	3.6	3.7	8.8	12.3	5.0	4.2	9.0	4.2
Per capita gross domestic product	-1.2	1.0	1.2	6.2	9.7	2.6	1.9	6.7	2.1
Gross domestic product, by sector									
Agriculture, livestock, hunting, forestry and fishing	7.1	6.7	2.2	10.7	11.1	-0.3	0.9	38.7	9.6
Mining	-4.2	-2.9	3.0	7.4	23.3	3.3	-5.4	0.0	...
Manufacturing	-0.3	4.2	-3.8	6.5	24.2	-0.7	1.5	-0.4	9.0 [c]
Electricity, gas and water	-5.5	4.7	1.3	8.2	9.9	0.4	2.3	8.4	-5.5
Construction	-2.1	-5.4	-2.3	16.6	38.9	-1.7	5.2	-13.7	15.3
Commerce, restaurants and hotels	3.6	5.3	8.6	9.8	11.9	8.7	3.7	5.6	4.5
Transport and communications	4.5	5.8	5.3	11.9	12.5	11.8	11.2	3.0	3.9
Financial institutions and insurance	-3.8	3.1	3.8	13.0	12.2	7.3	10.5	10.2	21.9 [d]
Other services	1.9	0.9	3.5	1.1	4.6	4.2	2.3	4.1	...
Gross domestic product, by type of expenditure									
Consumption	1.7	2.7	5.9	6.8	7.7	9.5	7.1	3.8	3.9
General government	2.1	4.0	2.1	-2.4	7.3	5.9	12.0	4.3	0.3
Private	1.6	2.4	6.7	8.6	7.8	10.1	6.3	3.7	4.5
Gross domestic investment	-3.5	0.4	-1.4	34.7	46.5	-18.5	2.3	-25.6	-2.0
Exports (goods and services)	5.3	13.2	5.1	13.0	7.2	6.9	9.4	20.3	-1.3
Imports (goods and services)	5.5	12.1	10.4	24.6	20.1	0.2	3.8	2.3	-7.4
	Millions of dollars								
Balance of payments									
Current account balance	-7	-32	-60	-78	-139	-185	-163	-207	-187
Merchandise trade balance	-58	-90	-105	-124	-191	-214	-190	-207	-182
Exports, f.o.b.	171	193	186	213	212	275	310	316	299
Imports, f.o.b.	230	283	291	337	404	489	500	523	481
Services trade balance	47	46	41	53	53	53	53	40	53
Income balance	-26	-23	-32	-44	-54	-72	-72	-86	-111
Net current transfers	31	35	36	37	53	48	46	45	52
Capital and financial balance [e]	27	33	46	90	96	181	155	177	...
Net foreign direct investment	11	8	13	47	18	60	25	28	...
Financial capital [f]	16	25	33	43	78	122	130	142	...
Overall balance	21	1	-14	13	-43	-3	-8	-30	...
Variation in reserve assets [g]	-21	-1	14	-27	-52	3	5	...	...
Other financing [h]	0	0	0	16	95	0	3	...	...
Other external-sector indicators									
Gross external public debt (millions of dollars)	…	…	260	252	434	487	575	750	841
Gross external public debt (percentage of GDP)	…	…	37.8	34.5	52.1	56.1	62.0	75.8	79.0
	Average annual rates								
Employment									
Open unemployment rate [i]	13.8	12.7	14.3	12.8	11.1	9.1	10.0	12.9	11.6
	Annual percentages								
Prices									
Variation in consumer prices (December-December)	6.4	1.0	-0.8	-1.2	0.6	1.1	2.3	2.6	3.1
Nominal deposit rate [j]	6.5	6.6	6.4	5.8	5.4	4.4	4.3	4.8	...
Nominal lending rate [k]	16.3	16.3	16.5	16.3	16.0	15.5	14.8	14.4	...
	Percentages of GDP								
Central government									
Current income	...	...	...	...	...	...	...	21.4	21.8
Current expenditure	...	...	...	...	...	...	...	19.9	22.1
Current balance	2.9	2.8	2.1	2.0	1.5	1.6	3.2	1.5	-0.3
Net capital expenditure [l]	-0.6	-0.6	-0.4	-3.6	0.0	-1.2	0.7	8.0	4.0
Overall balance [m]	7.8	7.4	8.5	13.1	14.0	15.5	14.9	6.5	4.2
Money and credit									
Domestic credit	49.7	53.7	44.5	47.0	45.6	50.7	51.4	57.2	63.8
To the public sector	3.5	2.4	1.6	2.7	3.7	4.0	3.2	5.7	10.5
To the private sector	46.1	51.3	42.9	44.3	41.9	46.6	31.9	51.5	53.3
Currency in circulation and local-currency deposits (M2)	61.4	68.0	55.7	57.4	58.1	60.0	57.4	55.7	58.9

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.
[a] Preliminary figures. [b] Based on figures in local currency at constant 2000 prices. [c] Includes mining. [d] Includes community, social and personal services. [e] Includes errors and omissions. [f] Refers to the capital and financial balance (including errors and omissions), minus net foreign direct investment. [g] A minus sign (-) denotes an increase in reserves. [h] Includes the use of IMF credit and loans and exceptional financing. [i] Unemployment rate as a percentage of the economically active population. Nationwide total. [j] Saving rate. [k] Weighted average rate for loans. [l] Includes grants. [m] Includes interest.

Current spending reflected, in turn, interest payments on public debt, which accounted for half of the total. There were also rises in payroll (11.4%), retirement and other pension payments (16.5%) and subsidies (15.8%).

Total income (22.9% and 24.7% of GDP in 2003 and 2004, respectively) reflected the impact on current income of hikes in the rate of sales tax, utility rates and the business tax on commercial property rentals. Higher revenues from taxes on income and profits, as well as international transactions, also contributed to the overall income balance. In contrast, non-tax income decreased.

The data available on budget year 2005 show central government spending for the year apparently growing more rapidly than income. Nevertheless the authorities expect the policy of public spending cuts, especially in capital spending, together with the higher level of tax collection, to bring an improvement in the fiscal situation. The performance of tax collection will mainly depend on the economic growth projected.

(b) Monetary and exchange-rate policies

In 2004, the authorities adopted a monetary policy which was based on expanding total net domestic credit (from 57% of GDP in 2003 to 64% in 2004), particularly commercial bank credit extended to the central government at preferential interest rates. Domestic credit to the private sector remained at levels close to the previous year, and external assets contracted. Credit to the private sector went mainly to the real estate and tourism segments (56% of the total), private services and commercial and residential construction projects (40%).

Movements in net external assets reflected the central bank's foreign-currency sales to the government for external debt payment. This was more than sufficient to counter inflows from loans, exports of traditional products (especially sugar) and the sale of investments by the Social Security Board of Belize. Consequently, the stock of international reserves diminished from US$ 85 million to US$ 53 million, which resulted in a drop in the coverage rate from 2.1 months of imports in 2003 to 1.3 months in 2004.

In order to counteract the effects on prices and exchange-rate stability of the increased monetary liquidity that resulted from the operations of the Social Security Board, at the end of the year the central bank raised the legal reserve requirement from 19% to 20% for liquid assets and from 6% to 7% for cash reserves.

Be this as it may, monetary aggregates expanded in both 2004 and 2005: by 1% and 13%, respectively, in the case of narrow money, and by 4% and 13%, respectively, in the case of broad money. Liquid assets in the commercial banks rose beyond the statutory requirement (to 20% in 2003 and 36% in 2004).

The excess liquidity did not bring down commercial bank interest rates, which were similar to those of the previous year (the weighted rate of commercial bank loans was 14% in real terms). The information available for the first quarter of 2005 indicates a consolidation of these trends, which will force the authorities to shift their monetary policy stance.

3. The main variables

(a) Economic activity

Economic activity grew by 4.2%, driven by rapid growth in tourism (17%), construction (15%) and agriculture (9.6%). Growth is expected to exceed 3% in 2005, thanks to a good performance by the agricultural sector and the continued expansion of tourist services.

Growth in the agricultural sector will depend on a number of factors. These include favourable weather conditions for sugar cultivation, as well as improvements in productivity and distribution. In the case of bananas, in addition to enhanced productivity and broader access to financing, the area under cultivation has been expanded. Citrus production made a good recovery from the effects of hurricane Iris, which had been felt over the past two years. In 2005, the sector will probably turn in a growth rate of 10%, thanks to productivity gains and better promotion strategies.

The manufacturing sector recovered from a contraction of 0.4% in 2003 to post an expansion of 9% (including mining) in 2004 as the result of growth in production capacity and yields. These factors resulted in an increase in sugar extraction (that is, a lower ratio of sugarcane volume to volume of sugar produced, from 10.28 tons of cane per ton of sugar in 2003 to 9.87 in 2004), and in citrus production. Rises in the production of alcoholic (38%) and non-alcoholic (1.2%) beverages also contributed, albeit to a lesser extent. An uneven performance is projected in 2005, as sugar extraction will probably diminish owing to poor weather conditions in the first half of the year. In contrast, citrus fruit will show an expansion because of a rise in international prices.

The buoyant performance of the construction sector, which moved from a setback of 14% in 2003 to an expansion of 15% in 2004, was the result of the implementation of a series of infrastructure projects, including a hydroelectric plant, two new casinos and a number of commercial and residential buildings. In 2005, construction will be negatively affected by the policy of fiscal austerity, while projects financed from external resources will have a positive impact.

Tourism maintained its growth trajectory on the back of cruise-ship arrivals. The number of arrivals increased apace to 766,000, representing a 50% expansion. Long-stay tourist arrivals rose by 5%, to reach 219,657. In the first quarter of 2005, the number of cruise passengers and long-stay visitors rose by 15% and 2%, respectively, in relation to the same period of the previous year.

The rise in average hotel rates, from 167.41 to 186.85 Belize dollars between 2003 and 2004, and in the number of rooms available brought an increase in total spending by overseas visitors, from 15.8% to 16.3% of GDP for those years.

In 2005 moderate growth is projected for tourism. The flow of long-stay tourists should increase by 5% and cruise visitors by 10%.

(b) Prices, employment and wages

The inflation rate rose slightly (by 2.6% and 3.1% in 2003 and 2004, respectively), in response to rises in international petroleum prices, in the rates on sales tax and the business tax on commercial property rentals, and in water utility rates.

With regard to the components of the price index, the main drivers of inflation were transport and communications (5.5%), public services (5.3%) and food and beverages (2.5%).

In 2005, the tight policy measures planned may slow the rate of inflation, but higher taxes will probably be reflected in price increases.

The reduction in the unemployment rate from 12.9% in 2003 to 11.6% in 2004 is attributable to the rapid creation of new jobs in the services sector, in particular tourism and other services, and to the recovery of agriculture and manufacturing.

(c) The external sector

The overall balance was negative to the tune of US$ 31 million, given that the current account deficit, which was equivalent to 16.7% of GDP, exceeded the 13.9% surplus on the capital and financial account. In consequence, reserve assets declined.

At 16% of GDP, the current account deficit was smaller than the figure of 18.3% recorded in 2003, thanks to the narrowing of the trade deficit (from 21.1% of GDP in 2003 to 16.2% in 2004) and an expansion in the services account surplus. The trade balance reflected a contraction in imports (estimated at 10% of GDP), more specifically, in external purchases of food and transport machinery and equipment, as well as smaller demand for goods imported for the export processing zones.

Exports were down because the drop in free-zone exports outweighed an increase in external sales of national products. The performance of national exports is related to the high growth in agricultural production, despite the drop in international prices of some products. Free-zone exports were affected by the higher level of customs controls and preferential prices for the sale of gasoline in the Mexican border down of Chetumal.

The surplus on the services balance, which went from 4% of GDP in 2003 to 5% in 2004, again showed vigorous growth as a result of the increase in the travel component (US$ 73 million and US$ 92 million in 2003 and 2004, respectively). In contrast, the components of transport and other goods and services showed net outflows of US$ 17 million and US$ 22 million, respectively.

Unilateral transfers, which amounted to US$ 45 million and US$ 52 million in 2003 and 2004, respectively, reflected an increase in official grants, since remittances showed a decline of US$ 4 million.

The capital and financial account surplus was basically the result of net direct foreign investment flows, which amounted to US$ 145 million in 2004. Investments went mainly to the tourist industry, the real estate sector and the purchase of equity in state enterprises. Albeit to a lesser degree, this surplus also reflected the implementation of external debt forgiveness programmes by Europe and the United States, for an amount of US$ 4 million.

The authorities project a narrowing of the external deficit, thanks to the tight policy measures announced, as well as the improvements expected in export performance. This second factor will reflect rises in productivity in the traditional sectors (including fishing), an increase in the area under cultivation for some agricultural products, and better financing conditions. The authorities consider that the increase in administrative efficiency, more intensive use of inputs, and favourable international prices for citrus fruits and some other products will help to achieve the projected result.

Cuba

1. General trends

In 2004, GDP increased by 3% and, despite adverse circumstances, the balance-of-payments current account posted a surplus after decades of negative external balances. This was driven by a 21% rise in exports of goods and services, mainly of nickel and tourist and professional services, as well as public services. The country suffered the worst drought in 100 years and the onslaught of two hurricanes, Charley and Ivan. The hurricanes caused damage that required contingency public transfers of the order of US$ 3 billion (8.8% of GDP). This was compounded by a crisis in the country's electric power system and the tightening of the economic embargo, which increased restrictions on remittances and travel to Cuba and put pressure on foreign banks, thus encumbering the country's external financial flows.

In November 2004 the United States dollar was withdrawn from cash circulation and replaced by the convertible Cuban peso (CUC). As of 18 March 2005, the exchange rate in the parallel market was set at 24 non-convertible Cuban pesos (CUP) per convertible peso or United States dollar for personal transactions, while the official rate remained at one to one.

The Cuban economy grew by about 6% in the first quarter of 2005. The year is expected to end with a 5% increase in output, driven by a greater availability of foreign currency thanks to the increased value of nickel exports and rapid growth in tourist services. Terms of trade are likely to be further eroded, however, by higher international prices for crude petroleum and foodstuffs.

2. Economic policy

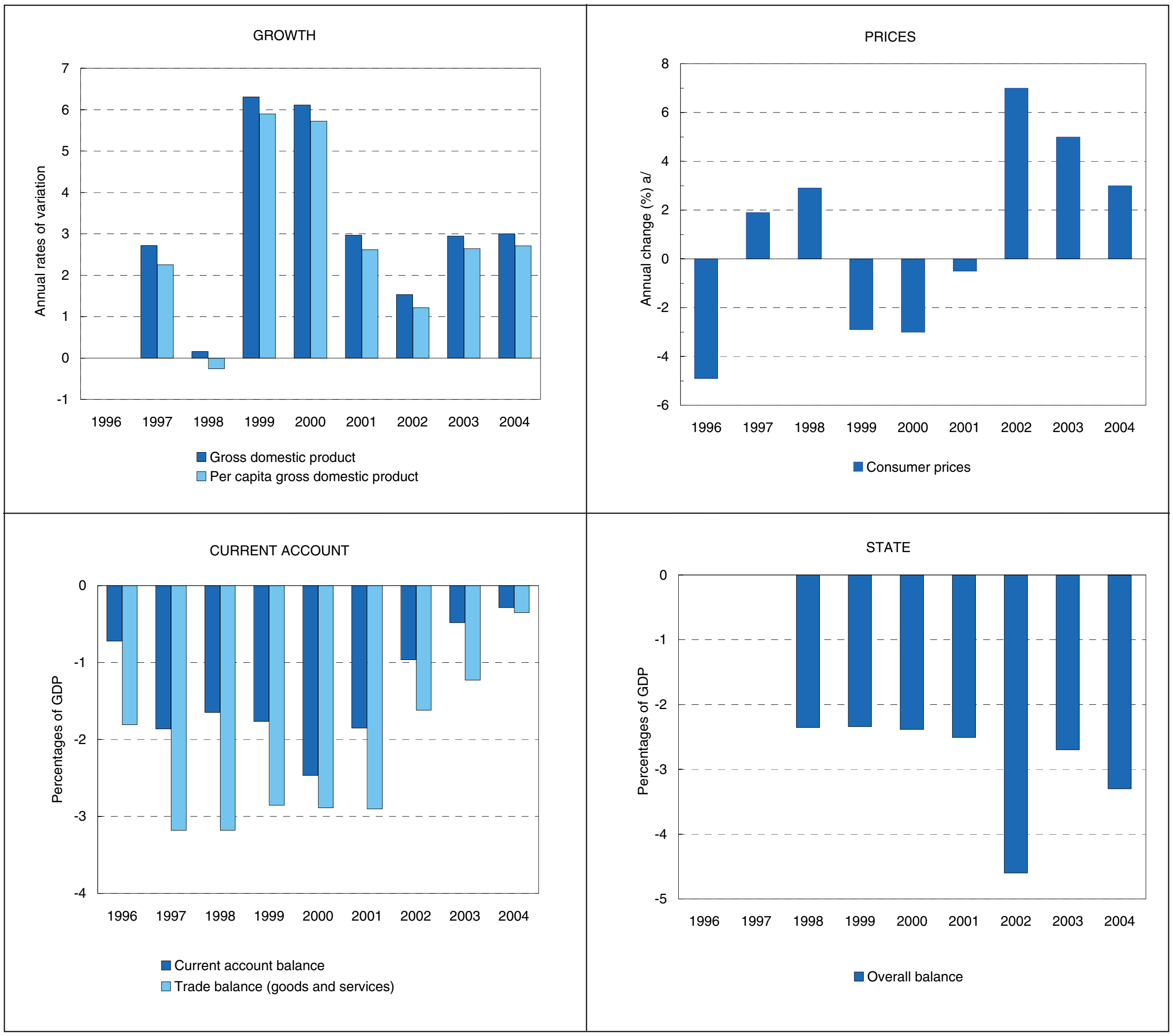
(a) Fiscal policy

The fiscal deficit (4.2% of GDP, compared to 3.3% in 2003) exceeded the 3.5% limit established in the framework of economic policy. Accordingly, the State Council authorized the financing of the deficit by the Central Bank of Cuba (BCC), as no public credit system exists in the country. Usually, the commercial banks buy public debt and the central bank repurchases it to regulate the level of monetary liquidity in the economy.

The larger fiscal deficit reflected the fact that the rise in expenditure (12.4%) exceeded income growth (11.2%); current income expanded by 11.8%, while capital income declined by 8.4%. Within current income, non-tax revenue rose faster than tax revenue (40.4% and 3.5 %, respectively).

The increase in tax income reflected higher revenues from both direct and indirect taxes (7.3% and 0.9%, respectively). Receipts from circulation and sales taxes showed an increase of 0.9% apiece and revenue from

Figure 1
CUBA: MAIN ECONOMIC INDICATORS



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

service taxes was up 1%. Social security contributions also expanded (10.4%), owing to the greater number of workers included in the corporate development programme and a rise in the tax rate (12.6% instead of the 12% rate in place up to the previous year). Profit tax revenues also rose (5.9%), thanks to growth in economic activity.

With regard to spending, there was a higher increase in capital spending (17%) than in current spending (11.8%). This reflects increased investment in social services, especially education, health, and sports and culture, as well as resources channelled to the agricultural sector in response to the adverse natural phenomena mentioned above. Current disbursements included financing for the expansion of social programmes.

There was also an increase in transfers to State enterprises and to private producers (8.9%), mainly in agricultural activities, the sugarcane segment and construction, owing to drought and hurricane damage. Expenditure on defence and public order rose (6.5%), in connection with the worsening of the dispute with the United States.

(b) Monetary and exchange-rate policies

As of 15 November 2004, the circulation of United States dollars in cash was prohibited. The main provisions of the measure were as follows:

(i) Individuals may hold unlimited foreign currency and their bank deposits are not affected. A grace period of three weeks was allowed for individuals to change dollars in their possession into convertible Cuban pesos free of commission. The central bank secures existing personal bank accounts in United States dollars. Unlimited withdrawals may be made in dollars or convertible pesos, as preferred, at the official rate of one to one, without tax.

(ii) All individuals, including foreign visitors, must pay a 10% commission to exchange cash dollars for Cuban pesos (whether CUC or CUP). This commission is intended to cover the costs of depreciation of the dollar and the risks inherent in handling it. This charge is not applicable to other foreign currencies or to transactions with credit or debit cards accepted on the island.

(iii) Transactions in hard-currency shops are to be conducted in convertible Cuban pesos, euros, Canadian dollars, Swiss francs and pounds sterling according to the exchange rate on the international market. In practice, convertible Cuban pesos will be floated on the market.

This reform, which was planned five years in advance, is intended to restore the management of monetary policy and the benefits of seigniorage to the central bank which has, it may be noted, scrupulously observed savers' existing contracts with the banking system. Lastly, the measures described apply only to the national territory, and therefore do not affect the operation of foreign enterprises which have business in the country, nor do they limit the use of credit and debit cards, which means there is little negative impact on international tourism.

Liquidity in non-convertible Cuban pesos (M2) rose by 7.4% as a result of a greater increase in fixed-term deposits (33.3%) in relation to M1 (4.6%). Within M1, cash in circulation expanded by 11.3% and regular savings accounts deposits decreased by 3.8%. Of the funds in the banking system's 4.8 million savings accounts, 37% were placed in deposits for terms of between 3 and 36 months, although there were no changes in interest rates. A significant part of those deposits correspond to own-account workers and small farmers.

(c) Other policies

Generally speaking, production management became more centralized, since enterprises operating in foreign currency have to buy it from the banking system after substantiating their purchase.

The public sector's foreign-currency income, including contributions, taxes, receipts and other revenues, are now deposited in a single account for foreign-currency income in the central bank, which has tightened control over the allocation of foreign currency.

Fresh restrictions were imposed on the legal exercise of own-account work in 2004, since it was limited 118 activities. A further 40 previously authorized activities were brought within the public sector. Private self-employment is construed only as a complement to State activity in the production of goods and services for the population.

3. The main variables

(a) Economic activity

In 2004, external demand grew much faster than domestic demand (11% and 2.1%, respectively). At 8%, growth in investment exceeded the 1.3% increase in consumption, and public consumption outstripped private, at 4% and 0.5%, respectively. Gross domestic investment, which amounted to 11.3% of GDP, is still below the average of the 1980s, and therefore needs to be increased. Investment is needed particularly in housing, transport, and water and electricity, which have borne the brunt of shortfalls in capital formation.

Imports of goods and services grew by 6%, above the rate of GDP (3%), in view of the structural traits of the Cuban economy, whose production system requires voluminous imports of natural resources, materials, fuel, energy resources and foods. Difficulties also arose in connection with the electricity crisis and the downturn in petroleum extraction.

The fastest-growing sectors were construction (11.2%), international tourism (10%) and public services (6.3%). Expansion in construction reflected hurricane repair work, housing construction and other projects.

International tourism was boosted by improved international promotion efforts. The government attempted

Table 1

CUBA: MAIN ECONOMIC INDICATORS

	1996	1997	1998	1999	2000	2001	2002	2003	2004 [a]
	Annual growth rates [b]								
Gross domestic product	...	2.7	0.2	6.3	6.1	3.0	1.5	2.9	3.0
Per capita gross domestic product	...	2.3	-0.3	5.9	5.7	2.6	1.2	2.6	2.7
Gross domestic product, by sector									
Agriculture, livestock, hunting, forestry and fishing	...	2.3	-14.1	11.6	9.1	0.9	-2.5	2.4	1.0
Mining	...	2.8	-11.7	2.7	33.2	-3.6	12.6	1.7	1.9
Manufacturing	...	6.2	-8.1	7.2	5.1	-0.6	0.1	-2.0	-2.0
Electricity, gas and water	...	7.0	3.7	8.1	12.8	1.1	2.4	3.1	-0.9
Construction	...	3.0	-2.6	7.5	8.4	-5.3	-2.4	4.4	11.2
Wholesale and retail commerce, restaurants and hotels	...	-0.2	5.8	0.7	7.6	4.4	2.0	5.0	2.0
Transport, storage and communications	...	3.1	15.6	17.6	5.0	8.4	0.0	2.7	5.0
Financial institutions, insurance, real estate and business services	...	1.7	5.1	12.7	0.9	5.4	1.2	0.2	3.0
Community, social and personal services	...	3.6	0.2	4.7	3.5	5.5	4.8	4.9	6.3
Gross domestic product, by type of expenditure									
Consumption	...	2.3	1.5	5.1	2.3	3.4	3.0	5.8	4.5
General government	...	2.3	0.1	5.2	2.9	2.2	5.8	4.5	4.0
Private	...	2.3	1.9	5.1	2.1	3.8	2.1	6.2	0.5
Gross domestic investment	...	7.6	-11.0	0.5	11.3	0.8	-10.8	-9.7	8.0
Exports (goods and services)	...	-4.9	5.8	12.8	14.1	-3.6	-3.8	5.8	11.0
Imports (goods and services)	...	-1.9	1.4	2.4	-0.2	-3.8	-7.3	12.1	6.0
	Percentages of GDP								
Investment and saving [c]									
Gross domestic investment	17.2	16.2	14.3	12.9	13.5	12.3	10.1	9.4	9.3
National saving	16.5	14.3	12.6	11.1	11.1	10.4	9.2	9.0	9.8
External saving	0.7	1.9	1.7	1.8	2.5	1.9	0.9	0.4	-0.5
	Millions of dollars								
Balance of payments									
Current account balance	-167	-437	-392	-462	-696	-547	-277	-132	176
Merchandise trade balance	-1 790	-2 265	-2 689	-2 909	-3 120	-3 171	-2 707	-2 947	-3 063
Exports, f.o.b.	1 866	1 823	1 540	1 456	1 675	1 622	1 422	1 678	2 223
Imports, f.o.b.	3 657	4 088	4 229	4 365	4 796	4 793	4 129	4 625	5 286
Services trade balance	1 372	1 519	1 932	2 163	2 306	2 313	2 211	2 550	2 940
Income balance	-493	-483	-449	-514	-622	-502	-600	-650	-800
Net current transfers	744	792	813	799	740	813	820	915	1 100
Capital and financial balance [d]	174	457	409	485	805	595	300	200	800
Net foreign direct investment	82	442	207	178	448	39	0	0	0
Financial capital [e]	92	15	203	307	357	556	300	200	800
Overall balance	8	21	17	23	109	47	23	68	976
Variation in reserve assets [f]	-8	-21	-17	-23	-109	-47	-23	-68	-976
Other external-sector indicators									
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)	19.20	23.00	21.00	20.00	21.00	26.00	26.00	26.00	26.00
Terms of trade for goods (index: 2000=100)	136.1	131.2	126.3	115.6	100.0	103.5	103.5	110.2	109.1
Gross external public debt (millions of dollars) [g]	10 465	10 146	11 209	11 078	10 961	10 893	10 900	11 300	12 000
Gross external public debt (percentage of GDP) [g]	45.3	43.3	47.1	42.4	38.9	36.9	35.5	34.1	35.5
	Average annual rates								
Employment									
Unemployment rate [h]	7.6	7.0	6.6	6.0	5.5	4.1	3.3	2.3	2.0
	Annual percentages								
Prices									
Variation in consumer prices [i] (December-December)	-4.9	1.9	2.9	-2.9	-3.0	-0.5	7.0	-1.0	3.0

Table 1 (concluded)

	1996	1997	1998	1999	2000	2001	2002	2003	2004 [a]
				Percentages of GDP					
State income and expenditure									
Current income	...	...	...	...	51.7	50.0	51.5	54.8	58.6
Current expenditure	...	...	...	...	56.2	53.4	56.2	51.1	54.7
Current balance	...	...	...	...	-4.4	-3.5	-4.7	3.7	3.9
Fiscal balance	...	...	...	...	-9.5	-9.3	-9.8	-3.3	-4.2
Liquidity									
Currency in circulation	...	...	...	...	17.9	21.7	22.6	20.6	21.8
M1	...	...	...	...	37.3	38.5	41.1	37.1	37.1
M2	...	...	...	...	39.9	41.8	44.5	41.7	43.0

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures, and *Cuba: evolución económica durante 2000* (LC/MEX/L.525), Mexico City.

[a] Preliminary figures. [b] Based on figures in local currency at constant 1997 prices. [c] Based on figures in local currency expressed in dollars at current prices. [d] Includes errors and omissions. [e] Refers to the capital and financial balance (including errors and omissions), minus net foreign direct investment. [f] A minus sign (-) denotes an increase in reserves. [g] Calculated using the official exchange rate of 1 peso to the dollar. [h] Unemployment rate as a percentage of the economically active population; nationwide total. [i] Local-currency markets.

to take advantage of adverse conditions in other destinations, such as outbreaks of severe acute respiratory syndrome (SARS) and avian flu in South-East Asia, armed conflicts in the Middle East, and the onslaught of hurricanes in the Caribbean, for which Cuba is better prepared. Room availability was expanded by 8.2% to 45,000 units and occupancy levels rose, while tourists also lengthened their average stay.

Both the manufacturing industry and electricity, gas and water services contracted (by 2% and 0.9%, respectively). The energy sector was also affected by a 2.5% decline in crude petroleum extraction, since no new oilfields have been discovered since 1999, which has pushed up imports of petroleum and petroleum products in the last few years. In contrast, gas extraction grew by 7.2% in 2004. The downturn in manufacturing is attributable mainly to the crisis in the sugar industry.

The expansion of the agricultural sector slowed by 1%, basically because of weather-related problems, including a drought and two hurricanes. Sugar farming picked up again, but the fishing sector slipped back. In mining, there was an increase in nickel production.

(b) Prices, wages and employment

In the local-currency markets, the consumer price index rose but remained in single digits (3%). Regulated prices remained unchanged, while informal market prices rose as a result of the dip in supply caused by the drought. In particular, tomatoes, sweet potatoes, beans and rice became much more expensive, while the prices of onions and oranges fell.

At the beginning of 2004 convertible peso prices and rates were cut for transactions among State firms, in order to improve hard-currency billing and payments. In May of that year, however, the authorities raised consumer prices on articles sold in hard-currency shops. The rise averaged about 15%: 10% in the case of food items, toiletries, cleaning products, children's footwear, cosmetics, home appliances, furniture and mattresses; between 12% and 20% for adults' clothing and footwear and sports articles; and between 5% and 22% for fuel.

The substantial hike in international petroleum prices was passed through not only to the hard-currency markets, but also to some in local currency —including the agricultural market and private own-account employment, which is regulated by the ratio of supply to demand— which nudged up inflation. The State budget subsidized the impact of this on regulated markets and utilities such as electricity, gas and water, so that it was not passed on to consumers.

In 2004, 35% of the total workforce (1,447,582 workers) benefited from the implementation of payment systems based on production results, representing wage rises of 70 Cuban pesos as a monthly average. A further 26% of workers (1,075,236 individuals) benefited from incentive systems in convertible pesos, based on special financing of US$ 107.6 million for stimulating priority activities, while wages in Cuban pesos were raised by 30% in about 500 business units as part of the programme to improve business practices. Overall, the average wage showed an increase of 3.3% which was, in any case, insufficient to compensate for the price rises in the free markets.

The authorities are gradually implementing a wage system reform to take into account workers' training, qualifications and knowledge, as well as their actual performance. The idea is to stimulate productivity increases and enhance other efficiency indicators; employ economically and socially determined wage bonuses for workers in priority activities, territories and entities; and to have the pay system reward exceptional and significant contributions to national production.

Lastly, the unemployment rate declined from 2.3% in 2003 to 2% in 2004.

(c) The external sector

The balance-of-payments current account balance turned positive, by US$ 176 million, or the equivalent of 0.5% of GDP. This reflected higher growth in exports of goods and services (21%) in relation to imports (14%), as well as a 20% increase in current transfers, although net factor service payments expanded by almost 23%.

Accordingly, the trade deficit narrowed decisively in 2004, despite the steep rise in international petroleum prices. Nevertheless, even though the prices of Cuba's export commodities (especially nickel) increased, its terms of trade were eroded in view of the significant price rises for energy resources and foodstuffs.

The higher value of imports was due mainly to increases in the oil bill, of 75% or US$ 1.5 billion, and to an increase of 19%, or US$ 1.2 billion, in the bill for foodstuffs. One third of the foods bought abroad, or US$ 400 million, came from the United States, compared to US$ 345 million the previous year.

The value of external sales of nickel and cobalt amounted to US$ 500 million (23% of the total value of goods exports). Nickel has become consolidated as the leading traditional export product, having displaced sugar for a number of years running in terms of foreign currency generation.

Exports of non-traditional products continued to expand, particularly sectors with high value added, including biotechnology, pharmaceutical products and genetic engineering.

With regard to foreign direct investment, the number of joint ventures declined from 342 in 2003 to 313 in 2004 but, importantly, their net profits increased from US$ 150 million to US$ 200 million over the same period.

Dominican Republic

1. General trends

The economy of the Dominican Republic grew by 2% in 2004, which reversed the contraction of 1.9% in 2003 and exceeded expectations formed early in the year. The export sector turned in a positive, although moderate, performance as tourist arrivals and exports of local goods increased, while free zone activity was virtually stagnant. Family remittances also grew (6.8%), reaching the equivalent of 12% of GDP. Domestic demand, in contrast, continued to suffer the consequences of the banking crisis in 2003. Consumption edged up gradually and investment slipped back for the second year running.

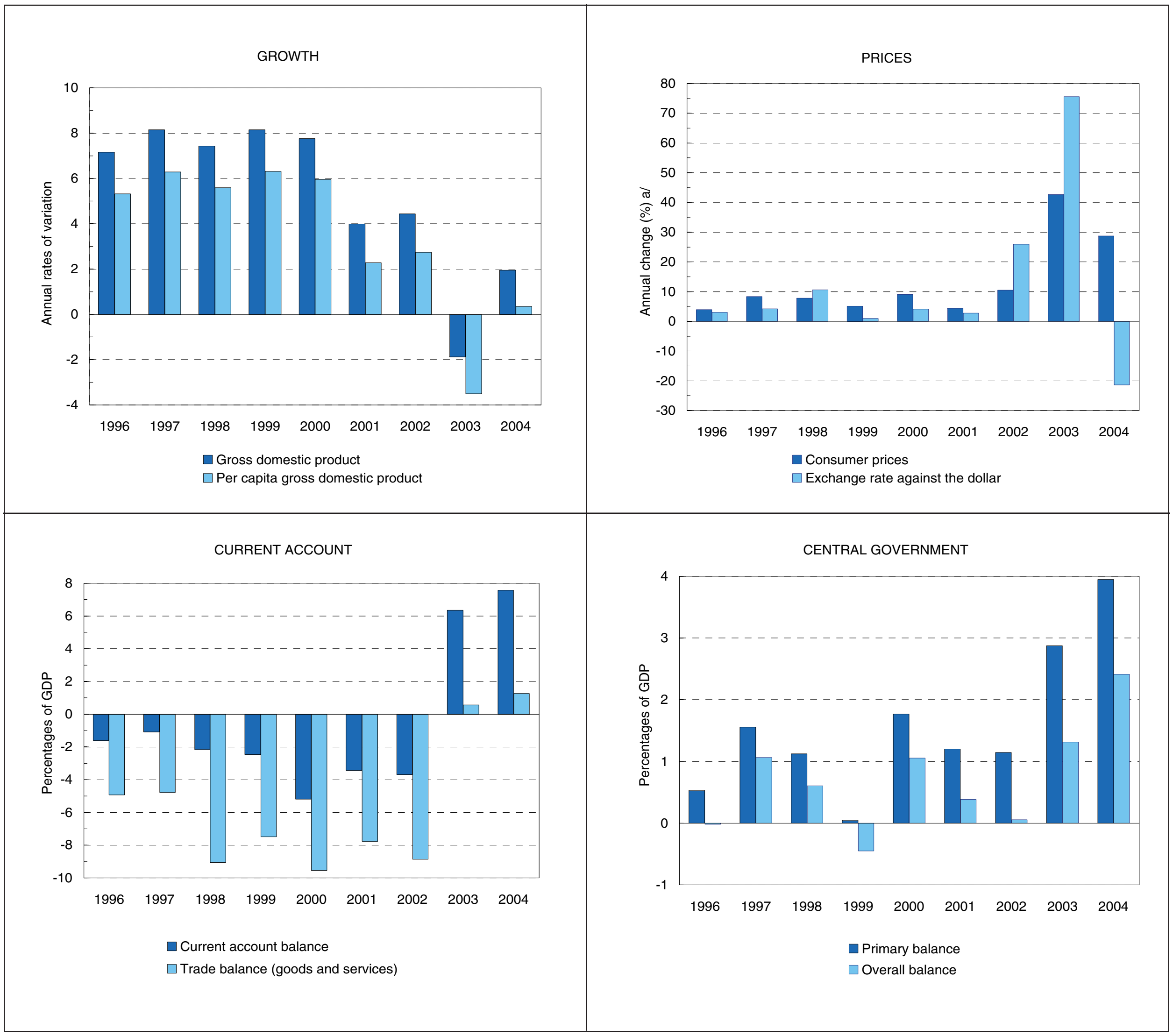
In the second half of the year, after the presidential elections and the adoption of a drastic stabilization programme, the depreciation of the nominal exchange rate (21% from December to December) was reversed, inflation decreased (28.7% over the same period), despite high international petroleum prices, and interest rates on central bank investment certificates dropped from almost 60% at mid-year to 25.4% in December. All of these factors contributed to the recovery of a number of sectors of production.

The overall public sector deficit remained high (6.7% of GDP), however, including the large quasi-fiscal deficit of the central bank (4% of GDP). Arrears built up in external debt servicing, due partly to renegotiation of liabilities owned to the Paris Club. The balance-of-payments current account recorded a surplus (7.4% of GDP) for the second consecutive year, and international reserves began to recover from meagre levels, after two years of capital flight. The country’s agreement with the International Monetary Fund was reviewed in the early months of 2005, which helped to reduce uncertainty.

In 2004 unemployment and underemployment in informal activities increased and real wages shrank for the third year running. At the end of the year, hurricane Jean caused substantial damage to infrastructure.

In 2005 significant progress should be made with regard to macroeconomic stabilization and economic growth is expected to be between 2% and 2.5%, driven by increased family remittances, external demand (especially for tourism) and, to a lesser extent, the free zones. Stabilization of the exchange rate will be crucial for keeping inflation low. Prices are expected to rise between 11% and 13% from December to December, and the current account is likely to record another surplus, equivalent to 1.8% of GDP. International reserves will increase.

Figure 1
DOMINICAN REPUBLIC: MAIN ECONOMIC INDICATORS



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

2. Economic policy

The new government entering office in August adopted drastic fiscal and monetary measures, and improved coordination of both areas. The stabilization of prices and of the foreign-exchange and financial markets, which had become more volatile at mid-year, meant reducing the high consolidated public-sector deficit, which was mainly attributable to the quasi-fiscal deficit of the central bank, and absorbing the considerable liquidity resulting from the massive support given to banks which had undergone intervention. The agreement with the International Monetary Fund (IMF), which had been suspended for several months, was renewed, and a fiscal reform was put in place in September. In January 2005 the economic targets and reforms agreed upon with IMF were redefined.

(a) Fiscal policy

The non-financial public sector deficit reached 2.8% of GDP, missing the target of 0.2% surplus established in the agreement with IMF, and the quasi-fiscal deficit came in at 4%. The central government recorded a deficit of almost 3% of GDP on an accrual basis in 2004, compared to 3.8% in 2003. In cash terms, however, it had a surplus of 2.4% of GDP, compared to 1.3% in 2003, owing to the accumulation of arrears in debt servicing.

Central government income was 4% higher in real terms, after falling by 6.4% the previous year. Indirect tax revenue expanded (4.3%), thanks to special taxes established at the beginning of the year and the tax reform implemented in October. Tax income from foreign trade increased by 39.8%, owing mainly to the taxes and surcharges applied.

Revenue from the industrialized goods and services transfer tax (ITBIS) was 2.3% higher in real terms, owing to a rate increase from 12% to 16% in the fiscal reform of October and to a modest upturn in private consumption. A number of selective taxes were also levied on consumption (including fuel, alcoholic beverages and tobacco) and the tax base was changed. A 10% tax on telecommunications services was created, in addition to a surcharge of 0.15% on the value of cheques paid by the banking system, payments by electronic transfer, transfers to third-party accounts in the same bank and cash withdrawals. Nevertheless, fiscal revenue in these segments fell in real terms.

Direct tax revenues were down by 20.9% in real terms, compared to a drop of 1.5% in 2003, as a result of the decline in real wages and the financial difficulties experienced by firms. In part, this was offset by the establishment of special levies of 1% on luxury housing and vacant lots with a value of over 5 million pesos, 3% on real estate transfers and 2% on real estate title transfers. Despite all these measures, the tax burden rose by scarcely 0.2 GDP percentage points to reach 15.1%. Non-tax revenues grew by 9.4% in real terms.

Central government spending was down 2.9% in real terms. This was due to a contraction in capital spending (26.4%) which, in turn, was caused by a decline in fixed investment, transfers (despite a last-quarter upturn in transfers to local governments, drinking water companies and the National Housing Institute) and other capital spending. In contrast, current expenditure expanded by 3.8% in real terms, mainly as a result of a substantial 74.9% increase in transfers to the electricity sector (some of which went to cover payments arrears owed to generating companies), local governments, and the subsidy on liquefied gas. In real terms, the interest payments on public debt remained virtually unchanged, but salaries and wages contracted by 26.5%, because of staff cuts in the central government as of July and a 14.9% drop in purchases of goods and services. In the last five months of the year, the government created a programme entitled *Comer es primero* ("Eating first"), in order to channel food assistance to the poorest households.

External public debt amounted to US$ 6.38 billion, which was 6.3% higher than the 2003 figure and equivalent to 34.6% of GDP. The increase was due mainly to the accumulation of arrears in debt servicing, which led to the renegotiation of debt owed to the Paris Club and, to a lesser extent, to changes in the dollar exchange rate against other currencies such as the euro and the yen. The country's renegotiation with the Paris Club involved liabilities of US$ 190 million, including arrears from 2003 and payments due in 2004 for debt incurred prior to June 1984.

(b) Monetary policy

The excess liquidity caused by the central bank's massive intervention during the banking crisis of 2003 was one of the most pressing monetary problems in 2004, costing the equivalent of 20.5% of GDP. The facilities extended to struggling banks led to the issuance of increasing numbers of deposit certificates, with a view to neutralizing the effects of excess liquidity.

The number of central bank investment certificates in circulation increased by 84.7% and their value rose from 60 billion to over 110 billion pesos. The interest rate on these issues was close to 60% per annum in the first half of the year, but in August it began to drop rapidly. Maturities were extended and an effort was made to diversify the conditions by indexing rates to the consumer price index, the dollar and the United States Treasury bond rate. In May the authorities also increased the minimum investment ratio for full-service banks from 5% to 8% and imposed a ceiling on total loans extended by the banking system to the public sector.

Nominal bank interest rates on both deposit and lending operations moved slowly. Lending rates for periods of 90 to 180 days reached an average of 31.2%, compared to 30.4% in 2003, while the rates on 30-day deposits declined from 20.3% to 19.6%. As an annual average, these lending rates yielded a real rate of 25.2%, compared to -7.4% in 2003, and real deposit rates went from -15.1% to -3.7%.

Table 1

DOMINICAN REPUBLIC: MAIN ECONOMIC INDICATORS

	1996	1997	1998	1999	2000	2001	2002	2003	2004 [a]
				Annual growth rates [b]					
Gross domestic product	7.2	8.2	7.4	8.2	7.8	4.0	4.4	-1.9	2.0
Per capita gross domestic product	5.3	6.3	5.6	6.3	6.0	2.3	2.7	-3.5	0.3
Gross domestic product, by sector									
Agriculture, livestock, hunting, forestry and fishing	9.2	3.3	1.1	8.8	5.6	8.1	2.5	-2.6	3.5
Mining	2.4	3.1	-15.9	-1.5	13.3	-15.6	-2.7	8.8	3.7
Manufacturing	3.1	7.5	5.7	6.0	7.5	-1.3	4.4	-3.1	0.7
Electricity, gas and water	10.3	10.1	13.8	8.1	7.0	18.4	7.8	-8.5	-19.6
Construction	13.4	17.1	19.6	17.7	5.6	0.5	3.2	-8.6	-6.3
Wholesale and retail commerce, restaurants and hotels	10.1	12.4	9.4	8.6	10.7	-0.1	3.9	-5.0	1.8
Transport, storage and communications	10.0	11.7	13.5	11.1	15.0	16.4	9.9	5.1	11.4
Financial institutions, insurance, real estate and business services	2.1	2.8	3.0	3.2	2.8	2.5	2.6	-1.7	0.6
Community, social and personal services	5.1	3.8	4.6	3.7	4.3	6.2	3.9	2.8	2.5
Gross domestic product, by type of expenditure									
Consumption	8.9	7.3	8.6	3.7	8.9	3.9	7.4	-10.3	2.4
General government	10.7	1.2	6.5	3.6	-1.0	14.9	7.3	6.2	6.3
Private	8.7	8.2	8.9	3.8	10.2	2.7	7.4	-12.4	1.8
Gross domestic investment	9.2	18.3	26.2	13.5	6.8	2.0	2.3	-12.5	-6.1
Exports (goods and services)	4.8	9.0	6.8	6.6	6.4	-7.2	-3.4	7.8	4.2
Imports (goods and services)	8.4	12.8	18.3	4.0	6.9	-6.2	0.8	-14.4	-0.4
			Percentages of GDP						
Investment and saving [c]									
Gross domestic investment	19.0	19.8	23.5	24.2	23.8	22.9	22.8	23.3	24.3
National saving	17.4	18.7	21.3	21.7	18.6	19.4	19.1	29.7	31.9
External saving	1.6	1.1	2.1	2.5	5.2	3.4	3.7	-6.3	-7.6
			Millions of dollars						
Balance of payments									
Current account balance	-213	-163	-338	-429	-1 027	-741	-798	1 036	1 399
Merchandise trade balance	-1 674	-1 995	-2 617	-2 904	-3 742	-3 503	-3 673	-2 156	-2 095
Exports, f.o.b.	4 053	4 614	4 981	5 137	5 737	5 276	5 165	5 471	5 750
Imports, f.o.b.	5 727	6 609	7 597	8 041	9 479	8 779	8 838	7 627	7 845
Services trade balance	1 019	1 275	1 182	1 602	1 854	1 826	1 757	2 249	2 328
Income balance	-725	-795	-890	-975	-1 041	-1 092	-1 152	-1 393	-1 332
Net current transfers	1 168	1 352	1 987	1 848	1 902	2 028	2 269	2 336	2 498
Capital and financial balance [d]	173	254	350	581	978	1 256	243	-1 583	-853
Net foreign direct investment	97	421	700	1 338	953	1 079	917	613	645
Financial capital [e]	76	-167	-350	-757	25	177	-674	-2 196	-1 498
Overall balance	-40	91	11	151	-48	515	-555	-546	546
Variation in reserve assets [f]	15	-40	-98	-194	70	-519	527	358	-542
Other financing [g]	25	-51	87	42	-22	4	28	189	-4
Other external-sector indicators									
Terms of trade for goods (index: 2000=100)	103.5	106.1	108.0	105.7	100.0	100.9	101.5	97.9	96.7
Net resource transfer (percentage of GDP)	-4.0	-3.9	-2.9	-2.0	-0.4	0.8	-4.1	-17.1	-11.9
Gross external public debt (millions of dollars)	3 807	3 572	3 546	3 661	3 682	4 177	4 536	5 987	6 380
Gross external public debt (percentage of GDP)	28.6	23.7	22.4	21.1	18.6	19.3	21.0	36.7	34.6
Net profits and interest (percentage of exports) [h]	9.8	10.1	11.1	12.1	11.9	13.0	14.0	15.6	13.4
			Average annual rates						
Employment									
Labour force participation rate [i]	52.6	54.1	52.6	53.5	55.2	54.3	55.1	54.7	56.3
Open unemployment rate [j]	16.5	15.9	14.3	13.8	13.9	15.4	16.1	17.0	18.4
			Annual percentages						
Prices									
Variation in consumer prices (December-December)	4.0	8.4	7.8	5.1	9.0	4.4	10.5	42.7	28.7
Variation in nominal exchange rate (December-December)	3.0	4.2	10.6	1.0	4.2	2.8	25.9	75.6	-21.4
Variation in real minimum wage	0.6	1.4	4.3	4.8	-0.1	5.5	-0.5	-9.5	...
Nominal deposit rate [k]	...	13.3	17.0	15.4	18.6	16.1	16.4	20.6	21.1
Nominal lending rate [l]	...	19.0	23.5	22.2	23.6	20.1	21.3	27.8	30.3

Table 1 (concluded)

	1997	1997	1998	1999	2000	2001	2002	2003	2004 [a]
			Percentages of GDP						
Central government									
Current income	14.2	15.9	15.9	15.6	15.8	16.3	16.5	15.8	16.2
Current expenditure	8.1	11.0	11.1	11.2	11.3	11.9	12.0	11.5	11.7
Current balance	6.1	5.0	4.7	4.4	4.5	4.4	4.5	4.4	4.6
Net capital expenditure	6.1	4.1	4.3	5.0	3.6	4.2	4.5	3.2	2.3
Primary balance	0.5	1.6	1.1	0.0	1.8	1.2	1.1	2.9	3.9
Overall balance	0.0	1.1	0.6	-0.5	1.1	0.4	0.1	1.3	2.4
Public sector debt									
Domestic	...	...	...	...	...	...	...	...	...
External	28.6	23.7	22.4	21.1	18.6	19.3	21.0	36.7	34.6
Interest payments (percentage of current income)	3.9	3.1	3.3	3.2	4.5	5.0	6.6	9.8	9.5
Money and credit [m]									
Domestic credit [n]	25.3	25.4	28.2	31.0	33.1	35.4	38.6	41.3	31.3
To the public sector	1.5	1.3	1.0	1.7	2.0	1.8	2.2	2.6	2.3
To the private sector	23.7	24.2	27.1	29.3	31.1	33.5	36.4	38.7	28.9
Currency in circulation and local-currency deposits (M2)	24.8	25.0	26.7	28.7	29.2	31.6	34.4	39.5	34.0

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.
[a] Preliminary figures. [b] Based on figures in local currency at constant 1970 prices. [c] Based on figures in local currency expressed in dollars at current prices. [d] Includes errors and omissions. [e] Refers to the capital and financial balance (including errors and omissions), minus net foreign direct investment. [f] A minus sign (-) denotes an increase in reserves. [g] Includes the use of IMF credit and loans and exceptional financing. [h] Refers to net investment income as a percentage of exports of goods and services as shown on the balance of payments. [i] Economically active population as a percentage of the working-age population. [j] Unemployment rate as a percentage of the economically active population, nationwide total. [k] 90-day certificates of deposit. [l] Average of the reference rate. [m] The monetary figures are annual averages. [n] Refers to net credit extended to the public and private sectors by commercial banks and other financial and banking institutions.

Monetary aggregates showed a sharp contraction in real terms as a result of the severe fiscal and monetary stabilization measures. Money creation fell sharply. M1 diminished by 24.6% from December to December, owing to a 30% fall in cash in circulation and a drop of 19.3% in current account deposits. Broad money decreased by 16.4%, reflecting a 12.7% decline in term deposits. The dollarization caused by the banking crisis eased in the latter months of the year. Credit to the private sector was down for the second year running (28.9% in real terms), which translated into a contraction in credit allocation to construction (-52.6%), commerce (-43.5%) and personal loans (-2%).

(c) Exchange-rate policy

In the context of the free-floating exchange rate regime established at the beginning of 2004, the price of the dollar rose persistently and reached a high of 54 pesos in February, compared to 37.5 pesos in December 2003. Subsequently, the local currency gained in value and the dollar stood at close to 30 pesos in December 2004; the peso thus appreciated by around 5% in real terms as an annual average.

(d) Other policies

In August 2004 the agreement associating the Dominican Republic with the Central America-United States free trade accord was signed, and is now awaiting approval by Congress in both the Dominican Republic and the United States.

The main reforms in 2004 were aimed at strengthening the institutional and regulatory framework of the banking and financial system. Regulations were adopted in relation to the exchange rate regime, credit limits for related parties, liquidity risks, market risk management, the establishment and operation of financial intermediation entities and representative offices, prudential standards for capital adequacy, and asset evaluation and related provisions.

Table 2
DOMINICAN REPUBLIC: MAIN QUARTERLY INDICATORS

	2003				2004[a]				2005[a]	
	I	II	III	IV	I	II	III	IV	I	II
Gross domestic product (variation from same quarter of preceding year) [b]	1.6	-7.0	-0.8	-1.1	-0.1	1.8	2.6	3.4	4.3	...
Merchandise exports, f.o.b. (millions of dollars)	1 351	1 414	1 414	1 287	1 335	1 496	1 460	1 459	1 277	...
Merchandise imports, c.i.f. (millions of dollars)	1 971	1 932	2 070	1 949	1 707	1 900	2 071	2 168	2 133	...
International reserves (millions of dollars)	561	437	251	253	424	453	560	798	1 247	...
Consumer prices (12-month percentage variation)	18.7	26.1	33.1	42.7	62.3	60.3	47.9	28.7	4.3	-1.0
Average nominal exchange rate (pesos per dollar)	23.64	27.96	33.80	37.92	48.49	47.28	41.61	31.09	27.78	27.85
Nominal interest rates (annualized percentage)										
Deposit rate [c]	20.0	20.4	21.4	20.6	20.2	23.0	20.7	20.7	19.3	10.5
Lending rate [d]	26.8	26.7	29.5	28.3	29.1	31.7	30.7	29.8	28.7	21.8
Interbank interest rate	19.7	23.0	26.8	27.4	45.8	50.5	26.3	24.5	19.3	9.5
Domestic credit (variation from same quarter of preceding year) [e]	17.2	39.9	42.4	30.9	37.5	10.7	6.3	7.2	-4.1	-6.0
Non-performing loans as a percentage of total credit [f]	6.2	9.4	7.3	7.4	7.4	7.3	6.6	6.0	6.4	6.8 [g]

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.
[a] Preliminary figures. [b] Based on figures in local currency at constant 1970 prices. [c] 90-day certificates of deposit. [d] Average of the benchmark rate. [e] Refers to net credit extended to the public and private sectors by commercial banks and other financial and banking institutions. [f] Refers to total credit extended by the consolidated financial system. [g] Data for April.

3. The main variables

(a) Economic activity

Exports provided the main impetus for economic growth in 2004. In addition, domestic demand recovered in the last quarter of the year. Consumption increased by 2.4% but uncertainty continued to affect investment, which fell back by 6.1%.

The performance of the sectors of production was uneven in 2004. Agricultural production recovered (3.5%) from the sharp contraction of 2003, as supply expanded in the livestock, forestry and fishing sectors. In contrast, adverse weather conditions associated with hurricane Jean, which scourged the country in September, caused a drop of 3.8% in crop farming, with declines in production of rice (5.3%), coffee (4.3%), tobacco (1.6%), bananas (16.3%) and most legumes, tubers and fruit.

It was a good year for mining (3.7%), as ferronickel production increased by 8.2%, in response to a rise in both external demand and international prices. Value added in the manufacturing industry ticked up (0.7%), reflecting a rise in sugar refinery production (6.7%) and in value added in the free zones (6.2%), thanks to the expansion of spending on local services. The production of pasta, beer and cigarettes continued to decline, however, as did earnings from rice and coffee processing and various sectors producing for the construction industry.

Construction was down by 6.3%, affected by high input prices and the rise in interest rates. In contrast, the communications sector continued to grow rapidly and reached an expansion rate of 18.3%, owing to an increase in the number of fixed telephone lines and the expansion of cellular telephone services.

The prolonged crisis in the electricity sector worsened and production declined by 19.6%, reflecting a 33% drop in thermal generation due to the generating companies' financial difficulties.

The hotel, bar and restaurant sector grew by 4.6%, thanks to the higher number of tourists. By contrast, the financial sector contracted again in 2004. After the crisis of the previous year, the restructuring of the banking and insurance system continued and there were difficulties in channelling the new credit. Commerce was virtually stagnant, despite an upturn in the last quarter.

(b) Prices, wages and employment

Average annual inflation reached 51.5%, almost double the figure for 2003, and the highest for more than a decade. The rate slowed in the second half of the year, however, bringing the December-to-December increase in prices to 28.7%, compared to 42.7% in the same period of the previous year. In fact, in the last quarter prices fell.

The prices of foods, beverages and tobacco, which account for close to half of the consumer price index basket, rose by 69.2% as an annual average, compared to 26.6% the previous year. In the hotel, bar and restaurant sector, the hikes were 63.3% and in transport, 58.3%. The price increases for furniture and accessories (49.7%), recreation, entertainment and culture (48.1%), education (26.4%) and housing (25.3%) were less than the national average. The moderation of inflation in housing costs was due to subsidies granted for electricity and gas consumption.

The difficult economic situation resulted in an increase in the labour market participation rate, to 56.3%, which was 1.6 points higher than the average for 2003. The expanded unemployment rate increased from 17% to 18.4%, although open unemployment was down from 6.5% in 2003 to 5.3% in 2004.

Formal enterprises in the private and public sectors adjusted nominal wages in 2004. In real terms, however, workers' incomes diminished for the third consecutive year.

(c) The external sector

The surplus in the balance-of-payments current account, at US$ 1.399 billion, was equivalent to 7.4% of GDP. The balance of goods and services showed a surplus; factor payments abroad diminished and family remittances increased. In contrast, financial capital flows were persistently negative since, despite a moderate rise in foreign direct investment, other capital movements, especially of private resources, led to a net outflow. Nevertheless, the central bank built up international reserves after two years of losses.

The value of goods and services exports rose by a moderate 3.8%, compared to 8.5% in 2003. Sales of local goods (23% of the total) performed best, with a 25% increase. Exports of ferronickel and tobacco performed particularly well (up 63% and 116%, respectively, on the previous year), driven by the sharp exchange rate depreciation in the first semester and high international prices. Quayside sales of fuel also increased, as did exports of various non-traditional goods, but the poor weather conditions which affected coffee and cacao production caused a setback in exports of these products.

Free zone exports performed poorly for the fourth year running, up only 0.2%, largely as a result of stiffer competition from Asian products in the United States market. The sales of the largest segments, clothing and footwear, diminished by 5.5% and 3.4%, respectively, although there were upturns for jewellery and related items (19.2%), tobacco manufactures (12.7%), pharmaceutical products (8.3%) and some others.

Owing to the impact of hurricane Jean in the last quarter of the year, income from tourist services increased by only 1.8%, after the climb of 13.1% in 2003. In 2004, 2.8 million tourists visited the Dominican Republic (4.1% more than the previous year), generating revenues of US$ 3.18 billion. The traditional services trade surplus rose to US$ 2.328 billion, which amply exceeded the merchandise trade deficit.

Goods imports rose by scarcely 2.9%, after a contraction of 13.7% in 2003. Free zone imports were down for the fourth consecutive year (2.2% in 2004), but local market imports rose by 5.4%. By category, imports of intermediate goods expanded by 10.9% while purchases of other inputs, excluding petroleum and petroleum products, rose 2.8%. The gradual strengthening of the population's purchasing power helped to boost imports of consumer goods (5.9%), especially durables, including some replenishment of inventories. Purchases of capital goods continued to fall (4.9%), especially construction and transport equipment.

Family remittances have acquired a growing significance, since they amounted to US$ 2.2 billion, or 6.8% more than in 2003. They almost matched the international services surplus and more than tripled foreign direct investment flows. Remittances were equivalent to 12% of GDP and 18% of private consumption.

Exchange-rate and financial instability led to a negative capital and financial account balance for the second year in a row, this time of around US$ 850 million. This stood in contrast to positive flows of resources in the years prior to the crisis. Foreign direct investment amounted to US$ 645 million, which was US$ 32 million higher than in 2003 but 30% less than in 2002. For the third consecutive year, both commercial loans and portfolio investment turned in negative figures, and there was an expansion in assets held abroad. At the end of the year the improvement in the exchange-rate and financial outlook began to counteract this trend. As a result, after two years of downturns, reserve assets rose by US$ 542 million.

Guyana

1. General trends

Economic activity improved slightly in 2004, with GDP showing 1.6% growth, compared with a contraction of 0.6% in the previous year. This upturn was due to a recovery in sugar and livestock production and to growth in the services sector.

The rise in petroleum prices and economic recovery had little impact on overall price levels, since inflation remained under control at 5.5% in 2004, albeit under pressure from increases in food, transport and housing prices. Public sector reform led to a 1.3% contraction in public employment. Boosted by economic growth, the private sector took up the slack. Average wages increased during the year, since the government raised the minimum wage by 5% in the final four months, making the measure retroactive to January. Some other sectors also recorded higher wages.

With a slightly more robust economy, the government's fiscal performance strengthened so that the overall fiscal deficit, including grants, stood at 4.9%, down from 7.1% in 2003. The increase in total revenue outpaced that of total expenditure, thereby contributing to a more favourable fiscal outturn.

In 2004, monetary policy was geared towards maintaining growth in liquidity in keeping with rising nominal GDP, improving the intermediation costs of credit to the private productive sector, and facilitating a more flexible rate of exchange. Liquidity in the banking system remained high, with excess reserves more than 15% up on the previous year, reflecting risk aversion in the banking system as well as a lack of profitable projects.

External constraints worsened in 2004, leading to an overall balance-of-payments deficit of US$ 43.1 million, four times the previous year's figure and equivalent to 5% of GDP. The lower current-account deficit (17% less than the previous year) was counterbalanced by a deterioration in the capital account. The weaker balance-of-payments position had an adverse effect on the exchange rate, which depreciated by almost 3% against the United States dollar.

Economic performance in 2005 is expected to reflect the negative impact of serious flooding in Guyana at the beginning of the year, which is likely to cancel out the incipient upturn recorded in 2004. GDP projections for 2005 point to a 2.8% contraction, which will be felt in most of the main sectors, including sugar, rice and some non-tradable services. The rehabilitation and reconstruction work, together with compensation for flood victims, will increase the central government deficit to approximately 14% of GDP.

2. Economic policy

(a) Fiscal policy

Fiscal policy was geared towards curbing the deficit in order to achieve public debt sustainability in the medium term. In 2005, public finances improved as a result of higher tax receipts and a relatively small increase in expenditure. The overall fiscal deficit trended downwards with a significant reduction from 7.1% of GDP in 2003 to 4.9% in 2004. This stronger performance was based on higher tax receipts and the containment of current spending, together with a better outturn by non-financial public enterprises.

Table 1

GUYANA: MAIN ECONOMIC INDICATORS

	1996	1997	1998	1999	2000	2001	2002	2003	2004 [a]
				Annual growth rates [b]					
Gross domestic product	7.0	7.1	-1.7	3.0	-1.4	2.3	1.1	-0.6	1.6
Per capita gross domestic product	6.7	6.8	-2.0	2.7	-1.7	2.0	0.9	-0.8	1.4
Gross domestic product, by sector									
Agriculture, livestock, hunting, forestry and fishing	5.1	4.0	-6.7	15.9	-9.0	3.4	3.4	-2.3	2.8
Mining	15.2	15.0	2.7	-8.4	5.9	4.2	-6.9	-8.7	-6.5
Manufacturing [c]	3.9	2.3	-8.7	15.5	-13.9	2.5	10.9	-0.5	2.5
Construction	14.0	13.1	4.7	-10.0	6.6	2.0	-3.9	5.6	4.1
Wholesale and retail commerce, restaurants and hotels	5.1	5.6	5.3	-8.0	5.2	0.5	-0.9	-2.6	1.9
Transport, storage and communications	10.9	8.9	-3.1	2.1	7.1	5.4	4.5	4.9	3.6
Financial institutions, insurance, real estate and business services	8.9	5.1	3.8	0.0	3.6	-3.5	-0.8	1.6	1.0
Community, social and personal services	3.1	3.4	0.7	1.2	4.6	0.7	-0.8	1.1	1.2
				Millions of dollars					
Balance of payments									
Current account balance	-69	-111	-102	-78	-115	-129	-106	-86	-71
Merchandise trade balance	-20	-48	-54	-25	-80	-94	-68	-59	-58
Exports, f.o.b.	575	593	547	525	505	490	496	513	589
Imports, f.o.b.	595	642	601	550	585	584	563	572	647
Services trade balance	-23	-23	-32	-31	-24	-20	-24	-15	-20
Income balance	-67	-80	-60	-61	-58	-59	-55	-55	-39
Net current transfers	41	40	44	39	47	44	40	43	46
Capital and financial balance [d]	81	110	89	100	156	32	31	44	46
Net foreign direct investment	59	52	44	46	67	56	44	26	30
Financial capital [e]	22	58	45	54	88	-24	-13	18	16
Overall balance	12	-2	-13	22	40	-12	-25	-9	-43
Variation in reserve assets [f]	-14	3	23	-11	-24	-17	-4	-1	32
Other financing [g]	2	-1	-10	-10	-16	29	29	10	12
Other external-sector indicators									
Gross external public debt (millions of dollars)	1 537	1 513	1 516	1 210	1 195	1 193	1 246	1 092	1 078
Gross external public debt (percentage of GDP)	205.5	185.7	188.6	163.6	144.7	143.4	152.4	132.3	128.1
				Annual percentages					
Prices									
Variation in consumer prices (December-December)	4.5	4.2	4.7	8.7	5.8	1.5	6.0	5.0	5.5
Variation in nominal exchange rate (December-December)	0.6	1.8	14.0	10.2	2.4	2.6	1.2	2.0	2.2
Nominal deposit rate [h]	7.7	7.4	7.1	8.1	7.3	6.7	4.3	3.8	3.4
Nominal lending rate [i]	17.0	17.0	17.0	17.1	17.2	17.3	17.3	16.6	16.6
				Percentages of GDP					
Central government									
Current income	35.5	32.0	30.7	29.8	31.8	31.1	32.2	31.5	33.0
Current expenditure	24.2	26.3	27.8	25.7	33.0	32.5	32.3	32.4	30.0
Current balance	11.3	5.6	2.8	4.0	-1.1	-1.4	0.0	-0.9	3.0
Net capital expenditure [j]	12.9	12.6	10.9	6.5	5.3	8.1	7.1	5.7	7.9
Overall balance [k]	-1.6	-6.9	-8.1	-2.5	-6.4	-9.5	-7.1	-6.6	-4.8
Money and credit									
Domestic credit	17.2	25.9	36.2	23.5	25.0	25.2	26.5	25.0	23.9
To the public sector	-19.4	-16.2	-11.8	-21.6	-19.9	-18.1	-15.9	-8.8	0.3
To the private sector	36.7	42.1	48.0	45.1	44.9	44.9	42.4	33.7	30.9
Currency in circulation and local-currency deposits (M2)	...	...	60.2	56.6	60.9	65.7	68.4	69.9	70.9

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

[a] Preliminary figures. [b] Based on figures in local currency at constant 1988 prices. [c] Includes electricity, gas and water. [d] Includes errors and omissions. [e] Refers to the capital and financial balance (including errors and omissions), minus net foreign direct investment. [f] A minus sign (-) denotes an increase in reserves. [g] Includes the use of IMF credit and loans and exceptional financing. [h] Small savings rate. [i] Weighted average prime rate. [j] Includes external grants. [k] Includes interest.

The upturn in tax receipts, coupled with prudent fiscal management under a public expenditure reform programme, enabled the authorities to turn the current-account deficit of recent years into a surplus equivalent to 3% of GDP. Current revenues (excluding refundable taxes on rice) were up by 13.8%, exceeding the projected figure of 7.9%. Income tax figures also showed solid growth, while consumption tax soared by 27%, reflecting rising revenues due to an expansion in imports.

Current spending, including interest payments, increased only marginally (0.4%), which meant a drop in GDP terms to 30%, compared with 32% of GDP in 2003. In keeping with the principle of fiscal prudence established by the government, this result represented 96% of the year's total budgeted expenditure. The main spending item —payroll expenses— increased by 6% in nominal terms, reflecting wage hikes during the year. Owing to the increase in GDP, fiscal spending on wages remained stable at 11% of GDP. Other current expenditure also grew (2.7%), fuelled by an increase in transfers to local organizations. An 86% increase in social spending, which nevertheless remains below 0.5% of GDP, was also a significant item.

In the framework of the Heavily Indebted Poor Countries (HIPC) Debt Initiative administered by the World Bank and International Monetary Fund, interest payments on the external debt diminished by 24.4% to stand at 2.9% of GDP. Interest payments on domestic debt also came down, to just under 2% of GDP.

The capital-account deficit rose by 38.2% in value, widening to 7.9% of GDP in 2004, compared with 6.2% in 2003. Capital inflows increased significantly as a result of non-project grants, but capital spending rose even more sharply, mainly reflecting higher spending on transport and communications, housing and agriculture.

Fiscal policy is expected to be countercyclical in 2005, in view of the recessionary impact of the floods on the economy. The overall fiscal deficit will widen substantially to approximately 14% of GDP, reflecting a surge in capital spending on reconstruction work in the aftermath of the floods and planned outlays on infrastructure associated with the building of a cricket stadium for the 2007 World Cup. In keeping with projections, current expenditure will increase more moderately, since the government is striving to keep these outlays within reasonable margins (even after the floods) and to reduce non-production expenditure.

The public debt showed mixed results in 2004: domestic debt increased by more than 5%, reaching some 44% of GDP; external debt diminished by 1.2% to 128.1% of GDP. Guyana benefited from debt relief granted by the Paris Club under the HIPC Initiative and external debt servicing payments declined by 11%. The resulting ratio of debt servicing to exports of goods and services came down to 7.5%, compared with 9.6% in 2003.

Guyana will also benefit from the new debt forgiveness initiative recently announced by the Organisation for Economic Co-operation and Development (OECD).

(b) Monetary and exchange-rate policies

Monetary policy remained focused on managing liquidity to secure exchange-rate and price stability and boost credit to the private sector in order to stimulate productive activity and economic growth.

The principal instrument for control of the money supply continued to be auctions of treasury bills on the primary market, using a monetary programming model.

The broad money supply (M2) expanded by 7.8%, driven by strong growth in demand for deposits in national currency (16.7%), although savings and time deposits expanded at a lower rate (5.9%). M3 also expanded, reflecting a 9.3% increase in foreign-currency deposits.

Bank credit to the public sector swelled by a substantial 48.4% (24% of GDP), following a contraction in 2003. This sharp increase was due mainly to a single operation in which the government, acting through the central bank, sold reserves to commercial banks to finance a loan to the sugar corporation, GUYSUCO. One cause for concern has been a contraction averaging 6.1% in credit to the private sector over the last three years. In 2004, credit to the private sector decreased by 0.4% to stand at 31% of GDP, with the bulk of such loans going to commerce (15.3%), personal services (13.5%) and property and mortgages (12.6%).The manufacturing industry was the only sector of production to receive a relatively large proportion of credit (14.5%). Agriculture and mining, by contrast, experienced a credit shortfall, receiving 5.6% and 0.7%, respectively.

3. The main variables

(a) Economic activity

Real GDP growth was modest (1.6%) in 2004, following a contraction of 0.6% in 2003. Growth was driven by significant upturns in sugar production, livestock, services and, on the demand side, private consumption.

Agricultural activity picked up strongly, with growth in all categories except rice production. Value added in the sugar sector increased by 3.9%. Production expanded by 7.6% with respect to 2003, to stand at 325,317 tons, thus meeting 95% of the target for the year. The increase in output was thanks to good weather conditions and higher on-farm productivity.

The livestock and fishing subsector also posted an upswing, with a substantial rise in egg production offsetting a collapse in fisheries output (-98.6%). Production in the forestry subsector was up by 43.2%, reflecting an increase in logging.

Real value added in mining and quarrying declined following a drop in gold and bauxite production (5.8% and 12.4%, respectively), which was only partly offset by rising diamond production. Gold production continued to wane with the depletion of the reserves of OMAI Gold Mines, the industry's main stakeholder.

The manufacturing sector remained in the doldrums in 2004, with improvements in the intermediate goods subsector being counteracted by a decrease in production of alcoholic beverages, owing to a fall in market share.

Construction expanded by 4.1%, reflecting a high rate of investment project implementation, which has often represented a challenge for the authorities. The services sector was up by 3% in 2004, with most subsectors posting an expansion; transport and communications grew particularly strongly thanks to planned expansions in fixed telephone lines, cellular phone systems and information technologies.

(b) Prices, wages and employment

At 5.5%, the rate of inflation in 2004 was slightly higher than the previous year's figure of 5% and was driven mainly by the pass-through to consumers of higher costs for fuel imports, transport services and communication equipment. Seasonal food shortages also helped to push up domestic prices.

Household income increased in the course of the year, after the government raised the minimum wage by 5%, bringing it into line with inflation, and increased the minimum income tax threshold by 11.1%. Wages were also raised in most of the other sectors.

The structural adjustment programme entailed a 1.3% cut in public-sector employment in 2004, with a freeze on new hiring and the curtailment of some areas of public service. The labour market was assailed by strikes (a total of 227 in 2004, compared with 205 in 2003). Consequently, the total number of work days and income lost to strike action increased by 55% and 40%, respectively. The effects of the flooding in early 2005 are expected to push inflation up to 6% for the year.

Some projections suggest that food shortages caused by the floods may result in price increases, while persistently high oil prices will probably affect transport and communications.

(c) The external sector

The external position worsened in 2004, since the overall balance-of-payments deficit expanded to US$ 43.1 million (almost 5% of GDP). An improvement in the current-account position was offset by a deterioration in the capital account.

The current account, which had worsened in the previous two years, posted an improvement, with the deficit dropping to US$ 71.3 million (9.0% of GDP). The trade deficit contracted to US$ 57.9 million, compared with US$ 58.8 million in 2003, thanks to a higher rise in exports with respect to imports and an upturn in the terms of trade.

Exports picked up by 15%, benefiting from higher prices for a number of commodities, although export volumes may have dipped. Export earnings from sugar and rice increased by 6% and 21%, respectively.

GDP growth, together with wage hikes and project activity, resulted in a 13% expansion in imports. Imports of consumer goods were up 3.6%, reflecting a rise in imports of food and vehicles, thanks in part to higher incomes. Imports of intermediate and capital goods increased by 10.5% and 16.8%, respectively, in step with rising fuel prices and demand for capital goods for investment projects.

The deficit on the services account narrowed by 15% in 2004. This was due to a sharp decline in payments for factor services, which was partly a reflection of a 75% drop in interest payments on public debt under the HIPC Debt Initiative.

The capital account weakened in 2004, owing to a decline of over 33% in net inflows. This was partly the outcome of a single transaction in which central bank reserves were used to set up a trust fund for the modernization of the GUYSUCO plantation at Skeldon.

The balance-of-payments deficit was financed thanks to the HIPC Debt Initiative. The central bank's reserves contracted. As a result, the Bank of Guyana's gross reserves totalled US$ 224.7 million, meeting the target of three months' import coverage.

Despite the floods, the balance-of-payments figure for 2005 is expected to show an overall surplus of US$ 12 million. The current-account deficit is projected to widen substantially to US$ 116 million, owing to a fall in the principal commodity exports, while imports will grow significantly to reach US$ 700 million. Nevertheless, the capital account should improve considerably with net capital inflows being channelled into rehabilitation and reconstruction work as well as projects to expand bauxite mining operations. In addition, it is anticipated that current transfers will increase with inflows of international assistance and grants for flood relief.

Haiti

1. General trends[1]

The socio-political events which shook Haiti in 2004 had a strong negative impact on its economic performance. The resignation of President Jean-Bertrand Aristide on 29 February, the deployment of a multinational force to the country, the formation of a transitional government, the establishment in June 2004 of the United Nations Stabilization Mission in Haiti (MINUSTAH), and the floods in May and September were among the factors which created a climate of instability in a country which had already been experiencing a difficult situation. There were falls in gross domestic product (GDP), which was down 3.8%, consumption (-2%) and investment (-3.1%). The slight rise in exports (2.8%) only partially made up for these negative developments.

In mid-2005, the political situation unquestionably remains the most important factor for Haiti in terms of possible economic scenarios and prospects for the current year. The violence reigning especially in the capital, Port-au-Prince, which has worsened since September 2004, is endangering the fragile political and institutional balance and the successful implementation of economic and social programmes; it could also jeopardize the holding of the municipal, legislative and presidential elections scheduled for October and November 2005.

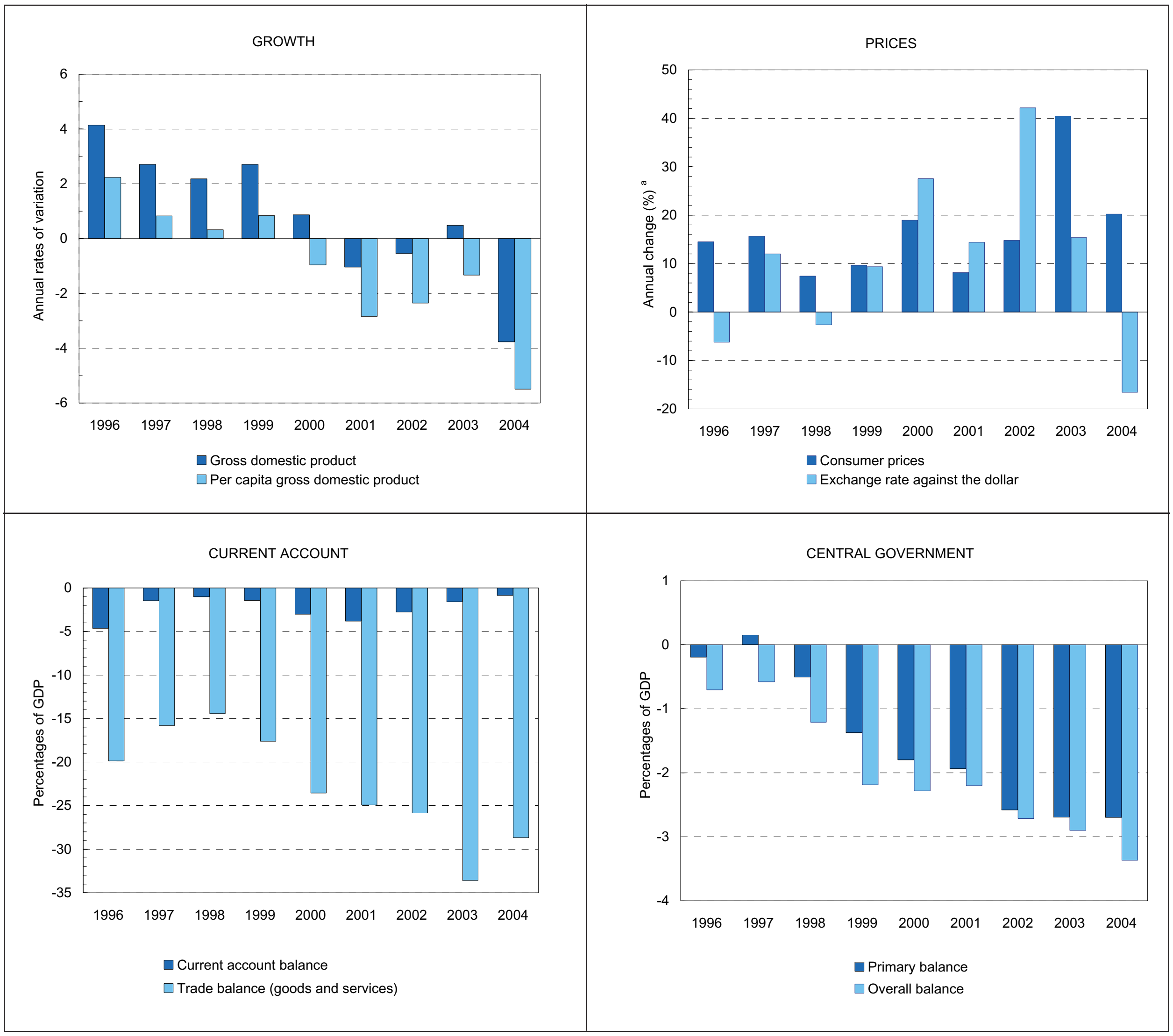
The target of a modest recovery in GDP for 2005 (2.5%), based on the external resources provided for in the Interim Cooperation Framework (CCI) and the Economic Recovery Programme (PROREC) is in doubt, owing to the poor results achieved to date. It is expected that GDP growth will probably be down, by 1.5% to 2%, and will hinge mainly on the performance of consumption and investment.

The increase in hydrocarbons prices (at an annualized rate of 47% from October 2004 to April 2005) has had a strong impact on inflation. Inflation seems very likely to exceed slightly the 12% inflation target established for September in the programmes agreed upon with the International Monetary Fund (IMF), with a rate of 15%.

The increased availability of dollars in the economy will probably ensure a stable exchange rate, however, while foreign currency purchases by the country's central bank (Banque de la République d'Haïti) should improve the level of net reserves. The second stage of the Emergency Post-Conflict Assistance (EPCA) programme, from October 2004 to September 2005, which provides for the receipt of some US$ 15.6 million in fresh resources, together with other fast-disbursing loans promised under CCI and remittances of about US$ 1 billion, may strengthen the appreciation of the gourde.

[1] The analysis refers to fiscal year 2004 (October 2003 to September 2004) and 2005 (October 2004 to September 2005).

Figure 1
HAITI: MAIN ECONOMIC INDICATORS



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

In terms of economic policy, the commitments undertaken in the framework of the IMF agreements are unlikely to change over the rest of the year. The greatest concerns are in the area of monetary policy, where the main challenges are the need to revive credit and control excessive liquidity in the banking system. Public expenditure may be the key to restoring some degree of growth in the economy, together with external cooperation, which will have to finance the totality of the programmed fiscal deficit of 6% of GDP.

2. Economic policy

(a) Fiscal policy

Faced with a diminished tax take (8% of GDP), together with financing requirements equivalent to about 25% of the past decade's total public expenditure, the Haitian authorities have turned to central bank financing to cover the public deficit. In fiscal 2004 financing from that source declined considerably (-40%), however, as the transitional government taking office in March deployed an economic policy directed towards restoring a measure of macroeconomic stability, as a matter of urgency. The fiscal deficit, which in late December 2003 already exceeded the level planned for the whole financial year, led the new authorities to reduce the spending of the public administration by 5.7% in real terms. Revenue also fell, by 7.5%, owing to the almost complete paralysis of economic activity in February and March.

Initially, the new authorities signed a short-term staff-monitored programme (SMP) with IMF, valid until September 2004, whose encouraging results subsequently led to the EPCA programme begun in January 2005. The goals of this programme, which were "to consolidate the stabilization gains and create conditions for economic recovery and reconstruction of government and social infrastructure", although subject to certain conditions, were attractive for the Haitian authorities because they guaranteed the immediate provision of fresh resources.

The first stage of this programme was completed in June 2005, and the preliminary results suggest that there will be a second phase. Aside from macroeconomic criteria, the execution of this programme calls for certain "structural reforms", including a comprehensive census of civil servants and the monitoring of arrears on domestic obligations, two tasks which do not yet appear to have been carried out.

Tax revenue dropped off abruptly during the first half of fiscal 2004 because of socio-political events; in particular, there was a substantial fall, almost 8%, in VAT revenue. Average tax revenue at that time was barely 84% of the amount seen in previous years.

There was also a significant fall in current spending (-3.7%) and investment expenditure (-12%). Public expenditure was virtually frozen from March to May 2004. The overadjustment on the current-account side seems to have worsened the decline in the level of economic activity.

The fiscal deficit was contained at 3.4% of GDP, thanks to the reduction in spending, and from April to June 2004 the current account was in surplus. The deficit was covered mainly by central bank financing, since external funding was still limited and in some cases conditional upon the settlement of arrears in external debt servicing which remained to be cleared.

During the first four months of fiscal year 2005 (October to January), loan disbursements of US$ 49 million, mostly from the Inter-American Development Bank (IDB) and the World Bank, greatly surpassed the amount for fiscal year 2004 as a whole. During that same period, however, net debt-servicing payments —especially to the World Bank— totalled US$ 66 million. As a result, there was a net resource outflow of US$ 17 million. This should change in the coming months, since the schedule of disbursements and payments provides for a positive balance of about US$ 89 million by the end of the year, mostly owing to IDB contributions.

(b) Monetary policy

For most of the second half of fiscal year 2004 (April-September 2004), the monetary authorities maintained a tight policy stance in order to contain the inflationary surges of the first three months (over 40%). Broad liquidity in the economy (M3) fell by 11% in real terms, while M1 and M2 were down 8% and 7%, respectively.

There was a steep fall in net credit to the public sector (-44%), in particular. The new authorities made successive cuts in the leading interest rate (central bank bonds) —from 27.8% in April to 7.6% in September— to promote the recovery of private credit, but these efforts were unsuccessful. Private financial institutions did not lower their lending rates to reflect the leading rate, but kept them substantially higher (33% and 14% in gourdes and dollars, respectively); on the other hand, the deposit rates offered did follow the downward trend in bonds. This allowed financial intermediaries to charge a still greater spread (an average of 26 and a spread of 12 percentage points from April 2004 to April 2005), which, nevertheless, did not compensate for the overall results of the financial system, whose major indicators showed a declining performance.

During the current financial year (2005), the authorities have been concerned over excessive liquidity in the banking system, since measures to reactivate credit do not seem to have had the desired effect, and they are faced with the dilemma of sterilizing the excess liquidity or changing their current monetary policy.

Table 1

HAITI: MAIN ECONOMIC INDICATORS

	1996	1997	1998	1999	2000	2001	2002	2003	2004 [a]
	Annual growth rates [b]								
Gross domestic product	4.1	2.7	2.2	2.7	0.9	-1.0	-0.5	0.5	-3.8
Per capita gross domestic product	2.2	0.8	0.3	0.8	-1.0	-2.8	-2.3	-1.3	-5.5
Gross domestic product, by sector									
Agriculture, livestock, hunting, forestry and fishing	1.0	-1.5	-0.2	-2.8	-3.6	0.9	-3.7	0.3	-5.4
Mining	-26.0	10.2	9.5	6.8	6.1	-4.9	1.5	1.4	-5.0
Manufacturing	5.6	0.3	0.3	-3.0	-0.5	0.1	1.6	0.5	-0.4
Electricity, gas and water	0.6	5.3	-2.8	-3.6	-9.2	-27.1	2.0	3.1	2.1
Construction	-7.9	9.1	11.2	10.4	8.3	0.7	0.8	1.5	-2.8
Wholesale and retail commerce, restaurants and hotels	8.6	5.8	3.1	4.0	4.5	0.4	1.8	1.1	-7.2
Transport, storage and communications	7.2	7.2	7.1	17.0	12.5	2.2	-0.3	1.6	0.9
Financial institutions, insurance, real estate and business services	31.9	6.8	5.9	3.2	4.4	-0.7	-1.5	0.2	-0.8
Community, social and personal services	1.8	1.2	1.3	-0.1	-1.6	-2.6	1.1	-1.4	-3.2
Gross domestic product, by type of expenditure									
Consumption	13.4	3.0	3.1	8.4	14.8	-1.6	-2.3	0.9	-2.0
General government	1.2	-0.1	1.1	0.2	1.3	-4.9	-3.5	...	...
Private	15.2	3.4	3.4	9.4	16.3	-1.3	-2.2	10.4	-2.0
Gross domestic investment	11.8	7.6	-3.2	24.0	18.3	-1.2	1.9	3.7	-3.1
Exports (goods and services)	27.3	14.2	23.3	16.5	6.3	-2.2	-2.1	7.1	2.8
Imports (goods and services)	32.6	7.2	6.6	22.7	29.3	-2.1	-2.6	3.4	0.2
	Percentages of GDP								
Investment and saving [c]									
Gross domestic investment	28.1	24.5	26.0	27.7	27.3	25.9	24.9	30.7	27.4
National saving	23.5	23.1	25.0	26.3	24.3	22.0	22.2	29.1	26.5
External saving	4.6	1.5	1.0	1.4	3.0	3.8	2.8	1.6	0.9
	Millions of dollars								
Balance of payments									
Current account balance	-138	-48	-38	-59	-111	-134	-89	-45	-30
Merchandise trade balance	-416	-354	-341	-677	-755	-750	-706	-783	-808
Exports, f.o.b.	83	205	299	341	332	305	274	333	378
Imports, f.o.b.	499	560	641	1 018	1 087	1 055	980	1 116	1 186
Services trade balance	-174	-158	-201	-43	-108	-124	-123	-166	-203
Income balance	-10	-14	-12	-13	-9	-9	-14	-14	-12
Net current transfers	463	478	516	674	761	750	754	918	993
Capital and financial balance [d]	87	78	73	80	64	131	8	37	66
Net foreign direct investment	4	4	11	30	13	4	6	14	6
Financial capital [e]	83	74	62	50	51	127	3	23	60
Overall balance	-50	30	34	21	-47	-2	-81	-8	36
Variation in reserve assets [f]	49	-51	-29	-34	57	-5	49	25	-50
Other financing [g]	2	21	-5	12	-10	7	32	-17	15
Other external-sector indicators									
Terms of trade for goods (index: 2000=100)	98.6	101.4	107.6	104.2	100.0	101.2	100.2	98.7	96.0
Net resource transfer (percentage of GDP)	2.7	2.6	1.5	2.0	1.2	3.7	0.8	0.2	1.9
Gross external public debt (millions of dollars)	914	1 025	1 104	1 162	1 170	1 189	1 212	1 287	1 316
Gross external public debt (percentage of GDP)	30.8	31.6	29.4	28.4	31.9	33.9	37.8	45.6	37.3
	Annual percentages								
Prices									
Variation in consumer prices (December-December)	14.5	15.7	7.4	9.7	19.0	8.1	14.8	40.4	20.2
Variation in nominal exchange rate (December-December)	-6.3	12.0	-2.6	9.4	27.5	14.4	42.2	15.4	-16.5
Variation in average real wage	-17.1	-13.9	-11.3	-7.9	-11.9	-11.6	-8.9	33.5	-14.7
Nominal deposit rate [h]	10.9	10.8	13.1	7.4	11.8	13.6	8.2	14.0	10.9
Nominal lending rate [i]	26.3	21.5	23.5	22.9	25.1	28.6	25.5	30.7	34.1

Table 1 (concluded)

	1996	1997	1998	1999	2000	2001	2002	2003	2004 [a]
			Percentages of GDP						
Central government									
Current income	7.4	8.9	8.5	9.1	8.0	7.4	8.2	9.0	9.0
Current expenditure	8.5	9.4	8.8	9.3	8.1	8.2	9.0	9.3	9.7
Current balance	-1.2	-0.6	-0.3	-0.2	-0.2	-0.8	-0.8	-0.4	-0.7
Net capital expenditure	0.3	1.3	2.0	2.1	2.4	1.8	2.0	2.8	2.6
Primary balance	-0.2	0.2	-0.5	-1.4	-1.8	-1.9	-2.6	-2.7	-2.7
Overall balance [j]	-0.7	-0.6	-1.2	-2.2	-2.3	-2.2	-2.7	-2.9	-3.4
Public debt	37.9	40.0	36.6	38.6	43.8	46.2	60.3	58.3	46.2
Domestic	12.6	12.0	11.1	12.1	13.6	14.8	17.5	17.4	15.6
External	25.3	28.0	25.5	26.5	30.2	31.5	42.8	40.9	30.6
Interest payments (percentage of current income)	7.0	8.3	8.3	9.0	6.1	3.6	1.6	2.3	7.5
Money and credit [k]									
Domestic credit [l]	21.3	21.4	20.4	21.3	21.5	24.1	25.6	23.6	26.5
To the public sector	11.5	10.7	8.7	8.2	8.8	10.4	12.2	11.7	12.9
To the private sector	9.8	10.7	11.7	13.1	12.7	13.7	13.4	11.9	13.6
Liquidity (M3)	...	...	29.7	30.8	34.8	36.1	37.8	41.3	41.1
Currency in circulation and local-currency deposits (M2)	...	...	22.8	22.9	24.0	24.2	24.5	24.7	24.5
Foreign-currency deposits	...	...	7.0	7.9	10.7	11.9	13.4	16.6	16.6

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.
[a] Preliminary figures. [b] Based on figures in local currency at constant 1986-1987 prices. [c] Based on figures in local currency expressed in dollars at current prices. [d] Includes errors and omissions. [e] Refers to the capital and financial balance (including errors and omissions), minus net foreign direct investment. [f] A minus sign (-) denotes an increase in reserves. [g] Includes the use of IMF credit and loans and exceptional financing. [h] Average of highest and lowest rates on time deposits, commercial banks. [i] Average of highest and lowest lending rates, commercial banks. [j] Overall balance calculated "below the line" (financing). [k] The monetary figures are annual averages. [l] Refers to net credit extended to the public and private sectors by the monetary authority and deposit banks.

Demand for credit is unlikely to contribute greatly to economic reactivation through a more active role for the private financial and business sector, especially in view of the social and political instability still prevailing. Once again, the public sector will have to stimulate economic growth from the demand side, through investment and wages.

As for deposit rates, despite the long-standing policy of lowering the rate of local-currency deposits in order to close the gap between rates on these and dollar-denominated deposits, the problem of dollarization remains, with dollar deposits making up 39% of total liquidity in the economy (M3).

(c) Exchange-rate policy

The end of the financial year 2004 saw a relatively high availability of foreign exchange, for reasons which included the lack of demand generated by economic activity (reduced imports) and also thanks to increased supply which was caused by abundant remittances and a relative upturn in foreign aid. This led to a nominal 12% appreciation of the gourde against the dollar between September 2003 and September 2004.

The real exchange rate rose by 21% during fiscal year 2004. The April 2005 figures show that trend continuing over the current fiscal year, by a further 14%. Comparison of the first six months (October to March) of the two fiscal years show that average monthly trading in dollars went up from US$ 75 to US$ 84 million, with an all-time high in December 2004, when transactions exceeded US$ 100 million.

From April to September 2004, the central bank rebuilt its reserves by systematically purchasing some US$ 71 million, thus ensuring that net international reserves were within the target agreed with IMF.

Table 2
HAITI: MAIN QUARTERLY INDICATORS

	2003				2004 [a]				2005 [a]	
	I	II	III	IV	I	II	III	IV	I	II
Merchandise exports, f.o.b. (millions of dollars)	73	75	92	92	93	56	100	107	99	...
Merchandise imports, c.i.f. (millions of dollars)	317	285	285	313	305	142	359	361	432	...
Consumer prices (12-month percentage variation)	37.0	41.7	42.5	40.4	25.4	24.1	22.5	20.2	17.2	...
Average nominal exchange rate (gourdes per dollar)	42.86	42.03	42.11	42.46	42.68	37.29	36.30	35.90	36.32	38.20
Nominal interest rates (annualized percentages)										
Deposit rate [b]	12.1	14.3	14.6	14.9	15.3	13.0	9.3	5.9	3.0	29.8 [c]
Lending rate [d]	27.0	30.6	33.0	32.3	33.0	36.5	33.8	33.0	31.8	2.5 [c]
Domestic credit (variation from same quarter of preceding year) [e]	37.9	38.5	27.1	23.2	15.8	8.4	11.8	1.3	2.6	...
Non-performing loans as a percentage of total credit [f]	5.8	6.5	5.8	...	7.5	...	...	...	...	...

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.
[a] Preliminary figures. [b] Average of highest and lowest rates on time deposits, commercial banks. [c] Data to May. [d] Average of highest and lowest lending rates, commercial banks. [e] Refers to net credit extended to the public and private sectors by commercial banks and other financial and banking institutions. [f] Refers to total credit extended by the financial system.

3. The main variables

(a) Economic activity

Productive sectors did not perform well in the unstable environment which prevailed in 2004. GDP declined by 3.8% and per capita GDP fell for the fifth consecutive year (-5.5%). Investment spending was significantly lower (-3.1%), owing to the negative influence of social and political conditions in the country and the steep fall in public investment (-12.4%). Although increased inflows of remittances softened the fall in purchasing power —the minimum wage was down 21% in real terms— this was insufficient to halt the downtrend (-2%) in consumption, particularly by households (-1.2%).

Value added in the agricultural sector declined by 5.4%, and commercial activity dipped by 7.2%. These two areas together make up more than 50% of GDP, and their slowdown had a particularly strong impact on overall economic performance.

Construction (-2.8%) was especially hurt by the unstable environment and the depressed state of the economy as a whole, especially the delayed implementation of new public works.

The energy sector experienced a considerable downturn, with a fall of 1.1% in thermal and hydroelectric power generation as a whole. There was little improvement until the last quarter of the financial year (July-September), which saw an upturn mainly thanks to grants amounting to US$ 22 million provided to the Haitian authorities by the United States Agency for International Development (USAID) for fuel purchases, under an agreement that lasted from May 2004 to February 2005. The current level of power generation, 498 million kWh, is 22% below the 1999 level, which was the highest of the past two decades.

Aside from a modest increase in the —maquila-dominated— textile segment (1.2%), which accounts for a fifth of manufacturing value added, the rest of the manufacturing industry experienced a heavy slump, reflected in the stagnation (-0.4%) of the industry as a whole.

(b) Prices, wages and employment

Inflation fell from 40.4% in 2003 to 20.2% in 2004, despite the impact of higher international prices for petroleum products, which was countered by exchange-rate stability. Food prices, however, saw a much greater increase because of rising commodity import prices and the relative shortages caused by the adverse environment in the country.

Up until April 2005, the annual rise in the consumer price index was 12.6%, compared with 25.4% in 2004. This decrease, together with the downward trend in the monthly inflation rate, might give grounds for a degree of optimism. Rather than its absolute level, however, what remains a matter of concern is Haiti's real capacity to contain inflation. This was demonstrated in April, when the monthly variation jumped to 2.4%, which was triple the average rate for the previous few months and mainly attributable to the continued climb of international fuel prices. There is also the question of whether the authorities may continue to use the exchange rate to anchor inflation, explicitly or otherwise, for the rest of the fiscal year without jeopardizing the established growth targets.

Since the adjustment in 2003, there has been no change in the minimum wage. Average salaries for civil servants, who number about 46,000, have been increased twice: in August 2004 (33%) and in February 2005 (15%), the latter by means of a post reclassification process. However, these increases have not been prompted the private sector to follow suit.

In the area of employment, the recessionary production environment worsened an already serious unemployment situation. The few exceptions to this were job creation in services and related industries, resulting from the presence in the country of many international contingents in the context of the United Nations mission and of other international and non-governmental organizations. The scheme of temporary labour-intensive employment programmes —provided under CCI as a short-term response to unemployment through the creation of 44,000 such jobs— was not fully deployed because of delays in disbursements and programme execution, in relation to what had been agreed.

(c) The external sector

The external sector, too, reflected the depressed state of productive activities and the special circumstances that prevailed during fiscal year 2004, but given the absolute level of imports —three times that of exports— the trade deficit widened by 7% and the current-account deficit amounted to 0.9% of GDP.

The instability prevailing in Port-au-Prince during the most trouble-filled weeks in February and March 2004 caused many maquila enterprises to scale down their activities or close altogether; there were also physical losses of stock and equipment because of looting and destruction. Nonetheless, fiscal year 2004 saw improvements in both the volume (7%) and the value (15%) of maquila exports. Traditional exports were not overly affected either, and there were increases in the export volume of goods such as mangoes (31%), cocoa (31%) and coffee (7%).

There was a 6.2% nominal increase in imports, but in real terms they were down 6.1%. Considerable price increases in both hydrocarbons and other import commodities (rice, wheat, chicken, milk and oils), with the notable exception of pulses, brought about a 6.7% deterioration in the terms of trade.

Once again, the level of remittances (US$ 993 million) made it possible to achieve equilibrium in the balance of payments current account, while the amount of external contributions was less than expected. The central bank's interventions to buy foreign exchange rebuilt net international reserves to a certain extent; at the end of the financial year, they represented the equivalent of 50 days' imports, in line with the criteria agreed upon with IMF.

In late September 2004, the country's net external debt stood at US$ 1.316 billion, almost three times the value of goods and services exports. Arrears of US$ 72 million in debt repayments remained an area of contention with the main international financial institutions. In particular, the country owed the World Bank US$ 44 million, and the largest bilateral debt, US$ 18 million, was owed to France. For this and other reasons, the figure for net disbursements in 2004 was negative by US$ 10 million. Since 2002, the ratio of debt servicing to disbursements has shown a net outflow of resources, with levels almost six times higher than those prevailing a decade ago.

Jamaica

1. General trends

Economic growth in 2004 (1.2%) marked a slowdown in comparison with the previous year (2.3%). This was due chiefy to damage caused by hurricane Ivan, which was estimated at 8% of GDP and affected mainly housing, agriculture and mining, tourism, and telecommunications. The largest contributions to growth came from manufacturing, construction and other services (3.6%, 4.7% and 2.1%, respectively).

Despite adverse weather conditions and their dampening effect on growth, the government was successful in reducing the fiscal deficit (from 5.6% of GDP in fiscal year 2003 to 4.8% in fiscal year 2004),[1] in line with the target set at the beginning of the year. Notwithstanding double-digit inflation (14%), macroeconomic stability, combined with higher international reserves, enabled the authorities to adopt an expansionary monetary policy.

The positive external sector balance reflected a narrower current-account deficit (down from 9.4% of GDP in 2003 to 7.9% in 2004), which was more than offset by the surplus on the capital and financial account.

The Jamaican economy is expected to record 2.5% growth in 2005, led by tourism, mining and construction. The resulting expansion in government revenue, together with the implementation of a series of tax reforms and a public spending containment policy, should help to balance the fiscal accounts by the end of the budget period corresponding to fiscal year 2005. This will be contingent upon fulfillment of the authorities' commitment to lower labour costs and interest rates.

2. Economic policy

(a) Fiscal policy

The central government fiscal deficit narrowed, thanks to efforts to contain total expenditure, which represented 34% of GDP in fiscal year 2004, down from 37% in 2003.

The decrease in expenditure was due to a contraction in current spending, in particular on wages and interest payments on domestic debt. The wage bill declined from 12% of GDP in fiscal year 2003 to 11% in 2004 and interest payments, from 15% to 13% over the same period. The decline in the wage bill was attributable to the implementation of a memorandum of understanding signed by the government and the Jamaica Confederation of Trade Unions. The purpose of this agreement is to reduce the payroll through a public employment and

[1] The fiscal year begins in April and ends in March of the following calendar year.

Table 1
JAMAICA: MAIN ECONOMIC INDICATORS

	1996	1997	1998	1999	2000	2001	2002	2003	2004 [a]
	Annual growth rates [b]								
Gross domestic product	0.3	-1.1	-1.1	0.9	0.8	1.5	1.1	2.3	1.2
Per capita gross domestic product	-0.6	2.0	-1.9	0.1	0.1	0.9	0.6	1.8	0.7
Gross domestic product, by sector									
Agriculture, livestock, hunting, forestry and fishing	...	-13.4	-1.7	1.0	-12.0	5.8	-7.0	4.8	-10.4
Mining	...	4.3	1.8	0.1	-1.0	2.6	3.3	4.9	3.1
Manufacturing	...	-2.7	-4.7	-1.9	0.6	0.8	-0.8	-0.8	3.6
Electricity, gas and water	...	6.6	6.3	4.6	2.2	0.7	4.6	4.7	-0.1
Construction	...	-3.5	-6.7	-1.7	0.7	2.2	2.4	1.2	4.7
Wholesale and retail commerce, restaurants and hotels [c]	...	0.8	-1.3	-0.5	1.2	0.0	0.1	1.0	1.4
Transport, storage and communications	...	6.3	6.4	6.8	6.5	5.1	6.2	3.7	0.7
Financial institutions, insurance, real estate and business services	...	-8.3	-3.6	3.6	1.9	-4.8	4.0	3.6	0.1
Community, social and personal services	...	0.5	1.0	0.8	1.5	-0.2	0.4	2.3	2.1
	Millions of dollars								
Balance of payments									
Current account balance	-143	-332	-334	-216	-367	-759	-1 074	-761	-700
Merchandise trade balance	-994	-1 132	-1 131	-1 187	-1 442	-1 618	-1 871	-1 944	-1 940
Exports, f.o.b.	1 721	1 700	1 613	1 499	1 563	1 454	1 309	1 386	1 586
Imports, f.o.b.	2 715	2 833	2 744	2 686	3 004	3 073	3 180	3 329	3 526
Services trade balance	453	467	477	655	603	383	315	565	561
Income balance	-225	-292	-308	-333	-350	-438	-605	-571	-651
Net current transfers	624	625	628	647	821	914	1 087	1 189	1 331
Capital and financial balance [d]	414	162	378	80	886	1 624	834	326	1 401
Net foreign direct investment	90	147	287	429	394	525	407	604	...
Financial capital [e]	324	15	91	-349	492	1 099	427	-278	...
Overall balance	271	-170	44	-136	518	865	-240	-435	701
Variation in reserve assets [f]	-202	205	-27	155	-499	-847	259	451	-694
Other financing [g]	-70	-35	-17	-19	-19	-18	-19	-16	-8
Other external-sector indicators									
Gross external public debt (millions of dollars)	...	3 278	3 306	3 024	3 375	4 146	4 348	4 192	5 120
Gross external public debt (percentage of GDP)	...	44.2	42.8	39.2	42.5	51.2	51.6	51.5	58.0
	Average annual rates								
Employment									
Labour force participation rate [h]	67.7	66.6	65.6	64.5	63.3	63.0	63.6	64.4	64.3
Unemployment rate [i]	16.0	16.5	15.5	15.7	15.5	15.0	14.2	11.4	11.7
	Annual percentages								
Prices									
Variation in consumer prices (December-December)	15.8	9.2	7.9	6.8	6.1	8.7	7.3	14.1	13.7
Variation in nominal exchange rate (December-December)	-11.8	3.6	2.6	10.7	10.2	4.3	6.0	20.7	2.1
Nominal deposit rate [j]	...	14.5	12.9	11.8	10.5	9.4	9.1	8.3	6.7
Nominal lending rate [j]	...	46.3	42.1	36.8	32.9	29.4	26.1	25.1	25.1
	Percentages of GDP								
Central government									
Current income	24.9	24.4	25.3	27.0	28.1	25.7	26.2	28.7	29.3
Current expenditure	26.1	27.0	29.5	30.0	27.6	29.9	33.8	35.0	33.9
Current account balance	-1.2	-2.6	-4.1	-3.0	0.5	-4.2	-7.6	-6.3	-4.6
Net capital expenditure	5.2	4.7	2.4	1.0	2.2	1.9	0.3	-0.3	1.2
Primary balance	5.0	1.7	5.4	9.4	11.5	7.8	7.2	12.0	11.7
Overall balance [k]	-6.1	-7.5	-6.7	-4.0	-0.9	-5.6	-7.6	-5.8	-5.0
Interest payments on public debt	11.1	9.2	12.0	13.4	12.4	13.4	14.9	17.8	16.7
Domestic debt	8.7	7.1	9.9	11.3	9.9	10.6	11.2	14.4	13.1
Foreign debt	2.4	2.1	2.1	2.2	2.5	2.8	3.6	3.4	3.6

Table 1 (concluded)

	1996	1997	1998	1999	2000	2001	2002	2003	2004 [a]
Money and credit [l]									
Domestic credit [m]	35.0	36.8	36.0	38.1	37.6	39.2	36.7	39.0	41.5
To the public sector	8.2	9.4	8.8	7.6	6.9	17.1	23.2	22.8	23.1
To the private sector	26.8	27.3	27.2	30.6	30.7	22.1	13.5	16.2	18.4
Currency in circulation and local-currency deposits (M2)	...	...	...	...	30.0	29.5	29.0	26.1	26.1

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.
[a] Preliminary figures. [b] Based on figures in local currency at constant 1996 prices. [c] Restaurants and hotels are included in community, social and personal services. [d] Includes errors and omissions. [e] Refers to the capital and financial balance (including errors and omissions), minus net foreign direct investment. [f] A minus sign (-) denotes an increase in reserves. [g] Includes the use of IMF credit and loans and exceptional financing. [h] Economically active population as a percentage of the working-age population. [i] Unemployment rate as a percentage of the economically active population. Includes hidden unemployment; nationwide total. [j] Average rates. [k] Includes grants. [l] The monetary figures are annual averages. [m] Refers to net credit extended to the public and private sectors by commercial banks and other financial and banking institutions.

wage restraint policy which will apply over a two-year period from 1 April 2004 to 31 March 2006. The trend in interest payments reflected the impact of lower rates of interest paid on domestic debt service.

The cost of the external debt service was similar to the previous year's figure (3.5% of GDP). Expenditure on public programmes rose from 5% of GDP in fiscal year 2003 to 6% in 2004, owing to reconstruction activities, which also translated into an expansion in capital spending from 1% of GDP in fiscal 2003 to 2% in fiscal 2004.

Fiscal revenue diminished from 31.4% of GDP in 2003 to 29.6% in 2004. The administrative and legislative tax measures adopted in the course of the year failed to increase this income, partly because of the impact of the hurricane on production activities.

The authorities' objective for fiscal year 2005 is to balance the budget by reining in public expenditure (which is expected to amount to 31% of GDP in fiscal year 2005) and, to a lesser extent, by increasing tax collection from 26% of GDP in fiscal year 2004 to 27% in 2005. The fulfilment of this target will depend on the extent to which the authorities and trade unions observe the memorandum of understanding, as well as on a continuing downward trend in interest rates.

The projected increase in tax revenue is based on the promulgation and application of a series of tax measures. The most salient of these are an expansion of the consumption tax base, through a hefty reduction in the list of exemptions, and an increase, to 16.5%, in the corresponding rate.

If revenues are, in effect, increased, the proposed fiscal policy will bring a significant reduction in the public debt balance. The authorities expect the ratio of public debt to GDP, which stood at 137% in fiscal year 2004, to drop to 126% in 2005.

(b) Monetary and exchange-rate policy

In 2004, the central bank followed a policy of reducing its rates on repo transactions, which it combined with sterilization operations to avoid unwanted surges in the money supply.

This policy was facilitated by favourable external conditions, prudent management of the fiscal accounts and an increase in foreign exchange inflows. This last factor reflected long- and short-term investment flows into both public and private sectors, as well as government issues of eurobonds, which accounted for much of the increase in international reserves from 16% of GDP in 2003 to 23% in 2004.

Monetary policy was expansionary, markedly so in the first half of the year but more moderately in the second. This attenuated the effects of hurricane Ivan and international fuel price hikes on macroeconomic stability.

In 2005, the central bank maintained the thrust of the monetary policy adopted the year before, given the continuing increase in international reserves, an economic upturn in hurricane-damaged sectors and a central government surplus in the first quarter of fiscal year 2005.

The rate of inflation remained at the same level as in the previous year, real interest rates declined and so did the central bank's benchmark rate (the repo rate).

The repo rate dropped by 300 basis points between December 2003 and December 2004 and by 85 basis points between December 2004 and March 2005. The average yield on treasury bills decreased by 221 basis points between January and December 2004 and by 148 additional points between December 2004 and March 2005. Lastly, the weighted nominal rate on commercial bank loans moved from 19% to 18% (representing a decrease from 7.8% to 3.9% in real terms) between December 2004 and March 2005.

Lower interest rates fuelled credit demand and benefited those sectors of production, such as manufacturing, which are locally financed, as well boosting the performance of construction. Even more importantly, it helped to reduce the cost of servicing local-currency-denominated debt, which is crucial to the achievement of central government fiscal targets.

Notwithstanding its positive effects, the decline in interest rates hurt commercial bank profits, since public securities form a large component of their assets portfolio (47% of bank investments).

The foreign-exchange market remained stable, partly thanks to sound fiscal performance and to interventions by the central bank. Thus, the bilateral exchange rate showed a slight depreciation of the Jamaican dollar against the United States currency, from J$ 60.70 to the dollar in 2003 to J$ 61.40 in 2004 and J$ 61.60 in the first semester of 2005.

3. The main variables

(a) Economic activity

In 2004, GDP growth slowed to 1.2% (from 2.3% in 2003), owing mainly to the destruction wrought by hurricane Ivan in the main sectors of economic activity (mining and tourism). Ivan also had a significant impact on the social sectors. Growth of 3% is projected for 2005, spurred by tourism, manufacturing and a partial recovery in agriculture and mining.

Adverse weather conditions, whose residual effects will be felt throughout most of 2005, led to a 10% contraction in agricultural activity in 2004, in contrast with a 5% expansion in 2003. A further contraction of 17% is anticipated for the first half of 2005.

Trends in the mining sector, whose growth rate slowed from 5% in 2003 to 3% in 2004, reflected both positive and negative factors. On the positive side, external demand for bauxite and alumina strengthened and there was an increase in production capacity at the alumina plants. On the negative side were the damage caused by hurricane Ivan to production infrastructure and mechanical problems at the bauxite loading port. Preliminary estimates point to a 1% increase in the first half of 2005, as a result of mechanical difficulties at the alumina refineries, which are expected to counterweigh bauxite production profits.

Manufacturing recorded its highest growth rate in five years, moving from a 1% contraction in 2003 to a 4% expansion in 2004. This performance reflected the impetus from construction, an increase in external demand for beverages, a drop in food imports, an expansion of productive capacity and efficiency gains. Despite constraints imposed by the closure of the oil refinery, the sector will maintain its current growth path, led by the food and beverages sector (2.4% in the first half of 2005).

Construction activity strengthened, with growth up from 1% in 2003 to 5% in 2004, thanks to the reconstruction and rehabilitation activities that followed the hurricane and both new and existing infrastructure projects. This sector is expected to expand at a similar rate in 2005 (6% in the first semester).

Tourism expanded by 6% in both 2003 and 2004, thanks to an increase in long-stay tourist arrivals (5% over the previous year's figure), which recorded unprecedented figures despite a hiatus caused by hurricane Ivan. In turn, this increase, which reflected favourable external conditions, greater flight capacity and more effective promotion of the tourist industry, had a positive impact on expenditure (6.4% in 2003). The number of cruise-ship passengers contracted by 3% with respect to 2003. In 2005, the tourist sector is expected to see an upturn of 6%, with increases in the number of long-stay tourists (8%) and cruise-ship passengers (2%) and higher tourist spending (13%).

(b) Prices, wages and employment

The adverse weather conditions that hit Jamaica kept the inflation rate in double digits (14.1% in 2003 and 13.7% in 2004). Also contributing to this result were the rise in prices for fuel and a number of commodities, as well as hikes in administered domestic prices (utility rates).

A breakdown of the consumer price index shows price trends being driven mainly by the food and beverages category, followed by fuels and housing costs.

According to projections, the rate of inflation will slow to between 9% and 10% in 2005, based on deployment of the wage restraint policy set out in the memorandum of understanding between the government and the Jamaica Confederation of Trade Unions.

The expected economic upswing and exchange-rate stability will have a positive impact on inflation. These two factors will help to offset upward pressure on prices from the contraction of agricultural output and high fuel costs in the first four months of 2005.

Unemployment increased from 11.4% in 2003 to 11.7% in 2004. This reflected a 3.4% decline in the number of employees in goods-producing sectors, particularly in agriculture (8%) and mining (7%), owing mainly to poor weather conditions.

(c) The external sector

The overall balance yielded a positive result in 2004, since the surplus recorded on the capital and financial accounts (5% and 16% of GDP in 2003 and 2004, respectively) was more than sufficient to finance the current-account deficit, which was smaller than in 2003. As a result, net international reserves increased from US$ 1.165 billion to US$ 1.859 billion.

The current-account balance reflected essentially a decrease in merchandise imports from 40.9% of GDP in 2003 to 40.0% in 2004. This was in keeping with the slackening of economic growth, which counteracted the effect of rising international fuel prices. It also reflected, albeit to a lesser extent, a rise in current transfers, which included financial support provided to hurricane victims by family members abroad. The performance of goods exports (17% of GDP in 2003 and 18% in 2004) was linked to the increase in the price and volume of traditional exports (bauxite, alumina and sugar).

The services balance showed no variation, since higher inflows from increased tourist spending were counteracted by a rise in the maritime shipment bill corresponding to imports. The income balance (7% of GDP in 2003 and 2004) reflected the repatriation of private-sector profits.

The capital and financial account balance reflected an increase in loans incurred on domestic and international markets and, to a lesser degree, in private investment flows. Net official investments amounted to US$ 479 million (up from US$ 364 million in 2003). Net private investments, including domestic-market loans to the government, stood at US$ 911 million (US$ 695 million in 2003).

The balance of payments is expected to show an improvement in 2005, thanks to good external conditions, including a rise in international ore prices and a higher level of tourist spending. If fulfilled, the fiscal targets established for fiscal year 2006 will enable the government to cover its domestic and international debt, with positive consequences for the financial and capital account balance.

Suriname

1. General trends

In 2005, in the absence of any brusque policy changes, Suriname's GDP is expected to grow for a third consecutive year, this time at around 5% (compared to 6.4% in 2003 and an estimated 4.6% in 2004), which has not occurred for at least a quarter of a century.[1] Favourable export commodity prices, as well as higher inflows of foreign investment, are the factors underlying the economic boom. The positive economic performance and the containment of inflation did not, however, secure the governing coalition the two-thirds majority it needed in the National Assembly to directly re-elect the President in office in May 2005. The new executive power will be elected by a larger assembly, and the parties are considering their options as regards the formation of coalitions. The outcome of these negotiations could have a significant impact on economic policy.

The macroeconomic stabilization achieved in 2003 paved the way for the introduction of a new currency, the Surinamese dollar, on 1 January 2004. Changes in the legal reserve policy for local and foreign currency deposits helped to rebuild public confidence in the local currency and to reverse the trend towards the dollarization of the economy. Fiscal policy became more expansionary, without macroeconomic stability being affected. In the reporting period, a longer-term perspective was adopted with regard to economic policy, with results that are modest as yet. The authorities began to roll out projects to modernize public administration. They established multi-year programmes for the health and education sectors and initiated structural changes, including the removal of several public enterprises from the state sphere.

2. Economic policy

Following the stabilization of the economy in 2003, which had brought a fiscal surplus, lower inflation, a narrowing of the balance-of-payments current account deficit and expansion of international reserves, economic policy for 2004-2005 was aimed at accelerating growth while safeguarding stability. Few instruments were available

1 After the closing date for this edition of the *Economic Survey*, the General Bureau of Statistics of Suriname published updated figures for these economic growth rates, of 5.4% for 2003 and 7.8% for 2004, which could not be included in this publication.

Table 1

SURINAME: MAIN ECONOMIC INDICATORS

	1996	1997	1998	1999	2000	2001	2002	2003	2004 [a]
	Annual growth rates [b]								
Gross domestic product	6.0	3.6	4.5	-1.4	1.8	4.6	2.8	6.4	4.6
Per capita gross domestic product	5.3	2.9	3.8	-2.2	1.0	3.8	2.1	5.8	4.0
Gross domestic product, by sector									
Agriculture, livestock, hunting, forestry and fishing	-5.1	-2.3	-6.5	4.3	6.3	11.1	-3.8	4.3	...
Mining	5.3	13.3	5.0	5.2	-8.4	24.9	-8.2	-0.5	...
Manufacturing	11.4	8.8	5.1	-8.9	58.6	13.3	-2.6	1.6	...
Electricity, gas and water	9.9	2.1	6.2	-5.8	-7.7	2.2	11.4	-2.4	...
Construction	16.3	15.7	35.0	-14.6	-11.9	4.5	0.6	17.2	...
Wholesale and retail commerce, restaurants and hotels	5.4	2.4	3.8	-5.6	-15.8	-14.6	8.5	32.6	...
Transport, storage and communications	6.7	-3.7	-1.1	1.8	24.8	28.8	11.9	-1.4	...
Financial institutions, insurance, real estate and business services	1.2	0.0	1.5	-1.6	2.8	0.1	0.6	3.0	...
Community, social and personal services	8.9	2.9	-0.5	2.0	-2.1	1.5	3.4	5.5	...
	Millions of dollars								
Balance of payments									
Current account balance	-64	-68	-155	-29	32	-84	-131	-159	-127
Merchandise trade balance	-2	36	-27	44	153	140	47	30	51
Exports, f.o.b.	397	402	350	342	399	437	369	488	481
Imports, f.o.b.	399	366	377	298	246	297	322	458	430
Services trade balance	-66	-102	-125	-72	-125	-115	-128	-136	-147
Income balance	3	-3	-1	0	6	-108	-42	-49	-41
Net current transfers	1	1	-2	-2	-2	-1	-9	-5	9
Capital and financial balance [c]	62	87	163	25	-23	162	112	166	151
Net foreign direct investment	19	-9	9	-62	-148	-27	-74	-76	...
Financial capital [d]	43	96	154	86	125	189	186	242	...
Overall balance	-2	19	8	-4	10	78	-19	7	24
Variation in reserve assets [e]	2	-19	-8	4	-10	-78	19	-7	-24
Other external-sector indicators									
Total gross external debt (millions of dollars)	...	...	...	...	196	270	280	270	236
Total gross external debt (percentage of GDP)	...	...	...	...	40.0	54.4	68.7	49.4	40.2
	Average annual rates								
Employment									
Unemployment rate [f]	11.0	11.0	11.0	12.0	14.0	14.0	10.0	7.0	...
	Annual percentages								
Prices									
Variation in consumer prices (December-December)	1.2	17.4	22.9	112.7	76.1	4.9	28.4	13.1	9.1
Variation in nominal exchange rate (December-December)	-0.3	0.0	0.0	146.3	120.6	0.0	15.4	4.4	4.2
Nominal deposit rate	...	...	...	...	...	11.1	8.4	8.5	8.1
Nominal lending rate	...	...	...	...	...	23.5	21.3	21.0	19.1
	Percentages of GDP								
Central government									
Current income	...	...	...	...	32.8	37.1	31.0	34.1	35.3
Current expenditure	...	...	...	...	46.0	36.4	37.0	31.5	34.7
Overall balance	...	...	...	...	-12.8	-1.6	-6.0	1.4	-2.5
Public debt	...	...	...	...	...	58.5	66.1	51.0	46.1
Domestic	...	...	...	...	...	10.3	19.9	17.4	18.9
External	...	...	...	...	...	48.2	46.2	33.6	27.3
Money and credit									
Domestic credit	...	...	...	...	...	13.6	20.1	23.2	26.5
To the public sector [g]	...	...	...	...	...	5.7	5.3	4.0	4.3
To the private sector	...	...	...	...	...	7.9	14.8	19.1	22.2
M1	...	...	...	...	...	26.5	27.6	21.3	23.9
M2	...	...	...	...	...	64.8	64.0	58.0	67.4

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.
[a] Preliminary figures. [b] Based on figures in local currency at constant 1990 prices (1996-1998: guilders; 1999-2004: Suriname dollars, new currency in circulation since January 2004). [c] Includes errors and omissions. [d] Refers to the capital and financial balance (including errors and omissions), minus net foreign direct investment. [e] A minus sign (-) denotes an increase in reserves. [f] Unemployment rate as a percentage of the economically-active population, nationwide total. [g] Refers to net credit extended to the public and private sectors by commercial banks and other financial and banking institutions.

to the authorities, however. Credit to the public and private sectors expanded, and an effort was made to save part of the approved budget, in particular by controlling government posts and wages. The fiscal deficit was financed by increasing domestic borrowing. As regards economic activity, markets were gradually liberalized and initial steps were taken towards privatizing some state enterprises in the areas of agricultural production, telecommunications services and transport. At any rate, growth in 2004 was slower than in 2003, as the propulsion from foreign investment in 2003 did not recur to the same extent in 2004.

(a) Fiscal policy

The fiscal policy adopted in 2003 had resulted in a financial surplus of 1.4% of GDP. In 2004, which was a pre-election year, fiscal policy was loosened, leading to a deficit of 2.5% of GDP. This reflected, in particular, a higher level of capital spending and a drop in receipts from certain taxes. Despite electoral expenditure, the government proposes to achieve a small current surplus in 2005 and expects a deficit on the financial balance, which will probably be covered by grants.

Fiscal income depends largely on receipts from a few large enterprises engaged in the extraction of bauxite, gold and petroleum, whose international prices have tended to fluctuate sharply. According to the International Monetary Fund, the volatility of fiscal income is further exacerbated by the system of gasoline taxes. The effect was not particularly negative in 2004, except for lower-than-expected takings from the gasoline tax referred to above. Direct taxes increased from 11% of GDP in 2003 to 12.8% in 2004. This compensated for the downturn in indirect taxes, from 16.2% to 15.2% of GDP. Including non-tax revenues, current income went down from 39.7% to 38.6% of GDP.

Fiscal expenditure grew at a faster rate than income in 2004, producing a deficit. Fiscal control is exercised mainly by means of monthly spending authorizations, which the Ministry of Finance uses to try to save a portion of approved spending. Consistent efforts have been made to curtail wage expenditures, which have dropped from 16.8% to 15.9% of GDP. In contrast, outlays on purchases of goods and services rose by 3.5 GDP percentage points, partly for pre-election reasons. Current expenditure increased by 3.2 GDP points, while payment of interest for debt-servicing remained close to 2.5% of GDP.

The main source of financing for the deficit (after grants) is the domestic capital market. The government issues six-month treasury bonds through the commercial banks at a rate of 12.5%. These are bought by pension funds, insurance companies and a certain number of private individuals. In 2004, domestic public debt expanded by 1.5% of GDP. The consolidated debt from 1995, programmed over 15 years, continues to be a significant component of domestic debt.

(b) Monetary and exchange-rate policies

Monetary policy was directed at ensuring the successful introduction of the new currency, the Surinamese dollar, which is equivalent to 1,000 units of the old currency (Surinamese guilders), and at restoring public confidence in the local currency. The main policy instrument is the legal reserve requirement for both local- and foreign-currency deposits. The legal reserve for local-currency deposits was reduced from 35% to 30% in the course of 2004, while the requirement for foreign-currency deposits increased from 17.5% to 22.5%, then to 33.3% in February 2005. In 2004 the legal reserve requirement was also enforced for the final two of the seven commercial banks operating in the country. The interest rate on legal reserves remains unchanged at 6% for Surinamese dollars and a real rate of 0.75% for foreign currency.

The money supply (M1) expanded by 28% in 2004, after a very low rate (1.6%) in 2003. Foreign-currency deposits, which form part of the broadly defined money supply (M2), increased by 33% in 2004, after a rise of 19% in 2003. An expansion of 17% is projected for 2005, together with a reversal of the economy's tendency towards dollarization. The expansion of the money supply reflects both the higher level of international reserves and the expansion of credit to the private sector.

The policy of the legal reserve requirement has also been combined with the objective of stimulating credit for housing construction. In 2004 the commercial banks were authorized to allocate up to 20% of their legal reserve to financing in that sector. The interest rate was set at 7% (one percentage point above the legal reserve rate) for a 25-year term. A credit ceiling of 70,000 Surinamese dollars, or approximately US$ 25,000, was set per housing unit. The banks seized this opportunity and virtually filled the available quota.

Another monetary policy objective is to bring down the lending rate and narrow the spread between lending and deposit rates. At the beginning of 2004, the lending rate stood at a real average of 12.3%, but by the end of the year it had eased down to 10.7%. Since the deposit rate, which remains slightly negative, declined less (by 0.4%), the spread between the two narrowed.

The exchange-rate reform entailed a change in the indicative exchange rate, from 2.6 to 2.7 Surinamese dollars per United States dollar, in order to bring it closer to the market exchange rate. The central bank kept the exchange rate stable for most of 2004, then revalued in

December to 2.68 Surinamese dollars to the United States dollar. Throughout the year, the rate offered in exchange offices was indistinguishable from the official indicative rate. Specific exchange rates are applied to some imported products, but these diverge little from the indicative rate. This policy has naturally led to a significant depreciation of the local currency in relation to the euro.

(c) Other policies

The Ministry of Planning and Development Cooperation is responsible for the management of international cooperation funds. These funds come from bilateral cooperation and the sources include the Netherlands, the Inter-American Development Bank and the United Nations Development Programme. The Netherlands cooperation funds, which were set up when the country became independent in 1975, provide grants and counterpart resources. At the beginning of 2005, agreement was reached on the disbursement of the final grants and the scheduling of counterpart resources. These funds go mainly to four sectors: health, housing, education and agriculture. The counterpart resources (136 million euros) are allocated to objectives established by the government, namely reform of the public sector and the enhancement of conditions for private investment.

3. The main variables

(a) Economic activity

In 2004 the economy expanded at a rate of 4.6%, compared to 6.4% in 2003. Growth of around 5% is projected for 2005, assuming that the formation of a new government will not be so lengthy as to create uncertainty. Growth in 2004 was led by mining, construction and, to a lesser extent, agriculture.

The early 2004 startup of the Rosebel gold mine, which is 95% owned by the Canadian firm Cambior and 5% by the government, meant an investment of US$ 95 million. This activity, which provides almost 1,000 jobs, generated US$ 2.5 million in royalties in 2004. The mine produced 273,700 ounces of gold in 2004, with a production value of US$ 46.5 million.

The United States firm ALCOA, the world's largest company in the subsector of aluminium and related markets, completed the expansion of its refinery in Paranam at the beginning of 2005.

The state oil company Staatsolie suffered a setback of 5% in physical production, but posted an increase of 17.5% in gross income in 2004, thanks to the start-up of international marketing activities.

Construction also provided an impetus for growth. On the one hand, the commercial banks had an incentive to allocate part of their legal reserves to long-term financing of low-cost housing projects. On the other, the government implemented a refurbishment programme for road infrastructure and rural roads, and work is under way to modernize the port and airport.

Projects aimed at effecting structural change were initiated in a number of sectors, particularly in agriculture. In the banana subsector, a loan from the Inter-American Development Bank facilitated restructuring of the state firm Surland, whose debts had become unsustainable. The new company resulting from the reform, Stichting Behoud Bananensector Suriname (SBBS), began exporting bananas to the European market in March 2004 and production should reach 60,000 tons in 2005.

In the rice segment, which provides 9% of employment in Suriname, the main rice producer, the state enterprise SML, was broken up. A new organization, SRO, was created to work with half of the 10,000 hectares owned by the former company. The remaining 5,000 hectares will be distributed among the workers of the former company. The restructuring has not yet gone through, however, and the sector remained at a standstill in 2005.

Telecommunications are in the process of being liberalized. The state enterprise Telesur is to become a corporation; a new telecommunications authority will be responsible for regulation of the sector, and two new companies will be allowed entry to the sector.

Tourism is still at an incipient stage of development. According to the tourism foundation, 137,000 foreign visitors entered the country in 2004, bringing in US$ 128 million, which was a substantial increase on the 85,000 visitors received in 2003.

It must be recalled that the informal sector also plays a very significant role in the economy, contributing between 40% and 60% of GDP, according to official estimates.

(b) Prices, wages and employment

Inflation is estimated to have been 9.1% in 2004 and was projected at slightly less for 2005 (9%). In the light of first-quarter data for 2005, however, it may be expected to be even lower than this figure. Inflation was non-existent in February, mainly due to a reduction in the cost of housing and basic services. In March, prices rose by only 0.2%, and this was the result of an increase in health service costs.

Wages at the lower end of the scale in the public sector average between US$ 185 and US$ 500. The average wage increase in the public sector was approximately 15%. The official projection for public-sector wage rises in 2005 is between 5% and 10%.

(c) The external sector

In the first nine months of 2004, the current account posted a small surplus (US$ 8 million), which was based on a higher surplus in trade in goods (US$ 138 million) and a positive current-transfers balance (US$ 7 million). Goods exports expanded from US$ 500 million in the first nine months of 2003 to US$ 600 million in the same period of 2004, driven by the external sales of gold produced by the new Rosebel mine. Other export products were petroleum, bananas and beer. Imports declined from US$ 500 million to US$ 470 million, owing to completion of construction work for Rosebel.

The goods trade surplus was sufficient to compensate for the structural deficit in trade in services (US$ 106 million), which reflected losses sustained in transport and business services as well as the income account deficit of US$ 30 million. The transfer account showed a positive result of US$ 7.5 million, owing to official transfers.

The deficit on the financial account widened from US$ 41 million in 2003 to US$ 56 million in 2004, in view of liabilities owed to foreign investors (US$ 44 million), payments on public debt (US$ 20 million) and debt restructuring. Public external debt, one third of which has been in arrears since 1999, declined from 33.6% to 27.3% of GDP.

Trinidad and Tobago

1. General trends

In 2004, the economy of Trinidad and Tobago showed real growth of 6.2%, driven by the energy sector. The other sectors grew at a moderate rate of 3%.[1]

Despite the slowdown in growth in non-energy sectors and intensive capital use in the energy sector, the unemployment rate decreased from 10.5% in 2003 to 8.6% in 2004. Construction, commerce and the public sector were the main sources of job creation. Employment fell in the agricultural sector, owing to restructuring of the sugar industry.

The strong upturn in the energy sector's performance (10.5%) brought an increase in its contribution to tax revenue, which led to a positive fiscal balance (1.4% and 2.1% for fiscal years 2003 and 2004, respectively).[2]

The economy's rapid growth, driven largely by high international petroleum prices, allowed a relaxation of monetary policy in order to encourage expansion in the other sectors. Signs of an upsurge in inflation in the last quarter of 2004, however, led to a policy shift in early 2005. The inflation rate almost doubled, from 3.0% in 2003 to 5.6% in 2004.

In 2005 the economy is expected to continue on its current growth trajectory, of around 6%-7%, especially in view of the energy sector's performance and expectations that international petroleum prices will remain high. The current-account surplus in the fiscal budget should therefore come in at between 2% and 3% of GDP. Inflation will probably increase by 7% owing to the sustained rise in food prices.

2. Economic policy

(a) Fiscal policy

The government's fiscal policy was oriented towards maximizing revenues from the energy sector by introducing a new tax regime. This regime is also intended to channel resources to support economic diversification with a view to reducing the country's dependence on the energy sector.

The surplus for fiscal year 2004 was 2.1% of GDP, compared to 1.4% in 2003, which occurred because of higher-than-budgeted international petroleum prices (US$ 31 per barrel instead of the US$ 25 projected). As a result, the revenue stabilization fund grew by more than 80% over fiscal year 2004.

The bulk of receipts (24% and 29% of GDP for fiscal years 2003 and 2004, respectively) came from income and value added taxes. Income from taxes on oil companies also increased significantly owing to the rise in petroleum and gas prices.

1 The analysis in this report is based on the new annual series of GDP at 2000 prices, which are prepared by the Central Bank using new weightings calculated by the Central Statistical Office for that year.
2 The fiscal year is from 1 October to 31 September.

Table 1

TRINIDAD AND TOBAGO: MAIN ECONOMIC INDICATORS

	1996	1997	1998	1999	2000	2001	2002	2003	2004 [a]
				Annual growth rates [b]					
Gross domestic product	7.0	7.7	8.1	8.0	6.9	4.2	6.9	12.6	6.4
Per capita gross domestic product	6.5	7.2	7.7	7.6	6.5	3.8	6.5	12.3	6.1
Gross domestic product, by sector									
Agriculture, livestock, hunting, forestry and fishing	6.9	13.1	-7.2	2.3	-2.4	8.7	6.0	-18.0	-20.2
Mining [c]	7.5	0.9	8.9	21.6	12.5	5.6	13.5	31.2	10.5
Manufacturing	4.4	7.9	11.5	-7.2	6.0	9.8	4.6	5.0	6.6
Electricity, gas and water	27.0	10.0	6.7	0.3	5.5	4.1	7.9	3.8	2.8
Construction [d]	5.3	-0.7	14.2	6.0	7.6	10.3	-16.0	6.7	9.0
Wholesale and retail commerce, restaurants and hotels	7.9	17.7	7.4	8.7	5.4	-2.5	1.0	1.7	2.3
Transport, storage and communications	11.6	18.3	15.6	0.8	8.9	7.7	9.9	5.8	4.4
Financial institutions, insurance, real estate and business services	11.2	22.5	-0.4	11.7	12.4	0.8	12.0	7.1	1.7
Community, social and personal services	2.4	0.9	3.6	-3.3	-4.3	-0.4	2.7	1.2	0.6
				Millions of dollars					
Balance of payments									
Current account balance	105	-614	-644	31	544	416	76	985	1 623
Merchandise trade balance	382	-529	-741	64	969	718	238	1 293	1 509
Exports, f.o.b.	2 354	2 448	2 258	2 816	4 290	4 304	3 920	5 205	6 403
Imports, f.o.b.	1 972	2 977	2 999	2 752	3 322	3 586	3 682	3 912	4 894
Services trade balance	244	292	416	329	166	204	264	314	671
Income balance	-514	-381	-341	-400	-629	-539	-480	-681	-450
Net current transfers	-7	4	22	38	38	33	55	59	53
Capital and financial balance [e]	133	807	724	131	-103	86	39	-583	473
Net foreign direct investment	355	999	730	643	680	835	791	...	...
Financial capital [f]	-222	-192	-6	...	...	...	...	...	...
Overall balance	238	194	80	162	441	502	116	334	734
Variation in reserve assets [g]	-213	-175	-76	-162	-441	-502	-116	-334	-734
Other financing [h]	-25	-18	-4	0	0	0	0	0	0
Other external-sector indicators									
Real effective exchange rate (index: 2000=100) [i]	104.7	107.9	105.3	102.2	100.0	94.5	91.1	91.1	92.5
Gross external public debt (millions of dollars)	...	1 565	1 471	1 585	1 680	1 666	1 549	1 553	1 351
Gross external public debt (percentage of GDP)	...	27.3	24.3	23.3	20.6	18.9	16.3	14.4	12.6
				Average annual rates					
Employment									
Labour force participation rate [j]	...	...	...	60.8	61.2	60.7	60.9	61.6	61.5
Unemployment rate [k]	16.2	15.0	14.2	13.2	12.2	10.8	10.4	10.5	8.6
Prices									
Variation in consumer prices (December-December)	4.3	3.5	5.6	3.4	5.6	3.2	4.3	3.0	5.6
Variation in nominal exchange rate (December-December)	3.3	1.7	-0.2	0.2	0.0	-0.3	0.3	0.0	-0.4
Nominal deposit rate [l]	13.5	13.4	14.4	15.4	14.5	14.0	12.3	11.4	…
Nominal lending rate [l]	5.7	5.4	5.9	6.0	5.7	5.5	3.5	2.5	…
				Percentages of GDP					
Central government									
Current income	...	...	...	23.4	25.3	24.3	26.1	24.0	29.0
Current expenditure	...	...	...	25.7	21.4	22.9	24.1	22.0	24.0
Net capital expenditure	...	...	...	-1.0	-2.3	-1.5	-1.3	-1.2	-2.2
Primary balance	...	...	...	2.4	6.3	4.0	4.8	5.2	5.4
Overall balance [m]	...	...	...	-3.3	1.6	-0.1	0.7	1.4	2.1
Money and credit [n]									
Domestic credit [o]	47.7	49.3	53.7	52.9	46.4	47.3	49.5	43.6	38.0
To the public sector	9.6	12.2	12.4	10.1	8.3	7.6	9.3	8.2	6.2
To the private sector	38.1	37.1	41.2	42.7	38.1	39.7	40.2	35.4	31.8
Liquidity (M3)	...	...	...	...	34.6	36.3	40.3	34.9	...
Currency in circulation and local-currency deposits (M2)	...	...	...	...	25.8	26.8	30.5	27.0	...
Foreign-currency deposits	...	...	...	...	8.8	9.5	9.8	7.9	...

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.
[a] Preliminary figures. [b] Based on figures in local currency at constant 2000 prices. [c] Refers only to the oil industry. [d] Includes quarrying. [e] Includes errors and omissions. [f] Refers to the capital and financial balance (including errors and omissions), minus net foreign direct investment. [g] A minus sign (-) denotes an increase in reserves. [h] Includes the use of IMF credit and loans and exceptional financing. [i] Annual average, weighted by the value of merchandise exports and imports. [j] Economically active population as a percentage of the working-age population. [k] Unemployment rate as a percentage of the economically active population. Includes hidden unemployment. Nationwide total. [l] Weighted average. [m] Includes interest. [n] The monetary figures are annual averages. [o] Refers to net credit extended to the public and private sectors by commercial banks and other financial and banking institutions.

Current expenditure (22% and 24% of GDP in fiscal years 2003 and 2004, respectively) corresponded mainly to wages, transfers and subsidies to households and State organizations and institutions. In accordance with the government's aim of improving overall well-being, gasoline prices were subsidized and pensions and other social benefits were increased. Interest payments decreased, as the interest rates on domestic debt dropped and the stock of public external debt stock was reduced.

Capital spending rose from 1.2% of GDP in fiscal year 2003 to 2.2% in fiscal year 2004, with resources allocated to the "dollar for dollar" programme (education), road upgrading and projects included in the public sector investment programme.

Public debt diminished from 55.9% of GDP in fiscal year 2003 to 52.7% in 2004, and external debt from 15% to 13.1% of GDP. Debt servicing remained relatively low, at 5.7% of exports of non-factor goods and services. In June 2004, Standard & Poor's raised the country's investment rating for long-term public debt to BBB+.

The increase in the liabilities of central government, public enterprises and other State institutions represented 4.6% of domestic debt. The higher level of central government debt was due to the issuance of liabilities to counteract increased market liquidity following the reduction of the legal reserve requirement for commercial banks and the payment of debts.

Receipts from the petroleum sector are expected to reach US$ 3.8 billion in 2005, which would account for 40% of total revenue. Programmed expenditure amounts to US$ 4.4 billion dollars. Any price differences will be passed through to the revenue stabilization fund. Taking this transfer into account, the fiscal surplus is expected to be close to 4% of GDP.

(b) Monetary policy

The goal of the government's monetary policy is to keep inflation low, the foreign-exchange market stable and international reserves at an adequate level.

Since 1996, the central bank has used market-based monetary policy instruments, namely open-market operations and the repo rate, which is used for repurchase transactions to provide day-to-day financing to the commercial banks. The legal reserve requirement applicable to financial institutions has also been used to influence liquidity in the system.

In 2003, the central bank lowered the repo rate by 25 basis points to 5%, and began to gradually reduce the legal reserve requirement. This policy reflected the need to stimulate growth in non-energy sectors, which had been lagging behind significantly. The legal reserve requirement was lowered from 14% to 11% in September 2004.

As a result, interest rates declined; the prime lending rate of the commercial banks went down from 11.5% in 2003 to 8.75% in 2004. The drop in interest rates was reflected in an appreciable expansion in credit to the private sector, from 27.8% of GDP at the end of 2003 to 31.3% of GDP at the end of 2004.

In the first week of March 2005, the central bank raised the repo rate by 25 basis points, to 5.25%, because of the upsurge in inflation and the narrowing of the short-term interest rate spread between local and foreign currency. The shift in the central bank's policy prompted a rise in commercial bank interest rates, as the prime lending rate jumped from 8.75% to 9%.

Monetary management represented a challenge for the authorities in 2004, in view of the economy's substantial growth and the significant increase in liquidity deriving from fiscal operations. Some of this liquidity was sterilized through open-market operations, which absorbed the equivalent of 3.5% of GDP.

(c) Exchange-rate policy

Foreign-currency operations increased during 2004 and the first four months of 2005. International reserves expanded significantly, thanks to capital inflows to the energy sector. The central bank therefore intervened in the exchange market in order to meet the demand for foreign currency and keep the local currency stable with respect to the United States dollar. The local currency did, in fact, remain relatively stable in United States dollar terms (6.2 Trinidad and Tobago dollars to the United States dollar in 2004).

3. The main variables

(a) Economic activity

Output has grown rapidly since 2001. In 2004 the growth rate was 6.2%, which was virtually the same as in 2002 (6.8%), after a peak of 13.2% in 2003. The expansion was due mainly to increased production of natural gas (10.7%), liquefied natural gas (21.3%) and petrochemicals (11.5%).

In 2004, the combined growth of the non-energy sectors was 2.9%. Construction, manufacturing and tourism were the most dynamic sectors, with rates of 9%, 6.6% and 5.9%, respectively. The expansion of services slowed considerably, from 4.2% in 2003 to 2.9% in 2004, as a result of sluggish growth in financial services and insurance. Agriculture continued to decline, adding a contraction of 20.2% in 2004 to the 18% drop recorded in 2003. This was chiefly attributable to restructuring in the sugar industry and poor weather conditions.

The energy sector will continue to be the main engine of growth. The government proposes to increase this sector's value added and its contribution to fiscal revenue by introducing a new tax system.

The strengthening of non-energy sectors will be based on tourism and will include the development of hotel activity and promotion of tourism. The agricultural sector's contribution to growth will be boosted by upgrading infrastructure, improving access to credit and enhancing the agricultural incentives programme, among other measures.

(b) Prices, wages and employment

Inflation almost doubled in 2004 (5.6%) with respect to 2003 (3%), with food prices being the determining factor in this result. The higher cost of food reflected rises in the prices of grains and other inputs, as well as a scarcity of fresh agricultural products (fruit and vegetables) caused by the extreme weather conditions in 2004, including the impact of hurricane Ivan on agricultural imports from neighbouring Caribbean countries.

Unemployment dropped sharply in 2004 (an average of 8.6% compared to 10.5% in 2003). Growth in employment (5.3%) outstripped the expansion of the labour force (2.8%). The services sector, particularly community, social and personal services, was the largest contributor to job creation. Employment also expanded considerably in construction, finances and insurance, manufacturing and energy, but declined significantly in agriculture.

Demand for skilled and unskilled labour will continue to rise and, in the view of employers, who indicate there is a supply shortage, will have to be met by imported labour. This shortage translated into a wage increase from 8 to 9 Trinidad and Tobago dollars per hour at the beginning of 2005.

(c) The external sector

The continuing buoyancy of the energy sector contributed to a significant rise in the surplus on the overall balance. This surplus amounted to 6.4% of GDP in 2004, compared to 3.2% in 2003, while the current account surplus expanded by 65%. Most of this surplus may be attributed to the merchandise trade balance, which rose by 17%, but other contributing factors included the doubling of the surplus on the services account and a sharp reduction in the repatriation of income and foreign investment.

Goods exports accounted for 55.8% of GDP in 2004, compared to 49.2% in 2003. Minerals and fuels represented 60% of exports, but grew by only 11% in 2004. Exports of chemicals posted the highest growth rate (67.8%), followed by manufactures (28.3%) and foods (12.6%). Manufactures account for 9% of exports and go mainly to the markets of CARICOM member countries.

Imports rose to 42.5% of GDP in 2004 (37% in 2003). Machinery and transport equipment, and minerals and fuels, were the largest import categories, accounting for 37% and 24%, respectively, of total imports in 2004. The largest jumps in imports were recorded by manufactures (50.3%) and capital goods (43%).

Exports of services were equivalent to 8.1% of GDP in 2004, compared to 6.4% in 2003. The leading exports corresponded to tourism, transport and insurance, which accounted for 34%, 33% and 12%, respectively, of total services exports in 2004. The fastest-growing categories were tourism (up 68.6%) and transport (25%).

The deficit in the capital and financial account of the balance of payments rose by approximately 4.6% in 2004 and was equivalent to 6.4% of GDP (4.8% in 2003). Net direct investment increased by 66.8% in 2004. Nevertheless, there was also substantial capital flight, most of which reflected asset purchases abroad and the issue of regional bonds on the domestic capital market. Regional bond issues were equivalent to 6% of GDP in 2004, which compares with 4.8% in 2003.

The expansion of the overall surplus led to further strengthening of the country's international reserves, which grew by 30% in 2004. Net official reserves were equivalent to 26% of GDP or about 7 months of imports of goods and services.

Energy exports continued to be significant in 2005 and, in a context of high international prices, will produce a surplus estimated at between 6% and 7%. Petrochemical exports will also continue to rise, thanks to a planned increase in production. Whether manufacturing exports continue to expand will depend on the growth of regional markets and the ability of the manufacturing companies to penetrate markets outside the region. In addition, the considerable efforts under way to develop tourism should contribute to the growth of the sector's services exports.

Countries members of the Organisation of Eastern Caribbean States (OECS)[1]

1. General trends

The countries members of the Organisation of Eastern Caribbean States (OECS) posted a positive growth rate for the third consecutive year since the events of September 2001. Economic activity expanded (by 3.5% in 2003 and 3.9% in 2004) in response to the buoyancy of tourism and construction. GDP grew in almost all the OECS countries except Grenada, where output fell by 3% as a result of the devastation caused by hurricane Ivan.

The impetus of economic activity pushed up tax receipts, which, combined with efforts to curb public expenditure, narrowed the fiscal deficit across the member countries from 8% of GDP in 2003 to 7% in 2004. Fiscal performance was uneven among the individual countries.

Inflation climbed from 1.5% in 2003 to 2.4% in 2004, in response to rising aggregate expenditure that resulted from increased economic activity, higher international oil prices, wage increases and the appreciation of the euro.

The external sector turned in an improved performance, mainly thanks to the narrowing of the current account deficit from 21% of GDP in 2003 to 17% in 2004. This reflected a widening service account surplus thanks to growth in tourism, and contributed to the expansion of net transfers following efforts to mitigate and offset the damage caused by natural disasters.

In 2005, the member countries anticipate that their economies will maintain their current growth trajectory, buoyed by tourism and construction. Despite increasing output, fiscal imbalances are expected to sharpen as capital spending rises in preparation for Cricket World Cup to be held in 2007 and public and private infrastructure projects are implemented.

Travel-industry revenues have been offset by the sustained increase in merchandise imports and only moderate growth in remittances, while production activity is still recovering from the impact of natural disasters, all of which will widen the external deficit. Member States anticipate that flows of public and private capital will be sufficient to meet their economies' financing requirements.

2. Economic policy

(a) Fiscal policy

The overall consolidated fiscal deficit of the OECS economies narrowed from 8% of GDP in 2003 to 7% in 2004, mainly due to an increase in tax receipts to 24% of GDP (up from 23% in 2003) and, albeit in smaller measure, to a drop in capital expenditure (from 8% of GDP in 2003 to 7% in 2004).[2]

1 The members and associate members of the Organisation of Eastern Caribbean States (OECS) are Anguilla, Antigua and Barbuda, British Virgin Islands, Dominica, Grenada, Montserrat, Saint Kitts and Nevis, Saint Lucia and Saint Vincent and the Grenadines. The analysis in this section refers only to the independent States members by OECS.

2 Fiscal results do not include grants.

Table 1

ORGANISATION OF EASTERN CARIBBEAN STATES (OECS): MAIN ECONOMIC INDICATORS

	1996	1997	1998	1999	2000	2001	2002	2003	2004 [a]
				Annual growth rates [b]					
Gross domestic product	2.7	3.2	4.0	4.5	3.9	-1.3	0.5	3.5	3.9
Per capita gross domestic product	2.0	2.6	3.4	4.0	3.4	-1.8	0.0	2.9	3.3
Gross domestic product, by sector									
Agriculture, livestock, hunting, forestry and fishing	...	-7.1	1.1	-4.7	0.4	-8.4	5.3	-4.7	0.1
Mining	...	7.0	2.1	6.5	21.5	-6.3	-1.5	5.6	3.7
Manufacturing	...	2.7	2.3	3.3	-0.1	-1.4	-1.3	0.6	-1.8
Electricity, gas and water	...	6.7	6.2	9.0	14.3	5.6	2.0	2.9	1.0
Construction	...	7.9	11.5	8.3	4.9	-1.5	-2.5	4.4	5.5
Wholesale and retail commerce, restaurants and hotels	...	5.5	2.4	4.2	1.5	-5.3	-0.4	8.3	5.9
Transport, storage and communications	...	6.1	5.9	9.2	2.6	-1.2	-0.6	3.7	7.2
Financial institutions, insurance, real estate and business services	...	6.9	6.1	5.5	15.3	0.8	3.3	2.8	2.2
Community, social and personal services	...	-5.7	-2.9	-2.4	-6.4	6.4	0.5	1.1	0.9
				Millions of dollars					
Balance of payments									
Current account balance	-329	-403	-366	-450	-438	-462	-585	-652	-563
Merchandise trade balance	-853	-948	-982	-1 056	-1 066	-1 006	-1 006	-1 176	-1 286
Exports, f.o.b.	338	298	316	327	359	303	305	307	321
Imports, f.o.b.	-1 191	-1 246	-1 299	-1 383	-1 426	-1 309	-1 311	-1 483	-1 607
Services trade balance	527	576	629	642	671	606	527	615	739
Income balance	-127	-132	-147	-170	-207	-174	-208	-218	-247
Net current transfers	124	100	134	133	164	112	101	127	232
Capital and financial balance [c]	310	426	417	472	451	527	646	698	666
Net foreign direct investment	183	261	313	335	307	271	...	...	...
Financial capital [d]	127	165	104	137	144	259	306	179	186
Overall balance	-19	23	51	22	12	65	61	46	103
Variation in reserve assets [e]	20	-23	-54	-22	-12	-65	-61	-46	-103
Other financing [f]	-1	-1	2	0	0	0	0	0	0
Other external-sector indicators									
Gross external public debt (millions of dollars)	759	885	976	1 266	1 319	1 511	1 856	2 073	1 964
Gross external public debt (percentage of GDP)	33.1	36.6	37.6	46.1	46.5	53.1	63.7	67.6	59.9
Net profits and interest (percentage of exports) [g]	80.9	76.5	83.7	96.2	99.0	88.1	87.8	82.1	71.5
				Annual percentages					
Prices									
Variation in consumer prices (December-December)	2.0	2.4	2.8	1.7	1.7	1.3	0.3	1.5	2.4
Nominal deposit rate [h]	…	11.6	11.3	11.8	11.6	11.4	11.0	12.8	…
Nominal lending rate [h]	…	4.2	4.2	4.2	4.4	4.3	3.7	4.6	…
				Millions of Eastern Caribbean dollars					
Central government									
Current income	1 567	1 628	1 775	1 903	1 947	1 910	2 012	2 166	2 371
Current expenditure	1 466	1 549	1 657	1 785	1 871	2 038	2 172	2 224	2 396
Net capital expenditure	…	380	456	531	586	556	445	602	549
Primary balance	…	-46	12	-63	-127	-245	-160	-73	50
Overall balance [i]	…	-171	-115	-220	-329	-500	-449	-403	-324
				Percentages of GDP					
Money and credit									
Domestic credit	58.9	63.4	63.5	68.0	75.5	75.6	74.9	71.0	71.7
Public	-0.3	-0.8	-1.6	0.1	2.1	-0.4	-0.6	-2.4	-2.6
Private	63.3	68.1	68.5	71.4	76.3	77.8	77.4	75.1	74.7
Liquidity (M3)	63.7	66.2	69.6	72.8	77.9	82.3	85.6	89.2	86.5
Currency in circulation and local-currency deposits (M2)	58.1	59.6	62.8	65.3	67.9	71.8	73.9	77.4	73.2
Foreign-currency deposits	5.6	6.6	6.8	7.5	10.0	10.4	11.7	11.8	13.3

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.
[a] Preliminary figures. [b] Based on figures in Eastern Caribbean dollars at constant 1990 prices. [c] Includes errors and omissions. [d] Refers to the capital and financial balance (including errors and omissions), minus net foreign direct investment. [e] A minus sign (-) denotes an increase in reserves. [f] Includes the use of IMF credit and loans and exceptional financing. [g] Refers to net investment income as a percentage of exports of goods and services as shown on the balance of payments. [h] Weighted averages. [i] Includes grants.

In 2004, current expenditure remained at the level recorded in 2003 (27% of GDP). The tax burden increased in response to healthier growth prospects, while the pattern of capital expenditure was determined mainly by the completion of infrastructure works. The level of indebtedness of the OECS as a group retreated from 105% to 100% of GDP, as a result of debt restructuring by Antigua and Barbuda. Indebtedness increased in the rest of the economies.

The aggregate fiscal results mask large differences in the countries' individual performances. Antigua and Barbuda, Saint Kitts and Nevis and Saint Lucia improved their fiscal results, while the government accounts of Dominica worsened. Grenada and Saint Vincent and the Grenadines showed no change on the previous year in terms of budget outturn.

Most of the OECS countries are expected to see their fiscal accounts deteriorate in 2005, since the anticipated rise in income will be more than outweighed by the climb in capital expenditure. Rising economic activity will have an effect on taxes on international trade and transactions, with an increase in revenue flows and in the demand for imports. The implementation of planned tax and administrative measures is also expected to make the governments' tax collection procedures more efficient. Once the countries begin preparations for the 2007 Cricket World Cup, however, the rise in capital expenditure is likely to offset the increase in current income.

The fiscal balance of Antigua and Barbuda, which went from -7% of GDP in 2003 to -6% in 2004, reflected higher income from international trade and transactions and hotel taxes, which made up for outlays on debt servicing payments.

Tax performance was the result of increased demand for imports and a rise in tourist spending. For 2005, the authorities have announced wage cuts (20% for civil servants) and a package of tax measures (including the reintroduction of income tax and tax rates of 5% on retail commerce and 7% on consumption) as a continuation of the policy aimed at reducing budgetary imbalances and lowering the external debt stock. This stock was halved in 2004 (41% of GDP, compared with 84% in 2003) thanks to restructuring operations.

The deficit of the Government of Dominica widened from 6% of GDP in 2003 to 8% in 2004, as a result of rising capital expenditure, which more than offset the positive effects of increased revenues from taxes on sales and international trade and transactions. Capital spending corresponded to rehabilitation and reconstruction work undertaken by the authorities in the wake of the earthquake in November. The pattern of income was attributable to the upturn in economic activity and the rise in the customs clearance rate. The fiscal accounts will reflect the full impact of the earthquake in 2005, with smaller receipts and higher capital expenditure.

Grenada again posted a deficit (-9.7% of GDP in both 2003 and 2004) and reduced capital spending, which offset the effects of shortfalls in government income and higher current spending. Tax performance was affected by the aftermath of hurricane Ivan. Current expenditure rose as a result of civil-service wage rises. In 2005, spending on reconstruction work and wages (8%) is expected to exceed income, despite plans to introduce a special income tax and increase petroleum retail prices.

In Saint Kitts and Nevis, the improved tax ratio offset an expansion in current expenditure, thereby narrowing the fiscal deficit from 9% of GDP in 2003 to 8% in 2004. Government revenues reflected better economic growth prospects and buoyant tourism. Current expenditure reflected higher payments for goods and services and payroll increases. The government intends to continue its fiscal consolidation efforts in 2005, although public-sector wages and capital expenditure are projected to increase. The repercussions for central government income and expenditure of the closure of the sugar industry in the second half of 2005 will have a crucial impact on fiscal performance.

Saint Lucia managed to narrow its budgetary imbalance significantly, from 6.4% of GDP in 2003 to 2.5% in 2004, thanks to the introduction of a series of tax measures and a decline in capital expenditure. The tax measures included increases in the airport tax payable by members of the Caribbean Community (CARICOM) and in the rate applicable to banking and marriage licences and work permits. The government also raised specific taxes, as well as rates of duty on the consumption of imported alcoholic beverages, tobacco and the retail price of gasoline and fuel.

The authorities expect the fiscal deficit to widen in 2005 as capital expenditure is up 51% on the previous year and receipts are anticipated to drop due to a cut in the corporate tax rate.

The fiscal deficit of Saint Vincent and the Grenadines remained at 4% of GDP, reflecting an increase in payroll and higher expenditure on goods and services, which was covered by a rise in tax revenues thanks to the economy's high growth rate. In 2005, the central government's current expenditure will climb by 8.4% owing to wage increases (7.8%), while capital expenditure will expand by 4.8%. On the income side, the authorities plan to introduce a tax exemption for small enterprises, raise the tax-free threshold and increase the retail price of petroleum products.

(b) Monetary and exchange-rate policies

The economies that make up the Organisation of Eastern Caribbean States formed a monetary union in

1983. Their single currency, the Eastern Caribbean dollar (EC$), is linked to the United States dollar at a fixed rate of EC$ 2.7. The union's monetary authority, the Eastern Caribbean Central Bank (ECCB), acts as a virtual currency board and is required by its statutes to maintain reserves equivalent to 60% of its monetary liabilities. Ever since the monetary union's inception, ECCB has maintained a neutral stance and has changed its benchmark interest rate only slightly. The monetary union has two features that account for this neutral behaviour: on the one hand, the management of external assets and liabilities has enabled the monetary authority to keep its reserves at a level well in excess of the statutory requirement; and on the other, the commercial banking system complies strictly with its obligation to maintain a balance between assets and liabilities.

The expansion of the union's broad money supply (M2 of 10% in 2003 and 13% in 2004) was mainly a reflection of a rise in net external assets (22%) and, to a lesser extent, an increase in net domestic assets (9%). The rise in net external assets was attributable to travel-industry revenues, foreign direct investment and private and official assistance to remedy the damage caused by natural disasters.

Net domestic credit was affected by a standstill in demand for credit to the private sector, despite good prospects for growth within OECS (3% in 2003 and 2.4% in 2004); as a result, liquidity in the commercial banking system swelled.

A sectoral breakdown of credit shows that personal loans represented 49% of the total. Tourism, construction and agriculture were the sectors to register the largest increases in demand for loans.

Monetary conditions are not expected to change in 2005. Indeed OECS should follow its characteristic patterns with liquidity above the statutory level, growth of monetary aggregates driven by net external assets, weak demand for loans from the private sector and a spectrum of interest rates with no significant variations.

3. The main variables

(a) Economic activity

The growth rate in the OECS economies trended upwards for the third year in a row, which was a reflection of growth in construction and tourism. In 2005, as in previous years, the growth pattern in the member countries will continue to be sustained by these two sectors. Economic activity will benefit from activities related to the Cricket World Cup (2007), increased air flight capacity and higher foreign capital flows.

Agriculture stagnated in aggregate terms (-4.9% in 2003 and 0.1% in 2004), as the downturn in Grenada, Saint Kitts and Nevis and Saint Vincent and the Grenadines offset the positive performances of all the other countries. In most countries, agriculture benefited from larger areas under cultivation, increased productivity and higher international prices. Bananas, in particular, posted a clear recovery (up 16% for OECS as a whole).

The repercussions of natural disasters, particularly in Grenada and, to a lesser extent, in Saint Lucia and Saint Vincent and the Grenadines, will be felt more keenly in 2005. In Grenada, agricultural production is expected to fall by 39%. Another significant factor that will affect the performance of agriculture in 2005 is the shutdown of sugar production in Saint Kitts and Nevis due to low profitability.

Manufacturing contracted in OECS as a whole (0.6% in 2003 and -1.8% in 2004), while individual performance varied from one country to another. The sector expanded by 1% in Dominica and 2.9% in Saint Vincent and the Grenadines, as a result of increased production of traditional goods such as soap, food, beverages and milling products (whose supply rose in keeping with higher consumption). Greater intraregional trade flows were also a contributing factor.

The standstill in manufacturing in Saint Kitts and Nevis (-0.2%) was due to high operating costs and low levels of technology in most of the sector's enterprises. In Saint Lucia, manufacturing performance (-2.5%) was attributable to reduced production capacity following a plant closure. In Grenada, the poor manufacturing outturn reflected the disruption and damage caused by hurricane Ivan.

The manufacturing sector is expected to post a positive growth rate in 2005, as Grenada's economy recovers and build up its capacity to respond to rises in domestic and foreign demand for manufactures.

Construction developed in step with economic growth and with new and ongoing public and private infrastructure projects. Preparations for the Cricket World Cup, expectations of higher growth and the effects of reconstruction work will provide a significant boost for the construction sector in 2005.

Tourism performed unevenly across the OECS countries (12.4% in aggregate terms for 2003 and 8.4% for 2004). In Grenada, it contracted by 13% in 2004, but in the rest of the economies, it responded to growth in its main foreign markets, increased flight capacity, larger flows of investment in tourist establishments and higher numbers of cruise stopovers and itineraries. These variables will also underlie the performance of tourism in 2005.

(b) Prices, wages and employment

Aggregate inflation rose (from 1.5% in 2003 to 2.4% in 2004), partly as a result of the rise in international oil prices, the introduction of new tax measures, wage increases, the appreciation of the euro in relation to the Eastern Caribbean dollar and the effects of natural disasters. These factors will also play a significant part in determining the rate of price increases in 2005, which is expected to exceed 2%.

In terms of countries, Saint Kitts and Nevis posted the lowest rate of inflation in 2004 (1.7%), while Saint Lucia recorded the highest (3.5%). By price components, inflation in Saint Kitts and Nevis was driven by rises in prices for beverages (1%) and housing (6%). In Saint Lucia, the inflation rate reflected higher prices for food (1%); electricity and fuel (6%); and clothing and footwear (5%).

Civil-service wages were raised by 4% in Grenada, 10% in Saint Kitts and Nevis, 3% in Saint Lucia and 4% in Saint Vincent and the Grenadines. The governments of Grenada, Saint Kitts and Nevis and Saint Vincent and the Grenadines expect additional increases in the public wage bill in 2005.

Employment trends in OECS followed the pattern of expansion in economic activity. The unemployment rate climbed steeply in Grenada and Dominica. In February 2005, Grenada's unemployment rate was estimated to stand at 30% of the workforce, due to the destructive effects of hurricane Ivan. The number of unemployed rose in Saint Kitts and Nevis as a result of the closure of the sugar industry, which employs 1,000 people.

(c) The external sector

The overall balance-of-payments position showed a surplus (1.5% of GDP in 2003 and 3.1% in 2004), as the current-account deficit (21% of GDP in 2003 and 17% in 2004) was easily financed by the surplus on the capital and financial account (23% of GDP in 2003 and 20% in 2004). As a result, OECS increased its stock of international reserves, thus helping to maintain the credibility of the monetary union.

The current-account position improved in line with the buoyancy of the tourist sector which, in turn, widened the services account surplus from 20% of GDP in 2003 to 23% in 2004. Travel-industry revenues jumped by 13% on account of higher visitor numbers (2.5 million in 2003 and 3.2 million in 2004). Current account operations also reflected an increase in unilateral transfers from 4% of GDP in 2003 to 7% in 2004, which resulted from private and public financial assistance for victims of natural disasters, plus insurance and reinsurance.

The balance of trade was much the same as the previous year (-38% of GDP in 2003 and -39% in 2004), owing to similar increases in imports and exports. Export performance responded to the recovery of agriculture, a rise in the international prices of some products, such as bananas (16% in 2004), and increased exports of certain manufactures (soap, beverages and food).

The capital account reflected flows of official grants, while the financial account balance was attributable to net foreign direct investment (US$ 479 million, compared with US$ 519 million in 2003). This investment went to tourism (60%), construction (3%) and sport-related activities (1%).

In 2005, the current-account balance will show the effects of increased exports, as a result of the economic upswing. At the same time, merchandise exports will drop as the effects of hurricane Ivan kick in fully. Sustained buoyancy in the tourism sector and preparations for the Cricket World Cup will be the key factors in the services account balance. The balance of current transfers will reflect the gradual reduction of official and private assistance for renovation and rehabilitation work. The capital account will record inflows related to infrastructure projects in those States affected by natural disasters. Lastly, the financial account will record foreign direct investment flows being channelled into development of the tourism sector.

Statistical appendix

Table A - 1

LATIN AMERICA AND THE CARIBBEAN: MAIN ECONOMIC INDICATORS

	1996	1997	1998	1999	2000	2001	2002	2003	2004 [a]
	Annual rates of variation								
Gross domestic product [b]	3.8	5.5	2.5	0.4	4.0	0.3	-0.8	2.0	5.9
Per capita gross domestic product [b]	2.1	3.7	0.9	-1.1	2.4	-1.2	-2.3	0.5	4.4
Consumer prices [c]	18.6	10.7	10.0	9.7	9.0	6.1	12.2	8.5	7.3
	Percentages								
Urban open unemployment rate [d]	9.4	8.9	10.0	10.7	10.1	10.0	10.7	10.7	10.0
Total gross external debt/GDP [e]	35.4	34.1	37.1	42.4	37.0	38.5	42.7	42.5	37.5
Total gross external debt/exports of goods and services	213	201	219	212	172	181	178	169	140
	Billions of dollars								
Balance of payments									
Current account balance	-38.6	-64.4	-88.2	-54.9	-46.6	-51.4	-13.5	7.9	18.0
Merchandise trade balance	5.2	-13.1	-35.0	-6.8	3.5	-3.8	24.0	44.1	58.2
Exports of goods and services, f.o.b.	257.4	286.7	283.4	299.4	359.1	343.3	346.8	377.3	463.6
Imports of goods and services, f.o.b.	252.2	299.8	318.4	306.2	355.6	347.2	322.8	333.2	405.4
Services trade balance	-15.9	-19.0	-19.0	-17.2	-17.1	-18.9	-14.1	-13.3	-14.6
Income balance	-42.7	-47.7	-51.3	-50.3	-53.6	-53.8	-51.9	-57.8	-66.8
Net current transfers	14.8	15.4	17.0	19.4	20.6	25.2	28.5	34.9	41.2
Capital and financial balance [f]	63.9	89.2	63.4	42.6	61.2	34.2	-12.1	3.2	-5.6
Net foreign investment	40.3	57.6	63.7	79.3	68.9	65.1	41.4	31.7	43.9
Financial capital [g]	23.6	31.6	-0.3	-36.8	-7.7	-30.9	-53.5	-28.5	-49.6
Overall balance	25.2	24.8	-24.8	-12.3	14.6	-17.2	-25.6	11.1	12.3
Variation in reserve assets [h]	-26.1	-15.8	9.1	6.2	-6.9	1.0	3.2	-29.5	-21.1
Other financing [i]	0.9	-9.0	15.7	6.1	-7.7	16.2	22.4	18.4	8.8

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.
[a] Preliminary figures.
[b] Based on official figures converted into dollars at constant 2000 prices.
[c] December-December variation.
[d] The data for Argentina and Brazil have been adjusted to allow changes in methodology in 2002 and 2003, respectively.
[e] Estimates based on figures denominated in dollars.
[f] Includes errors and omissions.
[g] Refers to the capital and financial balance (including errors and omissions), minus net foreign direct investment.
[h] A minus sign (-) indicates an increase in reserve assets.
[i] Includes the use of IMF credit and loans and exceptional financing.

Table A - 2

LATIN AMERICA AND THE CARIBBEAN: GROSS DOMESTIC PRODUCT

(Annual growth rates)

	1996	1997	1998	1999	2000	2001	2002	2003	2004 [a]
Latin America and the Caribbean	**3.8**	**5.5**	**2.5**	**0.4**	**4.0**	**0.3**	**-0.8**	**2.0**	**5.9**
Subtotal (20 countries)	**3.8**	**5.5**	**2.5**	**0.4**	**4.0**	**0.3**	**-0.8**	**1.9**	**5.9**
Argentina	5.5	8.1	3.9	-3.4	-0.8	-4.4	-10.9	8.8	9.0
Bolivia	4.4	5.0	5.0	0.4	2.5	1.7	2.4	2.8	3.6
Brazil	2.7	3.3	0.1	0.8	4.4	1.3	1.9	0.5	4.9
Chile	7.4	6.6	3.2	-0.8	4.5	3.4	2.2	3.7	6.1
Colombia	2.1	3.4	0.6	-4.2	2.9	1.5	1.9	4.1	4.1
Costa Rica	0.9	5.6	8.4	8.2	1.8	1.1	2.9	6.5	4.2
Cuba	7.8	2.7	0.2	6.3	6.1	3.0	1.5	2.9	3.0
Ecuador	2.4	4.1	2.1	-6.3	2.8	5.1	3.4	2.7	6.9
El Salvador	1.7	4.2	3.8	3.4	2.2	1.7	2.2	1.8	1.5
Guatemala	3.0	4.4	5.0	3.8	3.6	2.3	2.3	2.1	2.7
Haiti	4.1	2.7	2.2	2.7	0.9	-1.0	-0.5	0.5	-3.8
Honduras	3.6	5.0	2.9	-1.9	5.7	2.6	2.7	3.5	5.0
Mexico	5.2	6.8	5.0	3.8	6.6	-0.0	0.8	1.4	4.4
Nicaragua	6.3	4.0	3.7	7.0	4.2	3.0	0.6	2.3	5.1
Panama	2.8	6.4	7.4	4.0	2.7	0.6	2.2	4.3	6.2
Paraguay	0.4	3.0	0.6	-1.5	-3.3	2.1	-0.0	3.8	4.0
Peru	2.5	6.8	-0.7	0.9	2.9	0.2	4.9	4.0	4.8
Dominican Republiic	7.2	8.2	7.4	8.2	8.1	3.6	4.4	-1.9	2.0
Uruguay	5.6	5.0	4.5	-2.8	-1.4	-3.4	-11.0	2.2	12.3
Venezuela (Bolivarian Republic of)	-0.2	6.4	0.3	-6.0	3.7	3.4	-8.9	-7.7	17.9
Subtotal Caribbean	**1.9**	**1.6**	**2.7**	**2.8**	**4.2**	**1.7**	**1.7**	**6.5**	**3.9**
Antigua and Barbuda	6.1	5.6	4.9	4.9	3.3	1.5	2.1	5.5	5.9
Barbados	3.2	4.6	6.2	0.5	2.4	-3.4	-0.5	3.7	4.4
Belize	1.5	3.6	3.7	8.8	12.3	5.0	4.2	9.0	4.2
Dominica	3.1	2.0	2.8	1.6	1.3	-4.2	-5.1	-0.0	3.9
Grenada	2.9	4.4	7.9	7.3	7.0	-4.4	0.8	5.8	-3.0
Guyana	7.0	7.1	-1.7	3.0	-1.4	2.3	1.1	-0.6	1.6
Jamaica	-1.1	-1.7	-0.3	-0.4	0.7	1.7	1.0	2.3	1.2
Saint Kitts and Nevis	5.9	7.3	1.0	3.9	6.5	1.7	-0.3	0.6	5.6
Saint Vincent and the Grenadines	0.8	3.1	5.7	3.6	2.0	-0.1	3.2	3.4	5.4
Saint Lucia	2.9	-0.1	5.8	1.8	-0.1	-6.4	1.0	2.9	3.6
Suriname	6.0	3.6	4.5	-2.3	0.5	1.3	1.2	3.5	4.0
Trinidad and Tobago	3.8	3.1	4.4	6.9	9.3	4.2	3.2	12.8	6.2

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures converted into dollars at constant 2000 prices.

[a] Preliminary figures.

Table A - 3

LATIN AMERICA AND THE CARIBBEAN: PER CAPITA GROSS DOMESTIC PRODUCT

(Annual growth rates)

	1996	1997	1998	1999	2000	2001	2002	2003	2004 [a]
Latin America and the Caribbean	**2.1**	**3.7**	**0.9**	**-1.1**	**2.4**	**-1.2**	**-2.3**	**0.5**	**4.4**
Subtotal (20 countries)	**2.1**	**3.8**	**0.8**	**-1.2**	**2.4**	**-1.2**	**-2.3**	**0.4**	**4.4**
Argentina	4.3	6.9	2.7	-4.4	-1.8	-5.4	-11.7	7.8	8.0
Bolivia	1.9	2.5	2.5	-1.9	0.1	-0.6	0.1	0.5	1.3
Brazil	1.1	1.7	-1.4	-0.7	2.8	-0.2	0.5	-0.9	3.4
Chile	5.8	5.1	1.9	-2.0	3.2	2.2	1.0	2.6	4.9
Colombia	0.1	1.5	-1.3	-6.0	1.1	-0.3	0.2	2.4	2.4
Costa Rica	-1.6	2.9	5.7	5.7	-0.5	-1.0	0.9	4.5	2.3
Cuba	7.3	2.3	-0.3	5.9	5.7	2.6	1.2	2.6	2.7
Ecuador	0.7	2.4	0.6	-7.6	1.3	3.6	1.9	1.2	5.4
El Salvador	-0.4	2.1	1.6	1.4	0.2	-0.2	0.3	-0.0	-0.2
Guatemala	0.6	2.0	2.6	1.5	1.2	-0.1	-0.2	-0.4	0.1
Haiti	2.2	0.8	0.3	0.8	-1.0	-2.8	-2.4	-1.3	-5.5
Honduras	0.7	2.1	0.1	-4.5	3.0	-0.0	0.1	0.9	2.5
Mexico	3.4	5.0	3.3	2.1	5.0	-1.5	-0.7	0.0	3.0
Nicaragua	4.1	1.9	1.7	4.9	2.1	0.9	-1.4	0.2	3.1
Panama	0.7	4.3	5.3	2.0	0.8	-1.3	0.4	2.4	4.4
Paraguay	-2.2	0.3	-2.0	-4.0	-5.8	-0.5	-2.5	1.3	1.5
Peru	0.7	5.0	-2.4	-0.8	1.3	-1.4	3.4	2.4	3.3
Dominican Republic	5.3	6.3	5.6	6.3	6.3	1.9	2.7	-3.5	0.3
Uruguay	4.8	4.3	3.8	-3.6	-2.2	-4.1	-11.7	1.5	11.5
Venezuela (Bolivarian Republic of)	-2.2	4.3	-1.6	-7.8	1.8	1.5	-10.5	-9.3	15.8
Subtotal Caribbean	**1.2**	**0.9**	**2.0**	**2.1**	**3.6**	**1.1**	**1.2**	**6.0**	**3.4**
Antigua and Barbuda	3.9	3.4	2.9	3.1	1.6	0.1	0.8	4.3	4.7
Barbados	2.8	4.3	5.9	0.2	2.1	-3.7	-0.7	3.4	4.2
Belize	-1.2	1.0	1.2	6.2	9.7	2.6	1.9	6.7	2.1
Dominica	2.2	1.1	2.0	1.0	0.8	-4.5	-5.2	-0.2	3.6
Grenada	2.3	3.9	7.4	6.9	6.7	-4.5	0.8	5.7	-3.3
Guyana	6.7	6.8	-2.0	2.7	-1.7	2.0	0.9	-0.8	1.4
Jamaica	-1.9	-2.6	-1.1	-1.2	-0.0	1.1	0.5	1.8	0.7
Saint Kitts and Nevis	6.0	7.4	1.0	3.7	6.0	0.9	-1.3	-0.6	4.3
Saint Vincent and the Grenadines	0.2	2.6	5.2	3.1	1.5	-0.6	2.6	2.9	4.8
Saint Lucia	1.8	-1.0	4.9	1.0	-0.8	-7.2	0.2	2.1	2.8
Suriname	5.1	2.6	3.5	-3.2	-0.4	0.5	0.5	2.8	3.3
Trinidad and Tobago	3.3	2.7	4.0	6.5	8.9	3.9	2.9	12.4	5.8

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures converted into dollars at constant 2000 prices.

[a] Preliminary figures.

Table A - 4

LATIN AMERICA AND THE CARIBBEAN: GROSS FIXED CAPITAL FORMATION

(Percentages of GDP)

	1996	1997	1998	1999	2000	2001	2002	2003	2004 [a]
Latin America and the Caribbean	**18.7**	**20.2**	**20.6**	**19.3**	**19.2**	**18.7**	**17.7**	**17.4**	**18.5**
Argentina	16.8	18.3	18.9	17.5	16.2	14.1	10.2	12.8	15.8
Bolivia	16.2	19.3	23.7	20.0	17.9	13.8	15.9	14.0	13.1
Brazil	19.9	21.1	21.0	19.2	19.3	19.2	18.3	17.4	18.2
Chile	23.7	24.6	24.2	19.9	20.7	20.9	20.8	21.2	22.6
Colombia	22.0	20.9	19.4	13.1	12.6	13.4	14.6	17.3	18.8
Costa Rica	16.2	17.9	20.8	18.3	17.8	18.0	18.6	18.9	17.5
Cuba	11.6	11.9	12.4	12.4	12.9	12.1	10.8	9.8	10.3
Ecuador	29.5	27.1	27.5	28.7	20.5	22.9	25.5	29.5	28.4
El Salvador	15.6	16.2	17.3	16.5	16.9	16.9	16.9	17.1	16.3
Guatemala	13.4	15.9	17.9	18.2	16.1	16.1	16.4	15.4	15.2
Haiti	30.0	31.1	27.3	23.3	25.7	22.2	25.6	26.0	24.9
Honduras	22.8	25.0	27.1	30.1	26.1	23.6	21.5	22.7	25.3
Mexico	16.7	18.9	19.8	20.5	21.4	20.2	19.9	19.7	20.3
Nicaragua	23.6	25.7	26.6	33.8	29.8	28.1	24.7	24.0	25.2
Panama	20.3	20.5	21.9	23.4	21.2	15.7	14.5	17.1	18.3
Paraguay	24.0	23.0	19.5	17.0	17.5	16.1	15.1	15.6	15.6
Peru	23.3	25.2	25.0	21.9	20.3	18.7	18.6	18.7	18.9
Dominican Republic	17.1	18.9	22.5	23.9	23.5	23.0	22.4	20.0	18.3
Uruguay	14.8	15.4	15.7	14.8	13.2	12.4	9.8	8.6	10.0
Venezuela (Bolivarian Republic of)	19.6	22.6	23.6	21.3	21.0	23.1	20.6	14.2	17.2

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures converted into dollars at constant 2000 prices.

[a] Preliminary figures.

Table A - 5

LATIN AMERICA AND THE CARIBBEAN: FINANCING OF GROSS DOMESTIC INVESTMENT [a]

(Percentages of GDP)

	1996	1997	1998	1999	2000	2001	2002	2003	2004 [b]
1. Domestic saving	20.8	21.0	19.7	19.2	20.4	18.8	19.8	20.9	22.8
2. Net factor income	-2.4	-2.4	-2.6	-2.9	-2.8	-2.7	-2.9	-3.2	-3.2
3. Net transfers	0.8	0.8	0.9	1.1	1.1	1.4	1.7	2.0	2.1
4. Gross national saving	19.3	19.4	18.0	17.5	18.8	17.4	18.6	19.8	21.7
5. External saving [c]	2.1	3.2	4.4	3.1	2.4	2.7	0.8	-0.4	-0.9
6. Gross domestic investment	21.4	22.7	22.4	20.6	21.2	20.2	19.4	19.4	20.8

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

[a] Based on coefficients calculated in local currency and converted into current dollars.

[b] Preliminary figures.

[c] These percentages may differ from the figures for the current account balance (with the sign reversed) relative to GDP given 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		
	2002	2003	2004 [d]	2002	2003	2004 [d]	2002	2003	2004 [d]	2002	2003	2004 [d]
Latin America and the Caribbean	**346 847**	**377 281**	**463 639**	**322 814**	**333 163**	**405 436**	**24 033**	**44 118**	**58 203**	**-14 143**	**-13 268**	**-14 627**
Argentina	25 651	29 566	34 453	8 473	13 118	21 185	17 178	16 448	13 267	-1 561	-1 448	-1 733
Bolivia	1 299	1 573	2 129	1 775	1 610	1 863	-476	-36	266	-41	-78	-69
Brazil	60 362	73 084	96 475	47 240	48 290	62 782	13 121	24 794	33 693	-4 957	-4 931	-4 773
Chile	18 180	21 524	32 025	15 794	18 002	23 006	2 386	3 522	9 019	-701	-617	-580
Colombia	12 316	13 782	17 246	12 077	13 258	15 878	239	524	1 368	-1 435	-1 433	-1 773
Costa Rica	5 270	6 163	6 311	6 537	7 294	7 832	-1 267	-1 131	-1 522	688	839	907
Ecuador	5 198	6 197	7 813	6 196	6 268	7 492	-998	-71	321	-748	-708	-888
El Salvador	3 020	3 153	3 330	4 885	5 428	5 949	-1 865	-2 276	-2 619	-240	-180	-109
Guatemala	2 819	3 060	3 430	5 791	6 176	7 189	-2 972	-3 116	-3 760	79	-68	-115
Haiti	274	333	378	980	1 116	1 186	-706	-783	-808	-123	-166	-203
Honduras	1 977	2 094	2 411	2 806	3 059	3 678	-829	-965	-1 267	-187	-181	-224
Mexico	161 046	164 766	187 999	168 679	170 546	196 810	-7 633	-5 779	-8 811	-4 048	-4 601	-4 649
Nicaragua	681	749	910	1 599	1 720	2 022	-918	-972	-1 112	-112	-106	-110
Panama	5 315	5 049	5 886	6 350	6 162	7 471	-1 035	-1 113	-1 585	968	1 254	1 295
Paraguay	1 858	2 175	2 706	2 138	2 450	3 116	-280	-275	-410	214	237	235
Peru	7 714	9 091	12 617	7 422	8 255	9 824	292	836	2 793	-941	-854	-843
Dominican Republic	5 165	5 471	5 750	8 838	7 627	7 845	-3 673	-2 156	-2 095	1 757	2 249	2 328
Uruguay	1 922	2 281	3 025	1 874	2 098	2 990	48	183	35	153	167	302
Venezuela (Bolivarian Republic of)	26 781	27 170	38 748	13 360	10 687	17 318	13 421	16 483	21 430	-2 909	-2 644	-3 626

Table A - 6 (continued)

	Trade balance			Income balance			Current transfers balance			Current account balance		
	2002	2003	2004 [d]	2002	2003	2004 [d]	2002	2003	2004 [d]	2002	2003	2004 [d]
Latin America and the Caribbean	9 890	30 849	43 576	-51 868	-57 819	-66 841	28 472	34 863	41 230	-13 505	7 894	17 965
Argentina	15 617	15 000	11 534	-7 487	-8 208	-9 210	552	578	705	8 682	7 370	3 029
Bolivia	-517	-114	197	-205	-302	-369	371	452	429	-350	36	257
Brazil	8 164	19 863	28 921	-18 191	-18 552	-20 520	2 390	2 867	3 268	-7 637	4 177	11 669
Chile	1 684	2 905	8 439	-2 847	-4 606	-8 101	583	599	1 051	-580	-1 102	1 390
Colombia	-1 196	-908	-405	-2 848	-3 446	-4 193	2 704	3 334	3 647	-1 340	-1 021	-952
Costa Rica	-579	-293	-614	-517	-849	-517	181	213	239	-916	-929	-892
Ecuador	-1 745	-779	-567	-1 305	-1 464	-1 493	1 652	1 772	1 894	-1 398	-472	-166
El Salvador	-2 105	-2 456	-2 728	-323	-422	-460	2 023	2 114	2 576	-405	-764	-612
Guatemala	-2 893	-3 183	-3 875	-318	-318	-319	1 976	2 462	3 006	-1 235	-1 039	-1 188
Haiti	-829	-949	-1 012	-14	-14	-12	754	918	993	-89	-45	-30
Honduras	-1 016	-1 146	-1 491	-193	-252	-279	969	1 106	1 379	-241	-292	-391
Mexico	-11 681	-10 380	-13 460	-11 934	-11 931	-10 977	10 268	13 858	17 044	-13 347	-8 453	-7 394
Nicaragua	-1 029	-1 077	-1 222	-200	-191	-192	462	519	619	-767	-749	-795
Panama	-67	141	-290	-272	-820	-1 042	244	241	228	-96	-437	-1 104
Paraguay	-66	-38	-174	43	-4	10	116	165	194	93	122	30
Peru	-649	-18	1 950	-1 457	-2 144	-3 421	1 043	1 227	1 461	-1 063	-935	-10
Dominican Republic	-1 915	93	233	-1 152	-1 393	-1 332	2 269	2 336	2 498	-798	1 036	1 399
Uruguay	202	350	337	109	-491	-531	72	82	89	382	-58	-105
Venezuela (Bolivarian Republic of)	10 512	13 839	17 804	-2 756	-2 411	-3 885	-157	20	-89	7 599	11 448	13 830

Table A - 6 (concluded)

	Capital and financial balance [a]			Overall balance			Reserve assets (variation) [b]			Other financing [c]		
	2002	2003	2004 [d]	2002	2003	2004 [d]	2002	2003	2004 [d]	2002	2003	2004 [d]
Latin America and the Caribbean	**-12 115**	**3 209**	**-5 646**	**-25 620**	**11 103**	**12 319**	**3 205**	**-29 484**	**-21 129**	**22 416**	**18 381**	**8 809**
Argentina	-22 067	-16 407	-10 184	-13 385	-9 037	-7 154	4 516	-3 581	-5 320	8 869	12 618	12 474
Bolivia	57	41	-131	-293	77	126	275	-93	-139	17	16	13
Brazil	-3 542	-451	-5 062	-11 178	3 726	6 607	-302	-8 496	-2 244	11 480	4 769	-4 363
Chile	779	737	-1 580	199	-366	-191	-199	366	191	0	0	0
Colombia	1 479	837	3 493	138	-184	2 541	-138	184	-2 541	0	0	0
Costa Rica	1 079	1 268	973	163	339	82	-163	-339	-82	0	0	0
Ecuador	1 275	591	447	-123	119	281	66	-152	-277	58	33	-4
El Salvador	282	1 080	572	-124	316	-40	124	-316	40	0	0	0
Guatemala	1 257	1 589	1 797	22	550	609	-22	-550	-609	0	0	0
Haiti	8	37	66	-81	-8	36	49	25	-50	32	-17	15
Honduras	304	65	759	64	-227	368	-214	88	-504	150	139	136
Mexico	20 436	17 891	11 452	7 090	9 438	4 058	-7 090	-9 438	-4 058	0	0	0
Nicaragua	575	575	717	-192	-175	-78	-72	-52	-161	264	226	239
Panama	242	284	709	146	-153	-395	-138	163	396	-8	-10	-1
Paraguay	-217	109	238	-124	231	268	84	-301	-179	40	70	-89
Peru	2 030	1 459	2 427	968	525	2 417	-852	-516	-2 443	-116	-9	26
Dominican Republic	243	-1 583	-853	-555	-546	546	527	358	-542	28	189	-4
Uruguay	-4 310	1 092	447	-3 928	1 033	342	2 328	-1 380	-454	1 600	347	112
Venezuela (Bolivarian Republic of)	-12 026	-6 005	-11 932	-4 427	5 443	1 898	4 427	-5 454	-2 153	0	11	255

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

[a] Includes errors and omissions.

[b] A minus sign (-) indicates an increase in reserve assets.

[c] Includes the use of IMF credit and loans and exceptional financing.

[d] Preliminary figures.

Table A - 7

LATIN AMERICA AND THE CARIBBEAN: CURRENT ACCOUNT OF THE BALANCE OF PAYMENTS [a]

(Percentages of GDP)

	1996	1997	1998	1999	2000	2001	2002	2003	2004 [b]
Latin America and the Caribbean	**-2.1**	**-3.3**	**-4.5**	**-3.1**	**-2.4**	**-2.7**	**-0.8**	**0.5**	**0.9**
Argentina	-2.5	-4.2	-4.9	-4.2	-3.2	-1.2	8.5	5.7	2.0
Bolivia	-5.1	-7.0	-7.8	-5.9	-5.3	-3.4	-4.4	0.4	2.9
Brazil	-3.0	-3.8	-4.3	-4.7	-4.0	-4.6	-1.7	0.8	1.9
Chile	-4.1	-4.4	-4.9	0.1	-1.2	-1.6	-0.9	-1.5	1.5
Colombia	-4.8	-5.4	-4.9	0.8	0.9	-1.3	-1.6	-1.3	-1.0
Costa Rica	-2.2	-3.7	-3.7	-4.2	-4.4	-4.0	-5.4	-5.3	-4.8
Ecuador	-0.3	-1.9	-9.0	5.5	5.8	-3.3	-5.8	-1.7	-0.5
El Salvador	-1.6	-0.9	-0.8	-1.9	-3.3	-1.1	-2.8	-5.1	-3.9
Guatemala	-2.9	-3.6	-5.4	-5.6	-5.4	-6.0	-5.3	-4.2	-4.4
Haiti	-4.6	-1.5	-1.0	-1.4	-3.0	-3.8	-2.8	-1.6	-0.9
Honduras	-8.2	-5.8	-2.8	-4.4	-4.6	-4.7	-3.7	-4.2	-5.2
Mexico	-0.8	-1.9	-3.8	-2.9	-3.1	-2.8	-2.1	-1.3	-1.1
Nicaragua	-24.8	-24.9	-19.2	-24.8	-20.0	-19.7	-19.1	-18.1	-17.5
Panama	-2.2	-5.0	-9.3	-10.1	-5.9	-1.5	-0.8	-3.4	-8.4
Paraguay	-4.0	-7.3	-2.0	-2.3	-2.3	-4.1	1.8	2.2	0.4
Peru	-6.5	-5.7	-5.9	-2.8	-2.9	-2.1	-1.9	-1.5	-0.0
Dominican Republic	-1.6	-1.1	-2.1	-2.5	-5.2	-3.4	-3.7	6.3	7.6
Uruguay	-1.1	-1.3	-2.1	-2.4	-2.8	-2.7	3.1	-0.5	-0.8
Venezuela (Bolivarian Republic of)	13.1	4.3	-4.9	2.2	10.1	1.6	8.2	13.7	12.6

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

[a] These percentages may differ from the figures for external saving (with the sign reversed) given in table A-5.

[b] Preliminary figures.

Table A - 8

LATIN AMERICA AND THE CARIBBEAN: EXPORTS AND IMPORTS OF GOODS, f.o.b.[a]

(Annual growth rates)

	Exports			Imports		
	Value	Volume	Unit value	Value	Volume	Unit value
1996	12.2	12.5	-0.3	11.5	15.6	-3.6
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	5.7	6.5	-0.8	-3.8	0.3	-4.1
2000	19.9	11.3	7.7	16.1	14.0	1.9
2001	-4.4	2.4	-6.6	-2.4	0.7	-3.0
2002	1.0	0.9	0.2	-7.0	-6.8	-0.2
2003	8.8	3.7	4.9	3.2	0.5	2.7
2004 [b]	22.8	9.7	12.0	21.7	14.5	6.3

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of figures from the International Monetary Fund (IMF).
[a] Includes 17 Spanish-speaking countries plus Brazil and Haiti.
[b] Preliminary figures.

Table A - 9

LATIN AMERICA AND THE CARIBBEAN: EXPORTS OF GOODS, f.o.b.

(Indices: 2000=100)

	Value			Volume			Unit value		
	2002	2003	2004 [a]	2002	2003	2004 [a]	2002	2003	2004 [a]
Latin America and the Caribbean	**96.6**	**105.1**	**129.1**	**103.3**	**107.1**	**117.5**	**93.5**	**98.1**	**109.9**
Argentina	97.4	112.2	130.8	104.8	111.2	117.8	93.0	101.0	111.1
Bolivia	104.2	126.3	170.8	109.6	125.8	150.6	95.1	100.4	113.4
Brazil	109.6	132.7	175.1	119.0	137.7	163.8	92.1	96.3	106.9
Chile	94.6	112.0	166.7	107.4	116.7	133.6	88.1	96.0	124.8
Colombia	89.8	100.4	125.7	101.7	107.4	110.1	88.2	93.5	114.1
Costa Rica	90.7	106.0	108.6	98.6	114.2	114.7	91.9	92.8	94.7
Ecuador	101.2	120.6	152.1	118.0	132.7	156.4	85.7	90.9	97.2
El Salvador	101.9	106.4	112.4	105.9	111.7	113.4	96.2	95.3	99.1
Guatemala	91.5	99.3	111.3	99.7	108.2	112.3	91.8	91.8	99.1
Haiti	82.7	100.4	113.9	84.1	100.1	108.0	98.4	100.4	105.4
Honduras	98.3	104.1	119.9	124.9	133.6	143.8	78.7	77.9	83.4
Mexico	96.8	99.0	112.9	100.0	99.3	104.9	96.8	99.7	107.6
Nicaragua	77.4	85.0	103.4	90.8	99.8	114.4	85.2	85.2	90.3
Panama	91.0	86.5	100.8	91.2	88.4	100.1	99.8	97.8	100.8
Paraguay	79.8	93.4	116.2	87.9	95.2	107.7	90.8	98.1	107.9
Peru	110.9	130.7	181.4	116.6	127.2	150.1	95.2	102.8	120.9
Dominican Republic	90.0	95.4	100.2	92.1	96.0	97.3	97.7	99.3	103.0
Uruguay	80.6	95.7	126.9	87.1	97.6	119.8	92.5	98.1	105.9
Venezuela (Bolivarian Republic of)	79.9	81.0	115.6	92.0	81.2	90.5	86.8	99.8	127.8

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

Table A - 10

LATIN AMERICA AND THE CARIBBEAN: IMPORTS OF GOODS, f.o.b.

(Indices 2000=100)

	Value			Volume			Unit value		
	2002	2003	2004 [a]	2002	2003	2004 [a]	2002	2003	2004 [a]
Latin America and the Caribbean	**90.8**	**93.7**	**114.0**	**93.8**	**94.2**	**107.8**	**96.8**	**99.4**	**105.7**
Argentina	35.5	54.9	88.7	37.7	58.3	87.2	94.2	94.2	101.7
Bolivia	110.2	100.0	115.7	111.5	98.1	106.2	98.9	101.9	109.0
Brazil	84.7	86.6	112.5	90.5	87.1	103.0	93.6	99.3	109.3
Chile	92.4	105.3	134.6	101.9	112.8	134.7	90.7	93.4	99.9
Colombia	108.9	119.6	143.2	114.2	121.7	136.2	95.4	98.3	105.2
Costa Rica	108.5	121.1	130.0	114.4	124.5	126.2	94.9	97.2	103.1
Ecuador	165.6	167.5	200.2	167.6	165.4	188.3	98.8	101.2	106.3
El Salvador	103.9	115.4	126.5	109.7	118.3	123.5	94.7	97.5	102.4
Guatemala	122.1	130.2	151.6	127.5	132.0	140.9	95.8	98.7	107.6
Haiti	90.2	102.7	109.1	91.8	101.0	99.4	98.2	101.7	109.8
Honduras	105.1	114.6	137.8	122.8	129.4	144.1	85.6	88.6	95.7
Mexico	96.7	97.8	112.8	97.8	96.9	106.5	98.9	100.8	105.9
Nicaragua	88.7	95.5	112.2	90.6	94.2	102.5	97.9	101.4	109.5
Panama	91.0	88.3	107.0	92.6	87.7	101.3	98.2	100.7	105.7
Paraguay	74.6	85.5	108.7	79.4	88.4	105.0	93.9	96.7	103.5
Peru	100.8	112.1	133.4	104.2	111.5	122.8	96.7	100.5	108.6
Dominican Republic	93.2	80.5	82.8	96.9	79.3	77.7	96.3	101.4	106.5
Uruguay	56.6	63.4	90.3	64.1	69.4	92.4	88.3	91.4	97.8
Venezuela (Bolivarian Republic of)	79.2	63.4	102.7	79.9	62.7	94.9	99.1	101.1	108.2

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

[a] Preliminary figures.

Table A - 11

LATIN AMERICA AND THE CARIBBEAN: TERMS OF TRADE FOR GOODS, f.o.b./f.o.b.

(Indices: 2000=100)

	1996	1997	1998	1999	2000	2001	2002	2003	2004 [a]
Latin America and the Caribbean	**92.8**	**95.0**	**91.5**	**94.6**	**100.0**	**96.3**	**96.6**	**98.7**	**103.9**
Argentina	103.5	102.2	96.6	90.9	100.0	99.3	98.7	107.2	109.2
Bolivia	108.0	107.9	102.0	97.1	100.0	95.8	96.2	98.5	104.1
Brazil	107.1	113.6	111.9	97.0	100.0	99.6	98.4	97.0	97.9
Chile	89.4	94.5	91.0	94.2	100.0	93.3	97.2	102.8	124.9
Colombia	84.3	93.3	81.2	87.2	100.0	94.2	92.5	95.2	108.5
Costa Rica	102.1	125.9	117.5	106.9	100.0	98.4	96.9	95.5	91.9
Ecuador	80.5	89.1	75.8	89.1	100.0	84.6	86.8	89.8	91.5
El Salvador	97.1	95.0	95.8	99.6	100.0	102.5	101.6	97.7	96.8
Guatemala	92.7	97.9	115.3	101.9	100.0	96.7	95.8	93.0	92.1
Haiti	98.6	101.4	107.6	104.2	100.0	101.2	100.2	98.7	96.0
Honduras	145.4	125.5	108.9	107.5	100.0	94.8	92.0	88.0	87.2
Mexico	90.8	89.5	90.6	99.3	100.0	97.4	97.9	98.8	101.6
Nicaragua	84.4	82.0	79.6	95.3	100.0	88.4	87.0	84.1	82.5
Panama	105.5	103.9	104.7	104.6	100.0	102.7	101.6	97.2	95.3
Paraguay	104.7	106.2	108.0	101.7	100.0	100.2	96.7	101.4	104.3
Peru	104.9	115.5	103.4	100.8	100.0	95.6	98.4	102.2	111.3
Dominican Republic	103.5	106.1	108.0	105.7	100.0	100.9	101.5	97.9	96.7
Uruguay	108.6	110.2	116.7	106.2	100.0	103.8	104.8	107.4	108.4
Venezuela (Bolivarian Republic of)	67.1	70.1	51.2	66.1	100.0	82.2	87.6	98.7	118.1

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

[a] Preliminary figures.

Table A - 12

LATIN AMERICA AND THE CARIBBEAN: NET RESOURCE TRANSFERS [a]

(Millions of dollars)

	1996	1997	1998	1999	2000	2001	2002	2003	2004 [b]
Latin America and the Caribbean	**22 044**	**32 559**	**27 837**	**-1 594**	**-113**	**-3 396**	**-41 567**	**-36 229**	**-63 678**
Argentina	5 195	9 309	10 559	5 678	1 028	-15 984	-20 685	-11 998	-6 919
Bolivia	482	447	637	324	182	34	-130	-245	-488
Brazil	19 397	5 863	7 222	-1 227	4 078	6 778	-10 252	-14 234	-29 945
Chile	1 684	4 362	-162	-3 079	-1 621	-2 022	-2 068	-3 870	-9 681
Colombia	4 308	3 703	1 763	-2 339	-2 165	-304	-1 369	-2 609	-700
Costa Rica	2	448	-97	-674	-699	-79	562	419	457
Ecuador	-738	-316	467	-2 715	-2 020	-776	28	-841	-1 050
El Salvador	244	297	231	165	132	-293	-42	657	112
Guatemala	421	653	1 118	696	1 494	1 642	938	1 271	1 478
Haiti	79	85	56	80	45	129	26	5	69
Honduras	92	368	173	528	161	280	262	-48	617
Mexico	-9 169	6 073	5 371	2 604	6 194	11 161	8 502	5 960	475
Nicaragua	554	749	471	888	573	437	639	610	764
Panama	249	718	479	652	4	204	-39	-545	-334
Paraguay	423	478	189	287	-30	237	-134	175	160
Peru	3 532	3 037	975	-633	-324	318	458	-693	-968
Dominican Republic	-527	-593	-453	-352	-85	168	-880	-2 787	-2 189
Uruguay	185	486	793	480	728	707	-2 601	948	28
Venezuela (Bolivarian Republic of)	-4 368	-3 606	-1 955	-2 957	-7 792	-6 035	-14 782	-8 405	-15 562

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

[a] 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.

[b] Preliminary figures.

Table A - 13

LATIN AMERICA AND THE CARIBBEAN: TOTAL NET CAPITAL INFLOWS AND NET RESOURCE TRANSFERS

(Billions of dollars and percentages)

	Total net capital inflows			Balance on income account [a]	Net resource transfer	Exports of goods and services	Net resource transfer as a percentage of exports of goods and services
	Autonomous [b]	Non-autonomous [c]	Total		(5) = (3) + (4)		(7) = (5) / (6)
	(1)	(2)	(3)	(4)	(5)	(6)	(7)
1980	29.2	1.7	30.9	-18.9	12.0	106.9	11.3
1981	38.4	1.8	40.1	-29.1	11.1	115.6	9.6
1982	3.3	17.2	20.5	-38.9	-18.4	105.2	-17.5
1983	-22.3	30.1	7.9	-34.5	-26.7	105.4	-25.3
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	177.0	14.7
1993	68.4	-1.9	66.4	-34.5	32.0	193.5	16.5
1994	41.2	5.8	47.0	-36.1	11.0	222.5	4.9
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	42.6	6.1	48.7	-50.3	-1.6	343.0	-0.5
2000	61.2	-7.7	53.5	-53.6	-0.1	408.4	-0.0
2001	34.2	16.2	50.4	-53.8	-3.4	391.4	-0.9
2002	-12.1	22.4	10.3	-51.9	-41.6	393.6	-10.6
2003	3.2	18.4	21.6	-57.8	-36.2	427.3	-8.5
2004 [d]	-5.6	8.8	3.2	-66.8	-63.7	520.7	-12.2

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

[a] Corresponds to net payments of profits and interest.

[b] Includes errors and omissions.

[c] Includes the use of IMF credit and loans and exceptional financing, which includes transactions such as external debt forgiveness and accumulation of arrears.

[d] Preliminary figures.

Table A - 14

LATIN AMERICA AND THE CARIBBEAN: RATIO OF TOTAL ACCRUED INTEREST TO EXPORTS OF GOODS AND SERVICES [a]

(Percentages)

	1996	1997	1998	1999	2000	2001	2002	2003	2004 [b]
Latin America and the Caribbean	**16.0**	**15.5**	**16.8**	**16.2**	**14.2**	**14.5**	**12.7**	**11.6**	**9.7**
Argentina	27.7	28.9	34.4	41.0	40.0	39.5	35.9	29.6	24.8
Bolivia	14.2	14.8	15.0	15.7	14.3	21.3	19.2	19.4	18.3
Brazil	25.3	26.0	30.5	31.6	26.5	26.4	21.9	18.9	15.3
Chile	7.2	7.3	8.2	7.9	8.2	7.7	6.6	5.3	4.1
Colombia	16.2	18.7	19.8	18.3	16.9	17.1	17.6	15.4	12.8
Costa Rica	4.8	4.6	3.6	3.2	4.1	5.1	4.1	3.9	3.3
Ecuador	16.4	15.8	21.1	21.1	19.9	19.0	16.9	15.8	13.3
El Salvador	6.1	8.2	8.0	8.7	8.6	9.3	9.8	11.3	11.4
Guatemala	5.0	4.6	4.2	3.8	4.7	5.6	6.2	5.3	5.4
Haiti	5.4	3.6	2.4	2.4	1.8	2.1	3.2	3.0	2.3
Honduras	11.3	9.2	8.0	8.6	7.5	6.5	5.7	4.9	3.9
Mexico	12.6	10.5	9.7	8.7	7.6	7.4	6.9	6.6	5.7
Nicaragua	40.0	25.1	16.2	17.2	14.8	19.1	15.2	12.0	10.1
Panama	17.0	15.7	19.0	20.6	20.1	17.6	13.6	11.5	10.2
Paraguay	2.1	2.4	2.0	3.1	5.3	6.2	4.7	4.1	3.3
Peru	25.3	19.5	23.7	23.0	21.6	19.7	14.7	12.6	10.0
Dominican Republic	3.9	3.1	2.8	2.7	2.8	3.0	3.4	3.6	4.1
Uruguay	15.9	16.6	18.0	20.9	20.6	24.5	24.5	20.2	19.1
Venezuela (Bolivarian Republic of)	11.2	12.9	14.7	12.6	8.6	9.7	8.5	7.9	5.4

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.
[a] Includes interest paid (without deducting interest received) and interest due but not paid.
[b] Preliminary figures.

Table A - 15

LATIN AMERICA AND THE CARIBBEAN: RATIO OF PROFIT PAYMENTS TO EXPORTS OF GOODS AND SERVICES [a]

(Percentages)

	1996	1997	1998	1999	2000	2001	2002	2003	2004 [b]
Latin America and the Caribbean	**5.2**	**6.1**	**6.4**	**5.0**	**5.6**	**5.3**	**4.6**	**5.7**	**6.5**
Argentina	7.3	8.8	8.9	7.5	7.9	2.5	0.4	3.8	7.4
Bolivia	3.0	5.7	6.0	10.9	10.1	...	...	...	...
Brazil	7.6	10.3	11.0	9.3	6.6	7.4	8.5	7.2	6.3
Chile	9.4	10.0	6.9	7.0	10.9	10.0	10.8	17.4	21.2
Colombia	4.9	4.0	-0.2	-2.1	4.2	6.2	7.4	10.0	12.0
Costa Rica	1.8	3.4	5.6	20.9	14.7	8.2	4.9	7.8	4.0
Ecuador	3.4	3.2	4.6	4.7	4.7	5.9	5.0	5.2	4.1
El Salvador	0.0	0.0	1.0	3.5	1.6	2.0	2.3	2.1	1.9
Guatemala	4.6	5.1	3.7	4.3	5.8	4.4	5.7	6.6	5.2
Haiti	-0.2	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Honduras	3.5	3.2	2.9	2.0	2.8	4.3	4.3	6.3	6.8
Mexico	3.8	3.1	4.1	2.4	4.0	3.7	2.3	2.4	2.3
Nicaragua	6.2	5.9	6.2	6.5	6.3	8.3	7.9	7.6	6.7
Panama	5.5	6.1	7.8	10.1	7.4	7.3	2.6	9.4	11.1
Paraguay	1.8	3.8	4.3	3.6	2.9	3.6	1.6	2.0	2.0
Peru	9.3	11.0	2.9	0.2	4.1	1.5	5.2	10.3	15.9
Dominican Republic	9.8	10.1	11.1	12.1	11.9	13.0	14.0	15.6	13.4
Uruguay	0.9	0.9	1.4	2.0	2.4	3.1	-11.7	3.6	3.3
Venezuela (Bolivarian Republic of)	1.7	6.6	11.4	3.9	4.1	6.7	7.0	6.7	8.2

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of figures from the International Monetary Fund (IMF) and national institutions.
[a] Includes reinvestment of profits.
[b] Preliminary figures.

Table A - 16

LATIN AMERICA AND THE CARIBBEAN: NET FOREIGN DIRECT INVESTMENT [a b]

(Millions of dollars)

	1996	1997	1998	1999	2000	2001	2002	2003	2004 [c]
Latin America and the Caribbean	**40 301**	**57 599**	**63 677**	**79 345**	**68 876**	**65 110**	**41 429**	**31 739**	**43 937**
Argentina [d]	5 348	5 507	4 965	22 257	9 517	2 005	2 776	1 113	3 934
Bolivia	472	728	947	1 008	734	703	674	195	114
Brazil	11 667	18 608	29 192	26 886	30 498	24 715	14 108	9 894	8 695
Chile	3 681	3 809	3 144	6 203	873	2 590	2 207	2 501	6 660
Colombia	2 784	4 753	2 033	1 392	2 069	2 509	1 258	855	2 862
Costa Rica	421	404	608	614	404	447	624	547	535
Ecuador	500	724	870	648	720	1 330	1 275	1 555	1 160
El Salvador [e]	-7	59	1 103	162	178	289	496	154	459
Guatemala	77	84	673	155	230	456	111	131	155
Haiti	4	4	11	30	13	4	6	14	6
Honduras	91	122	99	237	282	193	176	247	293
Mexico [f]	9 186	12 831	11 897	13 055	16 075	23 317	14 396	9 879	13 112
Nicaragua	120	203	218	337	267	150	204	201	250
Panama	416	1 299	1 203	864	700	405	99	792	1 012
Paraguay	144	230	336	89	98	78	12	30	64
Peru	3 488	2 054	1 582	1 812	810	1 070	2 156	1 275	1 816
Dominican Republic	97	421	700	1 338	953	1 079	917	613	645
Uruguay	137	113	155	238	274	291	180	401	300
Venezuela (Bolivarian Republic of)	1 676	5 645	3 942	2 018	4 180	3 479	-244	1 341	1 866

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

[a] Refers to direct invesment in the reporting economy, minus direct investment abroad by reporting-economy residents (both excluding disinvestment). Includes reinvested profits.

[b] In accordance with the fifth edition of the IMF *Balance of Payments Manual*, all transactions between non-financial direct investment enterprises and their parent companies and affiliates are included in direct investment.

[c] Preliminary figures.

[d] For 1999, includes the value of the investment by REPSOL in Yacimientos Petrolíferos Fiscales. Part of this amount corresponds to the purchase of shares in the company held by non-residents. In the balance of payments, the value of those shares is reflected as a debit under the portfolio investment item.

[e] From 1998 onward the figures are not comparable, since up to 1997 no official records were kept.

[f] For 2001, includes the value of the investment by Citigroup in BANAMEX; for 2004, includes investment in Bancomer.

Table A - 17

LATIN AMERICA AND THE CARIBBEAN: INTERNATIONAL BOND ISSUES

(Millions of dollars)

	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005 [a]
Latin America and the Caribbean	**54 504**	**55 635**	**40 406**	**44 107**	**40 255**	**38 503**	**20 208**	**37 906**	**36 383**	**14 426**
Argentina	14 110	15 571	15 931	14 900	13 468	2 711		100	200	150
Barbados					200	150				
Belice							125	100		
Bolivia									108	
Brazil	13 868	15 839	8 380	11 180	12 068	13 010	6 857	19 364	11 603	3 959
Chile	2 349	1 800	1 063	1 765	676	1 515	1 694	3 200	2 350	398
Colombia	2 615	1 605	1 385	1 676	1 622	4 329	695	1 545	1 545	785
Costa Rica			200	300	250	250	250	490	310	
Ecuador		625								
El Salvador				150	50	354	1 252	349	286	
Grenada							100			
Guatemala		150				325		300	380	
Jamaica	75	225	250		422	812	300		814	
Mexico	20 462	15 250	8 914	11 441	9 777	11 016	6 505	7 979	13 312	5 618
Panama	125	1 146	325	500	350	1 100	1 030	275	770	
Paraguay				400						
Peru	26	450	150				1 000	1 250	1 305	400
Dominican Republic		200				500		600		
Trinidad and Tobago	150			230	250					
Uruguay	100	479	550	350	641	856	400		350	
Venezuela (Bolivarian Republic of)	625	2 295	3 259	1 215	482	1 575		2 354	3 050	3 116

Source: International Monetary Fund Research Department, Emerging Markets Studies Division.

[a] Data to April. Figures for 2005 were provided by Merrill Lynch.

Table A - 18

LATIN AMERICA AND THE CARIBBEAN: TOTAL GROSS EXTERNAL DEBT [a]

(Millions of dollars)

	1996	1997	1998	1999	2000	2001	2002	2003	2004 [b]
Latin America and the Caribbean	**653 566**	**687 812**	**750 731**	**762 208**	**738 126**	**744 369**	**733 028**	**758 188**	**762 480**
Antigua and Barbuda [c]	276	348	459	462	472	496	541	576	335
Argentina	114 423	129 964	147 634	152 563	155 015	166 272	156 748	165 045	172 773
Bahamas [c]	286	335	323	338	349	328	309	362	343
Barbados [c]	481	428	453	492	605	539	755	737	792
Belize [c]	...	...	260	252	434	487	575	750	841
Bolivia [c]	4 643	4 531	4 660	4 574	4 461	4 412	4 300	5 042	4 951
Brazil	179 935	199 998	223 792	225 610	216 921	209 934	210 711	214 930	201 373
Chile	26 272	29 034	32 591	34 758	37 177	38 538	40 675	43 396	43 764
Colombia	31 114	34 409	36 681	36 733	36 130	39 109	37 336	38 066	39 571
Costa Rica [c]	2 859	2 640	2 872	3 057	3 151	3 243	3 338	3 753	3 884
Cuba [c]	10 465	10 146	11 209	11 078	10 961	10 893	10 900	11 300	12 000
Dominica [c]	102	89	94	133	154	181	209	230	245
Ecuador	14 489	15 015	16 221	15 902	13 110	14 360	16 236	16 585	17 007
El Salvador [c]	2 517	2 689	2 646	2 789	2 831	3 148	3 987	4 717	4 778
Grenada [c]	86	93	107	116	135	183	321	343	410
Guatemala [c]	2 075	2 135	2 368	2 631	2 644	2 925	3 119	3 467	3 844
Guyana [c]	1 537	1 513	1 516	1 210	1 195	1 193	1 246	1 092	1 078
Haiti [c]	914	1 025	1 104	1 162	1 170	1 189	1 212	1 287	1 316
Honduras	4 121	4 073	4 369	4 691	4 711	4 757	4 922	5 143	5 793
Jamaica [c]	3 232	3 278	3 306	3 024	3 375	4 146	4 348	4 192	5 120
Mexico	157 200	149 028	160 258	166 381	148 652	144 526	134 728	132 021	130 531
Nicaragua [c]	6 094	6 001	6 287	6 549	6 660	6 374	6 363	6 596	5 391
Panama [c]	5 069	5 051	5 180	5 412	5 606	6 263	6 349	6 503	7 219
Paraguay	1 801	1 926	2 133	2 697	2 819	2 652	2 866	3 086	2 994
Peru	33 781	28 863	30 142	28 586	27 981	27 195	27 872	29 587	31 117
Dominican Republic [c]	3 807	3 572	3 546	3 661	3 682	4 177	4 536	5 987	6 380
Saint Kitts and Nevis [c]	59	108	124	153	162	206	261	367	322
Saint Vincent and the Grenadines [c]	86	89	101	160	160	170	170	192	221
Saint Lucia [c]	128	139	155	170	197	203	259	330	362
Suriname [c]	...	...	...	...	196	270	280	270	236
Trinidad and Tobago [c]	...	1 565	1 471	1 585	1 680	1 666	1 549	1 553	1 351
Uruguay [d]	11 595	12 485	13 582	8 261	8 895	8 937	10 548	11 013	11 593
Venezuela (Bolivarian Republic of)	34 117	37 242	35 087	37 016	36 437	35 398	35 460	39 672	44 546

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

[a] Includes debt owed to the International Monetary Fund.

[b] Preliminary figures.

[c] Public external debt.

[d] From 1999 on, the figures correspond to a new official series for the total debt which is not comparable with the preceding series, as it includes the private sector and does not include memorandum items on external liabilities and assets.

Table A - 19

LATIN AMERICA AND THE CARIBBEAN: RATIO OF TOTAL GROSS EXTERNAL DEBT TO EXPORTS OF GOODS AND SERVICES

(Percentages)

	1996	1997	1998	1999	2000	2001	2002	2003	2004 [a]
Latin America and the Caribbean	**213**	**201**	**219**	**212**	**172**	**181**	**178**	**169**	**140**
Antigua and Barbuda [b]	69	78	98	97	101	112	126	124	66
Argentina	403	420	473	546	498	535	544	491	439
Bahamas [b]	15	18	17	15	12	15	13	15	13
Barbados [b]	40	34	35	38	44	40	61	54	54
Belize [b]	...	...	80	67	113	108	116	142	160
Bolivia [b]	354	321	344	349	303	290	276	269	202
Brazil	343	338	381	409	336	311	301	257	185
Chile	130	133	161	165	160	172	180	164	115
Colombia	236	242	273	263	229	260	263	243	203
Costa Rica [b]	59	49	42	37	41	47	47	46	45
Cuba [b]	276	255	271	257	229	238	256	232	203
Dominica [b]	84	65	62	85	106	151	169	194	191
Ecuador	258	248	324	298	219	254	267	234	195
El Salvador [b]	114	92	87	88	77	88	105	118	111
Grenada [b]	66	67	65	53	57	93	183	190	219
Guatemala [b]	74	67	68	76	69	75	79	84	83
Guyana [b]	213	204	220	180	177	180	187	156	146
Haiti [b]	477	270	230	219	232	267	288	275	258
Honduras	214	186	180	210	189	196	196	191	189
Jamaica [b]	97	96	98	87	94	124	135	119	138
Mexico	147	123	124	112	83	84	78	74	65
Nicaragua [b]	842	666	666	680	604	685	702	655	449
Panama [b]	68	60	63	76	72	78	84	85	84
Paraguay	41	48	51	93	96	108	118	112	91
Peru	463	345	400	372	330	321	302	274	214
Dominican Republic [b]	61	51	47	46	41	50	55	67	69
Saint Kitts and Nevis [b]	47	77	86	105	108	134	168	223	163
Saint Vincent and the Grenadines [b]	58	60	64	91	90	97	96	111	126
Saint Lucia [b]	36	39	40	46	51	60	79	85	79
Suriname [b]	...	...	...	...	40	54	69	49	40
Trinidad and Tobago [b]	...	52	50	46	35	34	34	26	18
Uruguay [c]	301	296	327	238	243	274	392	357	289
Venezuela (Bolivarian Republic of)	135	148	183	166	105	126	127	141	112

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

[a] Preliminary figures.

[b] Public external debt.

[c] From 1999 on, the figures correspond to a new official series for the total debt which is not comparable with the preceding series, as it includes the private sector and does not include memorandum items on external liabilities and assets.

Table A - 20

LATIN AMERICA AND THE CARIBBEAN: STOCK EXCHANGE INDICES IN DOLLARS [a]

(Indices: December 2000=100)

	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005 [b]
Latin America and the Caribbean	**97.2**	**121.5**	**75.1**	**118.0**	**100.0**	**93.9**	**72.6**	**122.5**	**168.6**	**183.3**
Argentina	119.1	139.7	100.0	133.3	100.0	69.2	34.8	79.4	97.4	114.6
Brazil	94.5	113.9	65.4	109.2	100.0	77.7	51.9	105.9	141.8	154.8
Chile	118.9	122.9	86.0	116.4	100.0	94.8	80.7	145.9	176.9	184.2
Colombia	324.2	402.3	227.0	181.5	100.0	125.1	137.3	174.7	376.4	494.6
Mexico	77.4	114.2	69.9	125.6	100.0	112.2	93.6	123.5	182.8	197.8
Peru	166.7	189.9	114.5	138.5	100.0	112.3	146.9	263.1	294.9	303.5
Venezuela (Bolivarian Republic of)	152.4	187.8	90.5	79.0	100.0	79.9	51.8	59.2	88.9	68.5

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

[a] Year-end values; overall index.

[b] Figures to June.

Table A - 21

LATIN AMERICA AND THE CARIBBEAN: REAL EFFECTIVE EXCHANGE RATES [a b]

(Index: 2000=100, deflated by CPI)

	1996	1997	1998	1999	2000	2001	2002	2003	2004 [c]	2005 [c d]
Latin America and the Caribbean [e]	**105.2**	**99.8**	**98.6**	**100.0**	**100.0**	**99.1**	**106.8**	**112.2**	**113.3**	**112.5**
Argentina	115.0	112.7	108.8	99.6	100.0	95.6	221.9	204.5	214.8	215.9
Barbados	102.5	98.1	100.6	101.0	100.0	98.4	100.1	103.4	107.9	109.7
Bolivia	105.3	103.9	98.5	98.6	100.0	101.0	95.4	104.1	111.7	118.8
Brazil	71.2	69.9	72.3	108.0	100.0	119.7	130.5	130.6	124.6	110.2
Chile	97.1	90.8	92.5	98.2	100.0	111.2	109.1	114.5	106.9	106.6
Colombia	83.6	78.0	83.1	91.4	100.0	104.0	105.3	119.3	108.5	97.8
Costa Rica	100.9	100.9	114.0	101.7	100.0	97.1	97.6	103.6	106.5	108.0
Dominica	98.8	98.8	100.3	99.8	100.0	100.3	101.5	104.1	107.8	110.9
Ecuador	68.3	65.8	65.0	88.8	100.0	71.4	62.6	61.1	63.7	66.9
El Salvador	106.5	104.0	101.9	100.4	100.0	99.6	99.6	101.1	101.0	101.8
Guatemala	94.8	88.3	88.1	98.7	100.0	95.7	88.5	88.2	85.6	80.7
Honduras	130.0	119.0	108.8	104.5	100.0	97.1	96.9	98.6	100.0	100.7
Jamaica	115.0	100.7	96.0	97.7	100.0	101.7	101.1	115.9	114.2	108.7
Mexico	138.6	119.9	119.0	108.8	100.0	93.4	92.9	104.5	109.5	108.2
Nicaragua	99.8	101.2	101.3	101.9	100.0	101.1	103.1	107.2	109.1	110.4
Panama	100.6	102.5	100.1	100.7	100.0	103.0	102.1	105.0	110.2	112.8
Paraguay	97.2	93.3	99.2	96.6	100.0	102.4	106.3	111.7	107.4	119.6
Peru	90.6	90.7	91.7	101.5	100.0	97.8	95.6	99.8	101.3	100.7
Trinidad and Tobago	104.7	107.9	105.3	102.2	100.0	94.5	91.1	91.1	92.5	92.0
Uruguay	111.2	108.5	107.0	98.3	100.0	101.2	117.0	150.3	151.8	139.7
Venezuela (Bolivarian Republic of)	177.3	141.4	116.5	102.6	100.0	95.2	123.7	136.8	143.2	142.3

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

[a] See the methodological note given in the section of exchange-rate policy.

[b] Annual averages.

[c] Preliminary figures.

[d] January-May average.

[e] Simple average.

Table A - 22

LATIN AMERICA AND THE CARIBBEAN: URBAN UNEMPLOYMENT

(Average annual rates)

		1996	1997	1998	1999	2000	2001	2002	2003	2004 [a]
Latin America and the Caribbean [b]		9.4	8.9	10.0	10.7	10.1	10.0	10.7	10.7	10.0
Argentina [c]	Urban areas	17.2	14.9	12.9	14.3	15.1	17.4	19.7	17.3	13.6
Barbados [d]	Nationwide total	15.6	14.5	12.3	10.4	9.2	9.9	10.3	11.0	9.8
Belize	Nationwide total	13.8	12.7	14.3	12.8	11.1	9.1	10.0	12.9	11.6
Bolivia	Departmental capitals [e]	3.8	4.4	6.1	7.2	7.5	8.5	8.7	9.2	8.5
Brazil [f]	Six metropolitan areas	5.4	5.7	7.6	7.6	7.1	6.2	11.7	12.3	11.5
Chile	Nationwide total	6.4	6.1	6.4	9.8	9.2	9.1	9.0	8.5	8.8
Colombia [d]	13 metropolitan areas [g]	11.2	12.4	15.3	19.4	17.2	18.2	17.6	16.7	15.4
Costa Rica	Urban total	6.6	5.9	5.4	6.2	5.3	5.8	6.8	6.7	6.7
Cuba	Nationwide total	7.6	7.0	6.6	6.0	5.5	4.1	3.3	2.3	2.0
Ecuador [d]	Cuenca, Guayaquil and Quito [h]	10.4	9.3	11.5	15.1	14.1	10.4	8.6	9.8	11.0
El Salvador	Urban total	7.5	7.5	7.6	6.9	6.5	7.0	6.2	6.2	6.5
Guatemala [i]	Nationwide total	5.2	5.1	3.8	...	...	…	3.1	3.4	3.1
Honduras	Urban total	6.5	5.8	5.2	5.3	...	5.9	6.1	7.6	8.0
Jamaica [d]	Nationwide total	16.0	16.5	15.5	15.7	15.5	15.0	14.2	11.4	11.7
Mexico	Urban areas	5.5	3.7	3.2	2.5	2.2	2.5	2.7	3.3	3.8
Nicaragua	Urban total [j]	16.0	14.3	13.2	10.7	8.3	11.3	11.6	10.2	9.3
Panama [d]	Urban total [k]	16.4	15.4	15.5	13.6	15.2	17.0	16.5	15.9	14.0
Paraguay	Urban total	8.2	7.1	6.6	9.4	10.0	10.8	14.7	11.2	10.0
Peru	Metropolitan Lima	8.0	9.2	8.5	9.2	8.5	9.3	9.4	9.4	9.4
Dominican Republic [d]	Nationwide total	16.5	15.9	14.3	13.8	13.9	15.4	16.1	17.0	18.4
Trinidad and Tobago [d]	Nationwide total	16.2	15.0	14.2	13.2	12.2	10.8	10.4	10.5	8.6
Uruguay	Urban total	11.9	11.5	10.1	11.3	13.6	15.3	17.0	16.9	13.1
Venezuela (Bolivarian Republic of)	Nationwide total	11.8	11.4	11.3	15.0	13.9	13.3	15.8	18.0	15.3

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

[a] Preliminary figures.
[b] The data for Argentina and Brazil have been adjusted to allow changes in methodology in 2002 and 2003, respectively.
[c] New measurements have been used from 2003 on; these data are not comparable with the preceding series.
[d] Includes hidden unemployment.
[e] Up to 1999, the figures refer to departmental capitals.
[f] New measurements have been used from 2002 on; these data are not comparable with the preceding series.
[g] Up to 1999, the figures refer to seven metropolitan areas.
[h] Up to 1999, the figures refer to the total for urban areas.
[i] Official estimates.
[j] Up to 1999, the figures refer to nationwide totals.
[k] Up to 1999, the figures refer to the metropolitan region.

Table A - 23

LATIN AMERICA AND THE CARIBBEAN: CONSUMER PRICES

(Percentage variations, December-December)

	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005 [a]
Latin America and the Caribbean [b]	**18.6**	**10.7**	**10.0**	**9.7**	**9.0**	**6.1**	**12.2**	**8.5**	**7.3**	**6.5**
Argentina	0.1	0.3	0.7	-1.8	-0.7	-1.5	41.0	3.7	6.1	9.0
Bahamas	1.1	0.8	1.9	1.4	1.0	2.9	1.9	2.3	1.2	1.8
Barbados	...	...	...	...	3.8	-0.3	0.9	0.3	4.3	4.5 [c]
Bolivia	7.9	6.7	4.4	3.1	3.4	0.9	2.4	3.9	4.6	6.4
Brazil	9.6	5.2	1.7	8.9	6.0	7.7	12.5	9.3	7.6	7.3
Chile	6.6	6.0	4.7	2.3	4.5	2.6	2.8	1.1	2.4	2.7
Colombia	21.6	17.7	16.7	9.2	8.8	7.6	7.0	6.5	5.5	4.8
Costa Rica	13.9	11.2	12.4	10.1	10.2	11.0	9.7	9.9	13.1	13.8
Cuba	...	1.9	2.9	-2.9	-3.0	-0.5	7.0	-1.0	3.0	...
Ecuador	25.7	30.6	43.4	60.7	91.0	22.4	9.3	6.1	1.9	1.9
El Salvador	7.4	1.9	4.2	-1.0	4.3	1.4	2.8	2.6	5.3	4.3
Grenada	3.2	0.9	1.2	1.1	3.4	-0.7	2.3	...	...	...
Guatemala	10.9	7.1	7.5	4.9	5.1	8.9	6.3	5.9	9.2	8.8
Guyana	4.5	4.2	4.7	8.7	5.8	1.5	6.0	...	...	...
Haiti	14.5	15.7	7.4	9.7	19.0	8.1	14.8	40.4	20.2	12.6 [d]
Honduras	25.2	12.7	15.7	11.0	10.1	8.8	8.1	6.8	9.2	9.0
Jamaica	15.8	9.2	7.9	6.8	6.1	8.7	7.3	14.1	13.7	17.5
Mexico	27.7	15.7	18.6	12.3	9.0	4.4	5.7	4.0	5.2	4.3
Nicaragua	12.1	7.3	18.5	7.2	9.9	4.7	4.0	6.6	8.9	9.7
Panama	2.3	-0.5	1.4	1.5	0.7	0.0	1.9	1.5	1.5	2.4
Paraguay	8.2	6.2	14.6	5.4	8.6	8.4	14.6	9.3	2.8	6.1
Peru	11.8	6.5	6.0	3.7	3.7	-0.1	1.5	2.5	3.5	1.5
Dominican Republic	4.0	8.4	7.8	5.1	9.0	4.4	10.5	42.7	28.7	-1.0
Saint Vincent and the Grenadines	3.6	0.8	3.3	-1.8	1.4	-0.2	0.4	2.7	...	...
Saint Lucia	-2.3	1.9	3.6	6.1	0.4	0.0	1.4	...	...	...
Trinidad and Tobago	4.3	3.5	5.6	3.4	5.6	3.2	4.3	3.0	5.6	6.6
Uruguay	24.3	15.2	8.6	4.2	5.1	3.6	25.9	10.2	7.6	4.1
Venezuela (Bolivarian Republic of)	103.2	37.6	29.9	20.0	13.4	12.3	31.2	27.1	19.2	15.9

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

[a] 12-month variation up to June 2005.

[b] Does not include the Bahamas, Barbados, Grenada, Guyana, Saint Vincent and the Grenadines or Saint Lucia. The figure for 2005 does not include Cuba either.

[c] 12-month variation up to March 2005.

[d] 12-month variation up to May 2005.

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LATIN AMERICA AND THE CARIBBEAN: AVERAGE REAL WAGES

(Average annual indices: 2000=100)

	1990	1996	1997	1998	1999	2000	2001	2002	2003	2004 [a]
Argentina [b]	93.3	94.7	95.0	95.0	97.8	100.0	99.2	85.4	83.8	92.2
Brazil [c]	99.7	103.0	105.7	105.8	101.1	100.0	95.1	93.1	84.9	85.5
Chile [d]	69.3	91.6	93.8	96.3	98.6	100.0	101.7	103.7	104.6	106.5
Colombia [b]	76.3	88.4	92.1	92.2	96.3	100.0	99.7	102.5	102.4	103.4
Costa Rica [e]	81.5	88.9	89.7	94.7	99.2	100.0	101.0	105.1	105.5	102.8
Mexico [b]	88.9	90.9	90.4	92.9	94.3	100.0	106.7	108.7	110.1	110.2
Nicaragua [e]	75.8	89.2	92.5	96.2	100.0	100.0	101.0	104.5	106.5	104.2
Paraguay	87.8	103.2	102.7	100.8	98.7	100.0	101.4	94.9	93.0	90.5
Peru [f]	93.7	104.2	103.5	101.4	99.3	100.0	99.1	103.7	105.3	103.6
Uruguay	89.1	97.8	98.0	99.7	101.3	100.0	99.7	89.0	77.9	77.9
Venezuela (Bolivarian Republic of) [g]	140.5	78.0	98.0	103.3	98.5	100.0	102.4	92.1	76.7	73.7

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

[a] Preliminary figures.

[b] Manufacturing.

[c] Workers covered by social and labour legislation.

[d] General index of hourly wages.

[e] Average wages declared by workers covered by social security.

[f] Private-sector manual workers in the Lima metropolitan area. The figure for 2004 refers to labour income in the Lima metropolitan area.

[g] Private sector.

Table A - 25

LATIN AMERICA AND THE CARIBBEAN: PUBLIC-SECTOR DEFICIT (-) OR SURPLUS [a]

(Percentages of GDP)

	Coverage [b]	1996	1997	1998	1999	2000	2001	2002	2003	2004 [c]
Latin America and the Caribbean	**CG**	**-1.3**	**-1.1**	**-2.2**	**-3.0**	**-2.6**	**-3.2**	**-3.1**	**-2.6**	**-1.6**
Argentina	NA	-2.8	-1.4	-1.8	-3.0	-2.1	-3.8	-0.3	0.3	2.0
	NFPS	-3.2	-1.5	-2.4	-4.5	-3.3	-7.0	-0.8	1.6	3.6
Bolivia	CG	-1.3	-3.0	-3.3	-3.6	-4.6	-7.1	-8.1	-7.3	-5.4
	NFPS	-1.9	-3.3	-4.7	-3.5	-3.7	-6.9	-9.0	-8.1	-5.5
Brazil	CG [d e]	-2.6	-2.6	-5.4	-6.8	-3.1	-3.7	-6.4	-2.5	-1.3
	CPS [e]	…	…	-7.5	-5.8	-3.6	-3.6	-4.6	-5.1	-2.7
Chile	CG	2.2	2.1	0.4	-2.1	-0.6	-0.5	-1.2	-0.4	2.2
	NFPS	2.3	1.4	-1.4	-3.3	-1.0	-0.4	-2.5	-1.6	...
Colombia	CG [f]	-3.4	-3.7	-4.8	-6.1	-5.4	-5.3	-4.9	-4.7	-4.3
	NFPS	-1.7	-2.8	-3.7	-4.1	-4.0	-4.1	-3.5	-2.6	-0.9
Costa Rica	CG	-4.0	-2.9	-2.5	-2.2	-3.0	-2.9	-4.3	-2.9	-2.8
	NFPS	...	-0.8	-0.7	-1.7	-1.6	-1.6	-3.9	-2.4	-2.0
Ecuador	CG [g]	-1.7	-1.2	-4.1	-2.9	0.1	-1.1	-0.8	-0.4	-1.1
	NFPS [g]	-2.8	-2.1	-5.2	-4.9	1.4	0.0	0.8	1.7	2.3
El Salvador	CG	-1.8	-1.1	-2.0	-2.1	-2.3	-3.6	-3.1	-2.7	-1.1
	NFPS	-2.5	-1.8	-2.6	-2.8	-3.0	-3.7	-3.3	-2.1	-0.6
Guatemala	CG	0.0	-0.8	-2.2	-2.8	-1.8	-1.9	-1.0	-2.3	-1.0
Haiti	CG [h]	-0.7	-0.6	-1.2	-2.2	-2.3	-2.2	-2.7	-2.9	-3.4
Honduras	CG	-3.5	-2.8	-1.3	-3.7	-5.0	-6.0	-5.3	-5.6	-3.1
	NFPS	-2.5	-1.0	2.9	0.7	-2.3	-2.3	-1.8	-4.2	-1.7
Mexico	CG	-0.2	-1.1	-1.4	-1.6	-1.3	-0.7	-1.8	-1.1	-1.0
	PS	0.0	-0.7	-1.2	-1.1	-1.1	-0.7	-1.2	-0.6	-0.3
Nicaragua	CG [i]	-0.9	-0.8	-1.1	-3.3	-4.7	-7.5	-2.5	-2.8	-2.2
	NFPS	-2.9	-1.0	0.4	-2.2	-4.5	-6.3	-1.9	-2.2	-1.5
Panama	CG	0.2	-0.3	-4.2	-2.0	-1.1	-1.7	-1.9	-3.8	-5.6
	NFPS	1.7	0.1	-2.3	-0.9	0.7	-0.4	-2.0	-4.8	-5.0
Paraguay	CA	-1.2	-1.6	-1.1	-3.8	-4.6	-1.2	-3.2	-0.4	1.6
	NFPS	1.0	-1.0	0.4	-3.1	-4.0	-0.1	-2.0	1.1	2.4
Peru	CG	-1.4	-0.8	-1.1	-3.2	-2.8	-2.8	-2.1	-1.8	-1.3
	NFPS	-1.1	0.1	-1.0	-3.2	-3.4	-2.5	-2.3	-1.7	-1.1
Dominican Republic	CG	-0.0	1.1	0.6	-0.5	1.1	0.4	0.1	1.3	2.4
Uruguay	CG	-1.8	-1.6	-1.2	-3.9	-3.5	-4.5	-4.9	-4.6	-2.5
	NFPS [h]	-0.9	-0.9	-0.5	-3.8	-3.7	-4.0	-3.8	-2.8	-0.8
Venezuela (Bolivarian Republic of)	CG	0.6	2.0	-4.0	-1.7	-1.7	-4.4	-3.6	-4.4	-2.8
	RPS	7.0	3.7	-4.5	0.7	4.5	-4.6	-1.0	0.2	...

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

[a] Total income minus total expenditure, expressed in local currency.

[b] Abbreviations used: NA = National administration; CA = Central administration; CG = Central government; GG = General government; CNG = Central national government; NFPS = Non-financial public sector; PS = Public sector; CPS = Consolidated public sector; GPS = Global public sector; RPS = Narrowly defined public sector.

[c] Preliminary figures.

[d] Includes the federal government and the central bank.

[e] Nominal balance.

[f] These results do not include adjustments for accruals, floating debt or the cost of financial restructuring.

[g] In 2003, does not include US$ 130 million that the Office of the Under-Secretary of the National Treasury de-earmarked from central government accounts.

[h] Overall balance calculated "below the line" (financing).

[i] Includes grants.

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