SOUTH AMERICA

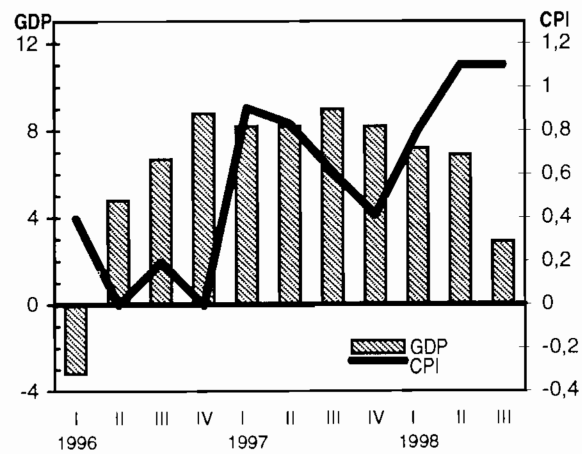
ARGENTINA

Growth in the level of activity slowed but, for the year as a whole, GDP again increased at an appreciable rate of about 4%. Given the deterioration in the terms of trade and increased outlays in the form of external factor payments, the growth rate for national income (8% in 1997 and 6% on average since the beginning of the decade) fell to 3%. Rising investment was once again a prominent component of expenditure, with fixed capital formation representing about 25% of GDP. Export volumes rose substantially. Output growth was concentrated in the first half of the period, during which the annualized increase exceeded 7%. During the second half of the year, there were signs that both demand and economic activity were cooling off, and seasonally adjusted GDP was lower than in the first six months. The average unemployment rate for 1998 was around 13%, and inflation was again very low (0.9%).

During the early months of 1998, the repercussions of the international crisis were reflected in lower international prices for exports. Since there was a sufficient supply of external funds, however, spending increases were not restricted to any great extent by that variable. During the first half of the year capital inflows were abundant; imports increased, particularly those of capital goods, and international reserves rose. The mood of financial markets changed suddenly in August, however, following the outbreak of the crisis in Russia. Share prices fell to levels below the 1995 average, and the spread in yields between Argentine securities and those issued by industrialized countries widened. Later, when the tension on international markets eased, the prices of Argentine securities recovered. Credit terms remained tighter than before, however.

ARGENTINA: GROSS DOMESTIC PRODUCT AND INFLATION

(Percentage variation)



Source: ECLAC, on the basis of official figures.

Unlike what had occurred in 1995, bank deposits did not contract, although there was some shift away from peso deposits and towards dollar deposits. The banking system, where the participation of foreign entities has grown considerably, still appeared to be free from any appreciable degree of fragility and, most importantly, to have considerable liquidity reserves. Nonetheless, the volume of bank credit stagnated in September and October. Spending on goods and services was curbed by the increase in interest rates

ARGENTINA: MAIN ECONOMIC INDICATORS

	1996	1997	1998[a]
	Annual rate of variation		
Gross domestic product	4.4	8.4	4.0
Consumer prices	0.1	0.3	0.9
Real wages	-0.2	-0.5	-1.2
Money (M1)	11.2	14.7	5.9
Real effective exchange rate[b]	1.9	-2.9	-2.5
Terms of trade	4.4	2.1	-4.5
	Percentages		
Urban unemployment rate	17.2	14.9	12.9
Fiscal balance/GDP	-1.8	-1.4	-1.2
Real deposit rate	7.6	6.6	5.9
Real lending rate	19.5	13.6	12.2
	Millions of dollars		
Exports of goods and services	27 037	29 318	29 450
Imports of goods and services	27 910	34 899	36 650
Current account	-3 787	-9 454	-12 200
Capital and financial account	7 025	12 516	15 200
Overall balance	3 238	3 062	3 000

Source: See the statistical appendix.
[a] Preliminary estimates.
[b] A negative rate signifies an appreciation of the currency in real terms.

and by the cautious attitude which seems to have spread among both lenders and potential borrowers. This also affected external trade flows, with signs being seen of a weakening demand for imports. This helped to hold down the trade deficit, although for the year as a whole it was higher than in 1997.

During the first three quarters of 1998 the public sector's cash deficit remained within the range provided for in the country's agreement with the IMF, but fiscal policy came under pressure in the fourth quarter. The total deficit for the period is estimated at close to 1.1% of GDP, which was somewhat above the target level. The increase in interest payments was offset by a larger primary surplus. This result was achieved, even though revenues rose less than expected, by reining in increases in expenditure. During the first 10 months, national tax receipts rose less (4%) than output. There was an especially significant increase in revenues from profit and wealth taxes, however, while VAT receipts rose by 3% and social security collections held steady.

Faced with this downturn in revenue, the authorities decided to introduce the prepayment of taxes on income earned in 1998. The Government also proposed various reforms of the tax structure, including modifications in the profit tax and the extension of the VAT to previously exempt activities. A system specifically designed for small taxpayers came into force in October under which income taxes, VAT and social security contributions were all consolidated into a single tax.

In the area of finance policy, it had been the Government's practice to programme issues of debt instruments ahead of the corresponding funding requirements. When the demand for government bonds contracted, the authorities were therefore able to refrain from floating any more debt paper without suffering from acute liquidity problems. When the bout of financial turbulence subsided, the Government began to issue bonds again.

Monetary policy remained focused on the behaviour of the financial system. There were increases in deposit insurance coverage and in the amount of stand-by credits available to the central bank should the need arise to provide liquidity to the nation's banks. The system as a whole did not fall prey to the problems experienced by a number of medium-sized institutions which were forced to suspend operations.

After much debate, labour reforms were passed which enjoy the support of the trade unions but not of employers' organizations. The new legislation lowers severance payments somewhat and eliminates certain types of fixed-term employment contracts whose use had been on the rise.

During the first half of the year the level of activity climbed rapidly as investment boomed (18%) in construction and, especially, in machinery and equipment. Consumption grew at a much slower but still appreciable rate (over 5%). The 1997/1998 grain harvest exceeded 65 million tons; this was 23% more than in the previous crop year, which itself had set an all-time record. In addition to favourable weather conditions, this result was due to the expansion of the area under cultivation and improvements in farming methods. Nonetheless, producers' decisions concerning the area to be planted for the 1998/1999 grain crop were influenced by the trend in international prices. In manufacturing, the first half of the year saw considerable increases in the output of motor vehicles, home appliances, construction materials and other intermediate goods such as iron and steel and chemicals. There was a significant increase in activity in public utilities as well, particularly communications and certain areas of the transport sector.

The downturn in activity in the last months of the year was reflected in sectors which are highly sensitive to variations in aggregate spending, such as those which produce construction inputs and consumer durables (especially the automotive industry, which was also affected by events in the Brazilian economy). The manufacturing production index for October was significantly lower than it had been 12 months earlier.

Unemployment in the country's major urban areas was down to 13.2% in May 1998 (13.7% in October 1997) and the labour participation rate rose slightly. The following months saw a decline in both employment and the labour supply, and the net result was that the statistics for August showed no significant change in the unemployment rate. Figures for October show a decrease in the unemployment rate (to 12.4%). Data on formal employment in the metropolitan area signal a persistent decline; this has been going on for years in the case of employment covered by traditional open-ended contracts, whereas the number of workers on probationary contracts has increased.

Over the first 11 months of the year, the consumer price index rose by 0.7% (0.2% during the same period in 1997). The increase was mainly due to rising food prices (2%), particularly for meat, owing to a contraction in the supply of livestock for slaughter. There was significant deflation in wholesale prices (more than 5%) between December 1997 and November 1998.

The current account deficit widened to US$ 5.7 billion during the first half of 1998 compared to US$ 3.65 billion during the same period in 1997. This was mainly attributable to an increase in the merchandise trade deficit caused by rising imports. There was also a worsening deficit under the headings of interest payments, profits and dividends. The non-financial public sector registered a slight increase in capital inflows. Foreign direct investment continued to rise, while the private sector's placement of debt instruments declined slightly. Banking operations once again produced a net capital outflow, although it was smaller in volume than it had been in the first half of 1997.

Taking the year as a whole, the value of merchandise exports is thought to have been similar to the figure for 1997, despite the steep fall (about 9%) in unit values. Figures for the first eight months show a significant increase in the value of exports of manufactured goods, especially motor vehicles, chemicals and iron and steel products. Sales of primary goods also rose despite falling prices, particularly in the case of cereals. Declining prices affected fuel sales as well. Among natural resource-based manufactures, exports of edible oils increased but meat sales were down. Brazil's share in total exports in the first eight months of 1998 (29.4%) was a little lower than the average for the previous year. Towards the end of the year, a decline was observed in sales to the Mercosur area in sectors such as motor vehicles.

During the first eight months of the year imports were considerably higher (10.4%) than during the same period in 1997, with a very sharp increase (21%) in purchases of capital goods. In mid-1998 the demand for imports began to weaken, and growth for the year as a whole is forecast to be around 6%.

BOLIVIA

For the sixth consecutive year, growth in the Bolivian economy was in the 4%-5% range. Following the price adjustments implemented at the end of 1997, inflation continued to decline gradually and was expected to be under 7% by December 1998. The fiscal gap widened to the equivalent of 4% of GDP owing to a combination of increased outlays for the implementation of pension system reforms and lower income due to falling hydrocarbon prices.

The tumbling prices of Bolivia's main export products, owing to the effects of the international crisis, led to a substantial widening of the current account deficit. Imports continued to rise swiftly. The real exchange rate remained stable in relation to the United States dollar, but the local currency appreciated against the currencies of the country's other major trading partners. The current account deficit was in large part financed by the plentiful inflows of foreign investment associated with the construction of the gas pipeline to Brazil and with what is referred to in Bolivia as the "capitalization" (i.e., privatization) of State assets in, among others, the telecommunications sector.

Priority continued to be given to consolidating the macroeconomic stabilization process but, as was expected, the operation of the new pension system made it more difficult to keep public finances in balance. During a prolonged transition period, the pension reforms will entail a decline in State revenue while, at the same time, the pensions being drawn under the previous system will continue to be paid out of public funds. To make up for this extra burden, the authorities have opted for reductions in public-sector investment. The first part of the year saw an upswing in transfers from Yacimientos Petrolíferos Fiscales Bolivianos (YPFB) as a result of the increase in domestic fuel prices announced in December 1997. Nevertheless, those transfers were far from sufficient to make up for the decline in royalties caused by the slump in international crude oil prices.

Monetary policy was, for the most part, contractionary. In the context of a shrinking monetary base, the broad measure of the local-currency money supply (M2) remained stable for the first eight months of the year, while M'2, which includes foreign currency, grew more slowly than during the same period in 1997. Interest rates continued to fall slowly.

Price stability and the preservation of a stable and competitive exchange rate remained the goals of economic policy in 1998. The real exchange rate against the dollar held steady, but the boliviano appreciated against the currencies of several major trading partners, especially Brazil, Chile, Mexico and

BOLIVIA: MAIN ECONOMIC INDICATORS

	1996	1997	1998[a]
	Annual rate of variation		
Gross domestic product	4.4	4.2	4.5
Consumer prices	7.9	6.7	7.8
Real wages	1.1	8.2	a
Money (M1)	10.4	15.6	9.0
Real effective exchange rate[b]	-6.6	-2.5	-4.7
Terms of trade	-14.8	3.4	-4.5
	Percentages		
Urban unemployment rate	3.8	4.4	...
Fiscal balance/GDP	-2.0	-3.4	-4.1
Real deposit rate	9.4	7.6	10.2
Real lending rate	43.4	41.0	37.2
	Millions of dollars		
Exports of goods and services	1 313	1 362	1 310
Imports of goods and services	1 731	2 048	2 145
Current account	-404	-714	-805
Capital and financial account	672	807	720
Overall balance	268	93	-85

Source: See the statistical appendix.
[a] Preliminary estimates.
[b] A negative rate signifies an appreciation of the currency in real terms.

some Asian countries. The management of the exchange rate was facilitated by sizeable foreign capital inflows associated with the privatization of public-sector enterprises and other direct investments.

Overall demand grew by a little over 6%; private fixed investment rose by 20%, thereby serving as an important stimulus for the growth of demand. Consumption increased somewhat less than GDP, and physical exports tended to stagnate. As for total supply, output grew by 4.5% and there was a noticeable surge in imports (6.3%).

Thanks to the implementation of development programmes by newly privatized enterprises and numerous foreign investment projects in the farming, mining, electric power and natural gas sectors, FDI continued to be the most dynamic component of private investment. Some of the largest investments in the country are being made in connection with the construction of the gas pipeline to Brazil and the exploration of oilfields and natural gas deposits.

The agricultural sector contracted by about 3.1%. Unfavourable weather conditions caused the farming sector to shrink by 5%, although this was partly offset by a 2% increase in livestock output. The forestry, fishing and hunting sector grew by 4.4%. In the mining industry, the only branches that performed well were gold and silver, but their increased output was enough to allow the sector as a whole to grow by almost 4%. The State-owned mining conglomerate (the Bolivian Mining Corporation, or Comibol) contracted by 12% as a consequence of the drop in zinc and tin production. Medium-scale mining was the only segment to show a significant expansion (9.5%), thanks to notable increases in silver and gold output (18% and 19%, respectively). Output of other ores fell, particularly in the cases of antimony (-32%), tin (-27%) and lead (-21%). Small-scale mining was down by just over 1%, mostly because of decreases in the output of tin (-20%) and lead (-8%). The manufacturing sector grew by 4% as a result of the strong performances of paper and paper products, beverages, non-metallic mineral products, and textiles, wearing apparel and leather. There was considerable growth in the electricity, gas and water sector (6%), where there was also a significant increase in investments both for the domestic market and for hydroelectric power exports, mainly to Brazil. There was a 24.4% boom in telecommunications thanks to the expansion of national and international telephone services (37% and 26%, respectively); this recently privatized sector has benefited from a generous share of FDI. Construction was up by 21% relative to 1997, largely because of the progress being made in building the gas pipeline to Brazil. Hydrocarbon extraction rose by almost 11% overall as a result of the vigorous increase in the production of crude oil (19%); natural gas output increased by 4%.

During the first 11 months of 1998, the consumer price index showed a cumulative increase of 4.6%, and it appeared quite possible that it might end the year below the 6.5% target figure set for the year. The Government's decision in December 1997 to raise hydrocarbon prices caused strong aftershocks in early 1998, and in the first two months of 1998 alone, the CPI consequently registered a cumulative increase of 2.2%. However, inflation slowed considerably in the second and third quarters.

In the external sector, imports rose and exports fell. The current account deficit increased relative to 1997, exceeding 9% of GDP. The steep drop in the prices of the country's main agro-industrial and mining exports was partly compensated for by increased sales volumes. Imports climbed sharply during most of 1998, with major increases in almost all segments, especially intermediate goods. More than 80% of the country's hefty current account deficit was covered by FDI. International reserves fell to the equivalent of seven months' worth of imports.

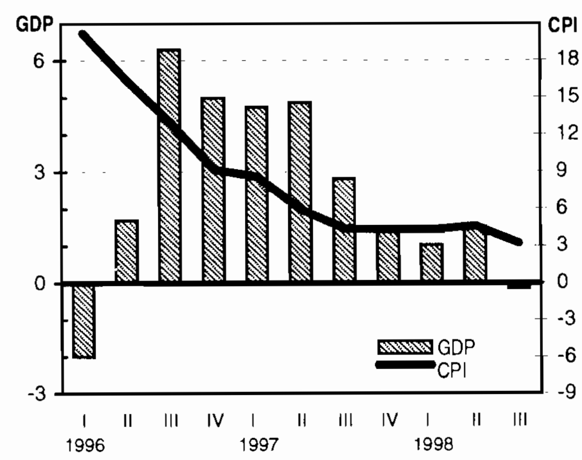
The debt relief scheme for heavily-indebted poor countries came into force in 1998, and Bolivia was declared to be eligible for this programme owing to its relatively low level of development and high incidence of poverty, as well as the high ratings which its macroeconomic policies have earned it thanks to the progress being made in the areas of economic stabilization and structural reform. The application of this scheme will bring about a reduction of approximately 20% (US$ 448 million) in the net present value of Bolivia's public external debt. Of that amount, US$ 157 million will be provided by bilateral institutions and the remaining US$ 291 million by multilateral bodies.

BRAZIL

Large fiscal and external deficits made Brazil's economy highly vulnerable to international turbulence in 1998. The severe adjustment measures applied by the Government held back output growth to a mere 0.5%, and per capita GDP consequently fell by 0.8%. The collapse of the Russian economy in August led to a repeat of the damage caused a few months earlier by the Asian crisis, with massive capital flight and the loss of access to international financing, all of which sparked wild fluctuations on Brazil's foreign-exchange market. To keep their promise to maintain the country's existing exchange-rate policy, the authorities once again resorted to spectacular interest rate hikes that drove up annualized real interest rates to over 35%. In the last quarter of 1998 the increasingly steep decline in reserves and the uncertainty reigning in international credit markets forced the Government to adopt a package of measures within the framework of an agreement with the IMF under which US$ 41.5 billion in financial assistance is to be provided by multilateral bodies and a number of industrialized countries.

BRAZIL: GROSS DOMESTIC PRODUCT AND INFLATION

(Percentage variation)



Source: ECLAC, on the basis of official figures.

The Government's **adjustment policies** strengthened the stabilization process to such an extent that the rate of price increases was held down to just 3%, but the figures for economic activity, employment, wages and the external sector were disappointing. According to projections for the year as a whole, industrial output were down by over 2%; unemployment rose to 7.8%, which was more than a third higher than in 1997; and real wages were stagnant. The country's hefty current account deficit shrank slightly, but the performance of the capital account was unfavourable. In the early part of the year international reserves swelled by more than US$ 20 billion, reaching almost US$ 72 billion by the end of May, but from August onward they eroded swiftly and had fallen to just US$ 42 billion by late November.

The external adjustment had a direct, adverse impact on fiscal accounts. The public-sector deficit is expected to be 7% of GDP (versus 6.1% in 1997), with the increase being largely attributable to the higher cost of servicing the public-sector debt, since outlays for interest payments rose from 5.2% to 7.2% of GDP. This heavier financial load was compounded by factors that hindered the achievement of a better outturn on primary accounts at the various levels of the government structure. There were some improvements at the federal level, but they were not large enough to cover the increased social security deficit, and the total net public debt by the end of the

BRAZIL: MAIN ECONOMIC INDICATORS

	1996	1997	1998[a]
	Annual rate of variation		
Gross domestic product	2.9	3.0	0.5
Consumer prices	9.1	4.3	2.6
Real wages	7.9	2.6	0.3
Money (M1)	4.6	58.9	12.3
Real effective exchange rate[b]	-5.8	-1.1	2.5
Terms of trade	-8.1	5.8	0.0
	Percentages		
Urban unemployment rate	5.4	5.7	7.8
Fiscal balance/GDP	-5.9	-6.2	-7.0
Real deposit rate	16.5	19.6	22.8
Real lending rate	41.6	44.1	85.8
	Millions of dollars		
Exports of goods and services	54 524	60 252	60 000
Imports of goods and services	69 110	79 821	76 750
Current account	-24 347	-33 484	-32 450
Capital and financial account	33 121	25 647	17 450
Overall balance	8 774	-7 837	-15 000

Source: See the statistical appendix.
[a] Preliminary estimates.
[b] A negative rate signifies an appreciation of the currency in real terms.

year is therefore expected to amount to 42% of GDP (as opposed to 34% at the end of 1997).

Economic policy pursued three immediate objectives in succession during the course of 1998: from January to April, the implementation of monetary and fiscal measures designed to stave off the effects of the Asian crisis; from May to August, the introduction of economic stimuli in order to bring about a recovery in the level of activity; and from September onward, the application of mechanisms to cope with the impact of the Russian crisis and the design of an external assistance and fiscal policy package to prevent the collapse of the Brazilian economy despite worldwide expectations to the contrary.

During the first of these periods, following the resumption of external capital flows, the central bank paved the way for a slow descent of interest rates. International reserves began to build up again in February, peaking at US$ 73.8 billion in May. The overnight interest rate, which had approached 3% per month in late 1997, fell to 1.63% in May.

In order to bolster its accounts, the Government implemented new rules on the taxation of income from financial assets, lowered the spending limits laid down in the 1998 budget, and intensified its efforts to curb borrowing by state and municipal governments.

When the impact of restrictive measures on economic activity became clear during the period from May to August, as industrial output slumped and unemployment rates reached unprecedented levels, the tax on financial operations was reduced from 15% to less than 6% and the motor vehicle production tax was cut by five percentage points; in addition, some budgetary limits were reintroduced. With the stabilization of capital flows and international reserves, the central bank continued to reduce interest rates, although more slowly than before. This set of measures paved the way for a recovery in the level of activity.

In August there was another episode of **massive capital flight.** International reserves fell by US$ 24 billion as a result of the exodus of short-term funds and the decrease in bond rollovers. The Central Bank once again raised its top interest rate, this time to 49% per annum. To strengthen the credibility of its commitment to fiscal equilibrium, the central government made its targets for the primary balance legally binding and cut budgetary ceilings by 20%.

In October, the persistence of capital flight forced the authorities to implement a **more drastic fiscal adjustment**, sign an agreement with the International Monetary Fund and seek help from industrialized countries in re-establishing lines of credit. In late October the Government submitted a fiscal package to Congress whose aim was to boost the primary balance by almost 26 billion reais. The package provided for increases in the tax rate on financial transactions (from 0.2% to 0.38%), in social security contributions (from 2% to 3%), as well as requiring that they also be paid by the previously exempt financial sector, and in the social security taxes to be paid by civil servants, including retired federal government officials. In addition, a further cut of 8.9 billion reais was made in the proposed budget for 1999.

The constitutional reforms relating to government service adopted during the latter part of the second quarter and the social security reforms passed in November will produce no immediate fiscal savings, but they will make the management of State finances more flexible and therefore appear to be in keeping with the measures set out in the adjustment package.

In July, control of the State telephone system, Telebrás, was transferred to private ownership for approximately US$ 19 billion in what was the largest privatization operation ever to be carried out in Latin America. The sale of assets or concessions in the port and electricity sectors also continued. In addition, state governments moved forward with their own privatization programmes (energy distribution, banking, railways, and urban train services).

The **level of activity** was hurt by high interest rates, and the timid economic expansion that had appeared to be starting up in the second quarter was halted by the Russian crisis. The manufacturing sector was hit the hardest by monetary measures, and consumer goods industries contracted, particularly in the case of consumer durables. The agricultural sector shrank 0.5% because of losses in rice, corn and bean harvests. Rising interest rates also cut growth in construction to 3.4% in the third quarter of 1998, compared to 8.5% the year before.

The sluggishness of the economy's production sectors and the cooling of demand relieved inflationary pressures, and **the CPI** consequently rose by just 3%. The trend towards smaller increases or even decreases in prices for services and non-tradable goods strengthened, providing further proof of the flexibility of relative prices since the introduction of the *Real* Plan. Indeed, in cities such as São Paulo where the impact of restrictive measures is strongest, there seems to have been some deflation.

Between January and October, industrial employment fell by 7.1% in São Paulo and by 4.6% nationwide. There were also considerable job losses in the commercial sector. As a result, the **unemployment rate** rose to nearly 8% (as compared to 5.8% in 1997).

To avoid any further deterioration of the situation in the labour market, a system of "temporary resignation" was set up as a way of reducing severance payments; regulations governing part-time and temporary work contracts were established; flexible working hours were introduced in order to lower overtime costs; unemployment benefits for more experienced workers were increased; and improvements were made in the training and retraining systems.

During the period from January to September, the average incomes of employed persons showed no increase over the corresponding period of 1997. However, a comparison of the figures for September 1998 and September 1997 reveals the first decrease in the index of average wages to be recorded in the past five years.

The **external sector** exhibited some degree of vulnerability owing to the size of the current account deficit; this problem has been heightened by the substantial deterioration seen in the real exchange rate since the introduction of the *Real* Plan in June 1994. The policy of controlled devaluations (that amounted to a nominal rate of 7.5% in 1998) has been one of the mainstays of economic policy. However, this overvaluation was reduced by 3% thanks to very low inflation and the weakening of the United States dollar against several world currencies.

As of the end of the third quarter, manufacturing **exports** were up 6.6%, in contrast with commodities (down 12%) and semi-manufactured products (down 1.5%), suggesting that total external sales for the year will turn out to have fallen by around 0.6%, a far cry from the targeted 11% increase. The shortfall can be attributed to the external crisis and to supply-side constraints in the Brazilian economy. Lower international prices and insufficient growth in the number of shipments led to a substantial decline in earnings from major agricultural exports, such as coffee and soybeans, and from aluminium-, iron- and steel-based semi-manufactures. Exports of manufactures were boosted by the upswing in sales of products having a relatively higher technological content, including motor vehicles and aircraft. Exports to Asia, including Japan, fell by 28% (49% in the five countries more seriously affected by the Asian crisis) and, while these markets represent a modest percentage of the country's total sales, this nonetheless affected the performance of the external sector as a whole.

The one-third drop in the merchandise trade deficit was mostly due to the 4.8% reduction in the value of imports. Factors of particular importance in this respect included the lower value of fuel purchases, thanks to the downturn in international oil prices, and of imports of durable goods, owing to weaker domestic demand. Motor vehicle imports were the exception, increasing by 7.4% to US$ 2 billion.

Foreign capital inflows plunged in the third quarter. Despite a balance of payments surplus of US$ 18.7 billion at the end of the second quarter, by the end of September Brazil was running a cumulative deficit for the year of US$ 6.5 billion. Net outflows in the form of payments for factor services were US$ 2.7 billion higher than in 1997, with a 22% rise in profit remittances. The capital account showed net outflows of US$ 5.9 billion in the third quarter, and cumulative net inflows for the year were therefore down to US$ 16.9 billion. Direct investments continued to rise, reaching US$ 22 billion in October. More than 25% of those inflows were for privatizations, which was 51% more than in the same period of 1997.

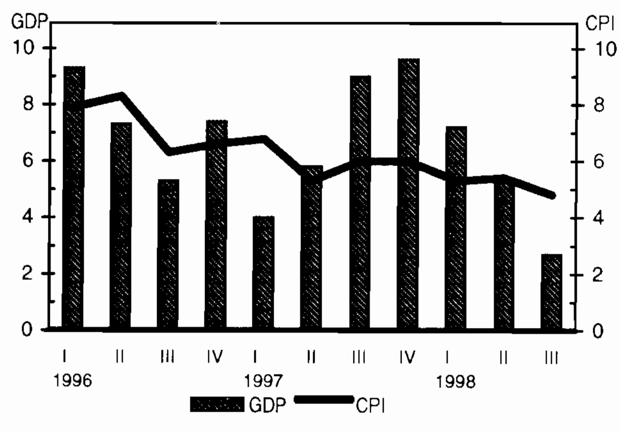
CHILE

Chile's balance of payments was hit hard by the external crisis. As a result, growth and spending were held down in an economy which had enjoyed almost 15 years of rapid expansion. The combination of internal adjustment and the impact of the external crisis led to a growth rate of only about 4% (7.1% in 1997) and pushed the current account deficit up to 7% of GDP. Inflation was down again, to about 4.5%, within the target set by the Central Bank. Although the steep drop in international copper prices has reduced the income of the public sector, the latter will once again end the year with a surplus.

With the deterioration of the terms of trade, high interest rates, and the upward trend of the exchange rate, **private spending has been reined in severely**. Very high interest rates over several months kept spending down and helped to narrow the external deficit, but they also slowed investment and productive activity, resulting in an anticipated fall in the level of output for the fourth quarter.

CHILE: GROSS DOMESTIC PRODUCT AND INFLATION

(Percentage variation)



Source: ECLAC, on the basis of official figures.

CHILE: MAIN ECONOMIC INDICATORS

	1996	1997	1998[a]
	Annual rate of variation		
Gross domestic product	7.0	7.1	4.0
Consumer prices	6.6	6.0	4.3
Real wages	4.1	2.4	2.8
Money (M1)	-7.8	20.0	-5.3
Real effective exchange rate [b]	-3.6	-6.7	2.2
Terms of trade	-16.6	3.8	-10.5
	Percentages		
Unemployment rate	6.4	6.1	6.1
Fiscal balance/GDP	2.3	1.9	0.7
Real deposit rate	6.4	5.8	10.1
Real lending rate	10.1	9.2	15.1
	Millions of dollars		
Exports of goods and services	18 771	20 608	18 940
Imports of goods and services	20 219	22 219	22 445
Current account	-3 744	-4 058	-5 160
Capital and financial account	6 249	7 243	2 460
Overall balance	2 505	3 185	-2 700

Source: See the statistical appendix.
[a] Preliminary estimates.
[b] A negative rate signifies an appreciation of the currency in real terms.

The Chilean economy suffered a blow in late 1997, when the Asian crisis caused a sharp drop in the price of copper and a cumulative fall of 10% in the **real exchange rate.** The market anticipated an adjustment of the parity, and this caused slight but unusual nominal devaluations, which put an end to 10 months of nominal stability and more than five years of persistent expectations that the peso would appreciate. High levels of activity and spending in the last quarter of 1997 (9.6% and 13.7%) and the escalation of the current account deficit caused nervousness in the financial system, bringing about a drastic portfolio adjustment with a shift towards dollar-denominated assets and liabilities, a process which continued until mid-1998.

In January, in the absence of nominal anchors, exchange and interest rate volatility intensified. The exchange rate climbed to 453 pesos to the dollar (414 in October 1997), while the interbank rate soared, coming close to 100% in real terms. The Central Bank decided to raise the real interbank rate from 6.5% to 7%, a measure which the market viewed as insufficient. Only after a further increase to 8.5% was the credibility of macroeconomic management restored.

In June the pressure on the peso resumed, this time in anticipation of possible repercussions for copper prices and external financing from the yen's fall against the dollar. In four weeks, **international reserves** fell by US$ 1.3 billion.

The Central Bank cut the reserve requirement on external credits from 30% to 10%, seeking to reduce the cost of external financing; introduced dollar-indexed paper; and, lastly, narrowed the currency band from 12.5% on either side of the reference parity to a floor of 3.5% below the "dollar acuerdo" reference exchange rate and a ceiling of only 2% above it. This improved confidence in exchange rate stability and the achievement of the inflation rate target.

In September the collapse of the Russian economy and the impending crisis in Brazil set off another attack on the peso. The Central Bank managed to fend it off with a package of measures including: (i) raising the ceiling of the currency band from 2% to 3.5% and gradual widening of the band; (ii) eliminating the 2.4% discount for external inflation in the calculation of the price of the dollar; and (iii) linking the flotation of the dollar to expected, rather than past inflation. This provided some room for the exchange rate to rise. In addition, the rate used for controlling the money supply was raised from 8.5% to 14% and the reserve requirement for external capital inflows was reduced to zero. A change for the better on the international scene in the last quarter helped to improve the outlook, allowing for orderly devaluation and gradual relaxation of monetary policy. The interest rate fell from the level of 14.5% to which it had risen in mid-September to 12% in mid-October, 10% in early November and 8.5% in late November.

Fiscal policy helped to contain spending through a 5.5% cut in planned outlays for 1998. Despite declining revenue from taxation and from copper, the public sector will once again show a surplus, which this year will be equivalent to 0.7% of GDP.

Thanks to improved stability on the external scene, calm returned to Chile's foreign exchange and money markets during the fourth quarter. The **stock market** registered strong gains, following cumulative losses for the year of about 25%, while there was a considerable adjustment in spending and inflation continued to fall.

As for **legislation**, the establishment of an international offshore stock exchange in Chile was approved. An infrastructure fund was created in order to improve the stability and continuity time of financial flows and commitments in relation to public works carried out under concession. A tariff reduction was approved whereby the general tariff of 11% on imports will be reduced to 6% within five years. Incentives were created for private savings in the form of shares, financial deposits and dividends from shares in limited corporations.

In late September the economy showed annualized **growth** of 5.4%, with increases which had declined from 7.9% in the first quarter to 2.7% in the fourth. Growth in expenditure had slowed even more markedly, the corresponding rates of increase being 15.6% and 0.5% for the same two quarters. The growth differential between expenditure and output, which had reached 7.7 percentage points during the first quarter, turned negative in the third quarter. Economic growth for the year as a whole is expected to be around 4%, with a slowdown in the pace of both output and expenditure in the fourth quarter.

The 12-month **inflation** rate was down to 4.3% in November, slightly below the 4.5% target. This favourable trend was due to a considerable slowing in tradables prices, particularly during the fourth quarter, helped by lower international inflation and exchange rate stability.

Growth in employment was declining, reacting with the usual time-lag to changes in the level of activity. Annualized growth in employment was 2.5% in the second quarter and 1.3% in the third, with an average of 1.9% for the first nine months. The unemployment rate, which stood at 5.3% in January, was approaching 7% at the end of the year, although, with slower growth in the labour force, the increases were marginal compared to the same period in 1997.

There was also slower growth in nominal **wage levels**, although they continued to benefit from previously high levels of activity. In late October the average annual variation in nominal wages stood at 7.9% and that in real wages at 2.5%.

The **current account** deficit will amount to about US$ 5.2 billion, equivalent to 7% of GDP, and the capital account should show a surplus of US$ 2.46 billion, less than half the surplus in 1997. International reserves are expected to show a loss of US$ 2.7 billion. The unfavourable current account result is basically due to the trade deficit of US$ 3.5 billion, which can be attributed to a deterioration in the terms of trade of close to 10%. Exports are expected to be down 11% and imports unchanged.

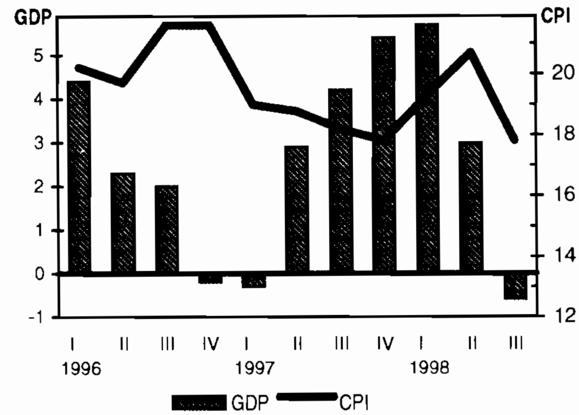
COLOMBIA

The economic recovery begun in 1997 remained strong up through the first quarter of 1998 but then started to falter in the second quarter; the net result was that growth for the year was about 2%. The shocks associated with the Asian and Russian crises reduced the availability of foreign capital and drove down export earnings by triggering steep drops in oil, coffee and coal prices. Prolonged turbulence on the foreign-exchange front began in the first half of the year, depriving economic authorities of much of their manoeuvring room and pushing up interest rates. These high rates cooled off production activity, weakened the financial system and, by increasing the public sector's interest burden, widened the central government's fiscal deficit to the equivalent of 4.8% of GDP. The balance-of-payments current account deficit also worsened, reaching 6.6% of output. Despite some upturn in employment, the situation in the labour market deteriorated to such an extent that the urban unemployment rate exceeded 15%. Some of these adverse economic effects may have been aggravated by the erosion of public order and the still uncertain outlook for the peace negotiations.

Despite these problems, the softening of monetary policy in recent months in response to more stable monetary conditions led to greater optimism at the end of the year. The central bank's inflation target was met for the second consecutive year, and the real exchange rate reached a level that will have a positive influence on the balance of payments. In addition, the new Government announced it would take steps to strengthen the fiscal adjustment measures introduced during the final years of the previous Administration.

Defending the local currency came to be a very important task in early 1998 and soon became the prime objective of **economic policy**. Pressure on the exchange-rate band had already been apparent in the last quarter of 1997. The harmful effects of the Asian crisis added to the deficits on the fiscal account and

COLOMBIA: GROSS DOMESTIC PRODUCT AND INFLATION
(Percentage variation)



Source: ECLAC, on the basis of official figures.

the balance-of-payments current account. It also became clear that the abundant supply of foreign exchange that had been expected to result from the oil boom was not going to materialize any time soon. Economic actors therefore modified their expectations and began to anticipate a further depreciation of the local currency.

The authorities chose to defend the existing exchange-rate band, which had a gradient of 13% and a width of 15 percentage points. Initially, the central bank facilitated private access to external financing, increased the cost of liquidity, and sold foreign exchange. In May, however, the intensity of the run on the currency forced the Banco de la República to limit the amount of funds used to replenish liquidity, and the interbank interest rate skyrocketed, climbing as high as 80% at one point. This increase quickly spread throughout the interest-rate structure. Turbulence on world markets in August renewed the pressure on the foreign-exchange market. On 2 September, the central bank decided to raise the level of the band by nine percentage points, while leaving its gradient and width

COLOMBIA: MAIN ECONOMIC INDICATORS

	1996	1997	1998[a]
	Annual rate of variation		
Gross domestic product	21	30	20
Consumer prices	216	177	163
Real wages	15	28	-07
Money (M1)	164	215	-02
Real effective exchange rate [b]	-73	-64	36
Terms of trade	38	117	-62
	Percentages		
Urban unemployment rate	112	124	151
Fiscal balance/GDP	-20	-36	-34
Real deposit rate	77	52	93
Real lending rate	172	142	179
	Millions of dollars		
Exports of goods and services	14 590	15 888	15 765
Imports of goods and services	16 746	18 756	19 135
Current account	-4 946	-5 683	-6 060
Capital and financial account	6 428	5 653	4 635
Overall balance	1 482	- 30	-1 425

Source: See the statiscal appendix.
[a] Preliminary estimates.
[b] A negative rate signifies an appreciation of the currency in real terms.

unchanged. Various events in late October helped to improve the outlook. Multilateral agencies agreed to lend over US$ 2 billion to Colombia in 1999 and a similar amount in 2000, which will help to finance the external deficit. Renewed confidence on world markets also opened up the possibility of obtaining new private credits. In October the Government began issuing dollar-denominated bonds on the domestic market, helping to alleviate the pressure on the exchange-rate band. The nominal depreciation of the peso is expected to amount to about 20% by the end of the year.

Monetary management became more restrictive, and monetary aggregates therefore grew less than had been expected. The money supply increased by barely 1% up to October, while broad money rose by a below-inflation rate of 16%, causing a rapid slowdown in credit growth. Consequently, the average deposit rate in the financial system rose from 24% in January to 36% in June and remained close to that level during the third and fourth quarters. Lending rates also rose during the first half of the year, from 33% to 45%, reaching the highest levels in real terms registered since the beginning of the decade. In order to counter a moderate deterioration in the financial system, the Government introduced extraordinary measures following its declaration of an "economic emergency" on 16 November and levied a tax on financial transactions that was designed to bring in 2.5 billion pesos (the equivalent of 2% of GDP) to strengthen the Financial Institutions Guarantee Fund (FOGAFIN). It also took steps to help low-income mortgage holders and participants in the cooperative savings and housing system.

Relatively calm conditions in the foreign-exchange market in the latter part of the year enabled the central bank to inject more liquidity into the financial system, to lower reserve requirements and begin to pay interest on those reserves, and to lower interest rates for cash replenishment.

Fiscal balances were negative, with the central government deficit rising to 4.8% of GDP. Total income fell by 5% in real terms, while total expenditure increased slightly (1.4%), since the deep cut in investment (-37%) was not sufficient to cover the increased debt burden (30%) resulting from higher interest rates. In fact, total central government spending on items other than interest payments fell in real terms in 1998. Since the other public agencies were able to balance their accounts, the surplus in the social security system had the effect of reducing the consolidated non-financial public sector's deficit to 3.4% of GDP. The central bank's quasi-fiscal surplus of close to 1% of GDP also eased the fiscal situation. When the new Government took office in August, it announced measures to correct fiscal imbalances and submitted a tax reform bill to Congress which is expected to pass in the near future.

Economic activity lost the momentum it had gained from the previous year's upswing, which was reflected in GDP growth of 5.7% in the first quarter of 1998. GDP growth had turned negative by the third quarter (-0.6%), however, and the figure for the year as a whole is therefore estimated at around 2%. As far as individual sectors are concerned, mining and quarrying was the only outstanding performer, with a growth rate close to 20% (in large part thanks to the results posted by the petroleum industry). Construction, on the other hand, was unable to pull itself out of the recession that overtook it three years ago.

The upturn in **employment** was not strong enough to offset the increase in the labour force participation rate. Consequently, the urban unemployment rate for Colombia's seven major metropolitan areas exceeded 15%. In view of this situation, job creation has become one of the new Government's top priorities.

The downward trend in **inflation** of recent years was interrupted in the first half of 1998, when, in annualized terms, the cumulative increase in the CPI for the period was over 20%. The damage sustained by the agricultural sector as a consequence of El Niño accounts for a large part of that inflationary surge. In the second half of the year, however, favourable weather conditions and the effects of the Government's tight monetary policy helped to cut back the rate of price increases substantially. Accordingly, the inflation rate is expected to stand at about 16% for the year as a whole.

Total **exports** for the first eight months of the year were down 3.7%, whereas imports were up 7.3%. As a result, the year is expected to close with a current account deficit of more than US$ 6 billion, or 6.6% of GDP.

An increase in the volume of the country's main commodity exports (petroleum, coffee and coal) did not make up for the decline in their international prices, and export earnings from these items are therefore expected to be lower. On the other hand, non-traditional exports were up 4.3% as of August. Imports rose considerably (12.3%) during the first two quarters, reflecting the delayed effects of the recovery in economic activity and perhaps expectations of a devaluation as well. However, the growth of imports slowed during the second half of the year as domestic demand slackened, chiefly as a consequence of the stagnation of both private and public investment. **Capital inflows** registered on the financial account fell to US$ 4.64 billion (compared to US$ 5.65 billion the previous year), as a result of which international reserves declined by about US$ 1.4 billion.

ECUADOR

In 1998 the economy of Ecuador suffered from the impact of the El Niño phenomenon, falling petroleum prices, the political uncertainty of an election year and, in the second half of the year, external financing problems resulting from the international crisis. Output grew by a meagre 1%, the financial public sector showed a deficit of 5% of GDP, and the balance-of-payments current account deficit exceeded 9% of GDP. At the same time, inflation rose to 45%.

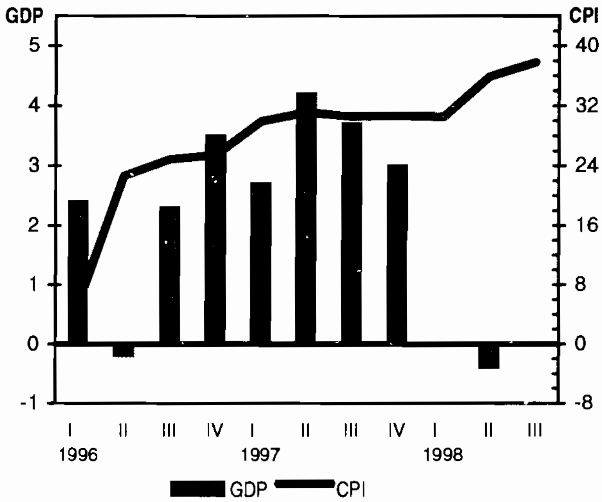
The disastrous effects of El Niño devastated the country's infrastructure and agricultural sector, and indirectly damaged other activities. Low petroleum prices led to a large fiscal deficit. The impact of the international economic crisis seemed relatively limited to begin with, owing to the embryonic nature of the domestic capital market and the weakness of trade links with the worst affected countries. In the second half of the year, however, the decline in external financing led to liquidity problems and caused turbulence on the foreign exchange market.

Fiscal policy was faced with a considerable contraction in revenue owing to falling petroleum prices, while current expenditure increased substantially. In September, the new Government abolished subsidies on gas, reduced those on electric power and increased the tax on diesel fuel, while awarding poor households a compensatory bonus. It also announced that it would cut public expenditure by the equivalent of 1.3% of GDP. These measures were intended to reduce the public-sector deficit to around 6% of GDP.

The **currency band** system was maintained in order to restrain inflationary expectations and the rate of price increases. On two occasions, however, it became necessary to raise the level of the band, by 7.5% in March and 15% in September, because of the uncertainty reigning in the foreign exchange market and growing inflationary pressures. Nonetheless, on average over the first nine months of 1998 the sucre

ECUADOR: GROSS DOMESTIC PRODUCT AND INFLATION

(Percentage variation)



Source: ECLAC, on the basis of official figures.

appreciated by 4%. From September onwards, the scarcity of dollars resulting from the curtailment of external financing led to considerable volatility in the nominal exchange rate and sharp real depreciation of the sucre.

The loss of international reserves resulting from the external imbalance and, at times, from the defence of the exchange rate slowed the growth of liquidity and counteracted the effects of the large fiscal deficit. Beginning in September the Central Bank provided lines of credit to a number of banks while simultaneously intensifying the use of stabilization bonds to limit the expansionary effects of such transactions. As a result, by November growth in the **monetary base** had moderated to 17%, signifying a marked reduction in real terms. The shortage of liquidity led to interest rate rises: the reference lending rate increased to almost 80%, reaching a peak of 14% in real terms in August and then declining gradually.

The **growth** target for 1998 was set at 4%, but late in the year it was estimated that only about 1% growth

ECUADOR: MAIN ECONOMIC INDICATORS

	1996	1997	1998[a]
	Annual rate of variation		
Gross domestic product	2.3	3.3	1.0
Consumer prices	25.6	30.6	45.0
Real wages	5.4	-2.3	...
Money (M1)	35.4	29.7	15.8
Real effective exchange rate [b]	0.4	-4.2	-3.8
Terms of trade	9.6	2.1	-8.4
	Percentages		
Urban unemployment rate	10.4	9.3	...
Fiscal balance/GDP	-3.1	-2.5	-6.0
Real deposit rate	12.9	-2.0	-4.2
Real lending rate	...	10.0	2.5
	Millions of dollars		
Exports of goods and services	5 748	6 000	5 240
Imports of goods and services	4 548	5 787	6 325
Current account	111	- 746	-1 765
Capital and financial account	- 252	779	725
Overall balance	- 141	33	-1 040

Source: See the statistical appendix.
[a] Preliminary estimates.
[b] A negative rate signifies an appreciation of the currency in real terms.

would be achieved, representing a decline of approximately 1% in per capita output.

The El Niño phenomenon caused losses of almost US$ 3 billion and reduced the growth of GDP by 1.3 percentage points. The full brunt of the disaster was borne by agriculture in the coastal area, particularly banana plantations. Tourism also contracted owing to the bad weather. Damage to the transport system indirectly affected various activities, including manufacturing and commerce. Other factors which slowed growth were high interest rates and the deterioration in the terms of trade.

As a result, the economy showed only minimal growth of 0.4% for the first three quarters of the year. Agriculture, petroleum, and financial services contracted, in some cases substantially. Apart from construction and government services, which should show some expansion as a result of the work of reconstruction, the performance of the country's major activities for the year as a whole was expected to be poorer than in 1997.

The **banking system** suffered from the impact of El Niño on the productive sector and the interruption of external capital inflows. The size of the overdue portfolio expanded considerably, and the authorities had to intervene in a number of country's major banks, while some banks received liquidity loans from the Central Bank and others merged to strengthen their competitive position.

The volume of exports, which for several years had been a driving force in the growth of Ecuador's economy, stagnated because of the fall in external demand and the destruction caused by El Niño. Household consumption, the main component of overall demand, only increased at a rate close to that of population growth, since the erosion of real wages and weak job creation prevented stronger recovery in purchasing power. Real minimum **wages** fell for the second consecutive year, this time by about 7%. Gross fixed capital formation expanded a little less than in 1997; this was due to lower growth in private investment, as well as the increased weight of public investment caused by the need to repair the devastation caused by El Niño.

There were two surges in **inflation.** The first took place early in the year, owing to the impact of the disastrous weather on agricultural output and transport; and the second, beginning in September, was caused by the elimination of certain subsidies. As a result, the annualized inflation rate rose to 45% in November.

Exports, which suffered the impact of the aforementioned critical factors, contracted by 20%. There was a 40% drop in the value of petroleum exports, chiefly because of falling prices. The devastation caused by El Niño and the abrupt fall in demand in Asia and Russia weakened banana sales. There was also a small decline in the value of shrimp exports owing to falling prices. In contrast, there was growth in all categories of imports. The **balance of trade,** typically a surplus, went into deficit and caused the current account deficit to approach 10% of GDP.

During the third quarter, international monetary reserves suffered heavy losses owing to growing difficulties in covering the current account deficit, but the situation stabilized in November. Taking the year as a whole, the main source of financing was credit from multilateral organizations for the reconstruction of infrastructure damaged by El Niño and the stabilization of the balance of payments (Latin American Reserve Fund). In addition, the loss of reserve assets was held down by increased foreign direct investment (US$ 750 million) owing to greater investments in petroleum and the accumulation of delays in servicing the external debt (Paris Club).

PARAGUAY

The Paraguayan economy remained stagnant in 1998 owing to the bad weather that hit the country's important agricultural sector. Uncertainty due to the foreign exchange and financial crisis prompted economic agents to take refuge in the dollar, and by the end of the third quarter the guaraní showed an annualized depreciation of 10% in real terms. By late September, feverish demand for foreign exchange had brought down international reserves to the equivalent of two months of imports. The depreciation of the national currency and the decline in supply of agricultural products brought about an inflationary surge. By late November the annualized variation in the consumer price index reached 16%, ten points higher than a year earlier and the highest level in four years.

The main goal of **economic policy** was to contain inflationary pressures, so that tight monetary and fiscal policies were implemented. These, however, were eroded by the prolonged banking crisis.

Central government accounts will end the year with a deficit of 1.5% of GDP, somewhat higher than in 1997, owing to the virtual stagnation of revenue accompanied by increased spending. Revenue was undercut by the slower pace of economic activity; efforts to reduce tax evasion did not succeed in making up for the loss. Current revenue contracted because of declining receipts from value added tax, import duties and income taxes. This decline resulted from the

PARAGUAY: MAIN ECONOMIC INDICATORS

	1996	1997	1998[a]
	Annual rate of variation		
Gross domestic product	1.1	2.6	0.0
Consumer prices	8.2	6.2	16.0
Real wages	3.1	-0.4	-0.8
Money (M1)	2.1	13.9	4.3
Real effective exchange rate[b]	-4.3	-1.7	10.9
Terms of trade	10.5	20.8	-4.8
	Percentages		
Urban unemployment rate	8.2	7.1	...
Fiscal balance/GDP[c]	-0.8	-0.2	-1.5
Real deposit rate	9.8	9.8	-13.8
Real lending rate	22.2	20.7	-4.8
	Millions of dollars		
Exports of goods and services	4 547	4 184	3 895
Imports of goods and services	5 022	4 960	4 280
Current account	-317	-642	-235
Capital and financial account	289	444	105
Overall balance	-28	-198	-130

Source: See the statistical appendix.
[a] Preliminary estimates.
[b] A negative rate signifies an appreciation of the currency in real terms.
[c] Beginning 1998, calculated on an accrual basis.

disappointing performance of economic activity and from lower levels of imports owing to the depreciation of the currency. Royalties from the Itaipú and Yacyretá binational hydroelectric dams increased by almost 50%, but were insufficient to make up for the loss of revenue from other sources.

Despite the implementation of austerity measures, overall expenditure expanded because of larger outlays on wages and salaries, interest payments and social security benefits. Physical investment projects were also expected to increase during the fourth quarter. Net lending by the Central Bank to the public sector should therefore be about 40% higher than in 1997. From 1998 onwards, the Ministry of Finance will present the results of fiscal management on an accrual, rather than a cash basis.

Monetary policy encountered many problems in its efforts to control inflationary pressure. The critical situation in the banking sector, the poor outlook for the productive sector and fear of a traumatic devaluation of the Brazilian *real* caused uncertainty among economic agents, which led to a run on the guaraní. The Central Bank intervened to defend the currency during the first and third quarters, which cost it US$ 140 million over the year, almost one-fifth of its total dollar reserves. To boost demand for guaraníes, it floated monetary regulation instruments with an average yield of about 25%, more than 13 points higher than the average for 1997. This was another factor in the upward movement of interest rates. By September, however, the national currency showed an annualized depreciation of 10% in real terms. This caused further damage to fiscal accounts by swelling the external debt expressed in national currency.

The Central Bank continued with its financial system reform policy for the fourth successive year. During the first quarter the liquidation of two of the country's largest financial institutions was announced, and during the third quarter the Central Bank had to intervene in two banks and another financial institution. The liquidation of one of the banks was scheduled for late November.

At the end of the third quarter, despite open market operations and sales of foreign currencies, the annualized variation in money in circulation stood at 12%. Reactions to the banking crisis led to the substitution of money in circulation for demand and savings deposits. As a result, the M1 money supply grew slightly (3%), while M2 contracted. A clear preference for deposits in dollars was also observed; as of September, these showed an annualized increase of 48%.

Adverse weather conditions damaged **agricultural productivity**, and the sector's slight growth was basically due to an increase in area sown. This was particularly true in the case of the cotton crop, which recovered after a drop of more than 50% the previous year, although it remained well below the average for the decade. Yield was down, owing to excessive amounts of rainfall and problems with plant health. These difficulties were compounded by the crisis in the financial system, which made access to credit difficult for producers. On the other hand, the soybean crop once again topped the previous year's record, although not by as much. As in the case of cotton, this performance was due to increased area sown rather than improved yields. Activity in agriculture, forestry, construction, industry and commerce declined.

The cumulative variation of the **consumer price index** as of November was 15%, so that the inflation figure should be about 16% by the end of the year, ten percentage points higher than the 1997 figure. This change was mostly due to rising food prices caused by the shorter supply of agricultural products and the sharp depreciation of the guaraní. The cost of education, health and transport services also rose.

The **minimum wage** increased by 9% in nominal terms, but with annualized inflation of 16% this meant a substantial decline in real terms. However, the real average wage of manual workers showed an average increase for the year of 4%, owing to pay rises in the basic services and construction sectors.

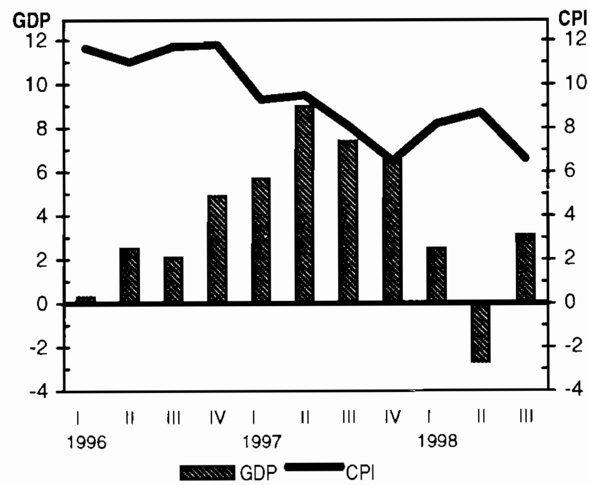
The **current account** remained in deficit, but significantly less so than in 1997: the gap narrowed from US$ 640 million to US$ 240 million. One of its components, the trade deficit, remained sizeable, although about a third of imports and almost two thirds of exports consist of unregistered transactions. **Capital flows** diminished to 25% of their 1997 level, amounting to a little more than US$ 100 million.

The value of **registered exports** during the first nine months of 1998 was down by 12% compared to the same period in 1997. This fall was due to lower cotton and soybean sales. Both decreased by 13% owing to falling international prices and a decline of almost 30% in demand in Brazil; increased purchases by Argentina were not sufficient to make up the difference. The value of **registered imports** as of September was down by 27% owing to the depreciation of the guaraní, the sluggish performance of the national economy and declining cross-border trade.

PERU

The growth rate of the Peruvian economy fell back to 1% in 1998, as a result of the devastating effect of the El Niño climatic phenomenon and a succession of shocks originating abroad. Rainfall over extensive areas of the country, without precedent in decades, caused the collapse of much of the highway infrastructure and a contraction in the supply of agricultural and fishing products, categories that account for a high percentage of total exports. In addition, the Asian crisis eroded the international price of mining products –especially copper– which are crucial to the Peruvian export basket. Lastly, in September the effects of the international financial crisis set off by the Russian moratorium began to be felt, and tightened the availability of foreign credit to emerging economies.

PERU: GROSS DOMESTIC PRODUCT AND INFLATION



Source: ECLAC, on the basis of official figures.

In the face of severe constraints on the supply side, the Government opted to preserve price stability and concentrated its efforts on reining in demand. It is estimated that by year's end the 12-month accumulated inflation rate will be below 6%.

Fiscal policy played a restraining role and brought about reductions of 3% in public consumption and 4% in capital expenditure. The spending cuts offset the decrease in revenues caused by the economic slowdown and a reduction in the National Housing Fund (FONAVI) tax rate from 7% to 5%. Central government operations produced a deficit equivalent to 0.3% of GDP, while outlays for interest payments on the external debt amounted to 1.8% of output. The non-financial public sector, as a whole, achieved a current surplus equivalent to 3.8% of GDP, which helped it to finance investment amounting to 4% of GDP, and still end up with a deficit of only 0.1% of output. Privatization proceeds declined again in 1998, this time to half a per cent of GDP, and came largely from the national private sector.

Monetary policy closely tracked the slowdown in the pace of activity and the trend in inflation. The loss of

PERU: MAIN ECONOMIC INDICATORS

	1996	1997	1998[a]
	Annual rate of variation		
Gross domestic product	2.3	7.4	1.0
Consumer prices	11.8	6.5	6.0
Real wages	-4.7	-0.7	-1.6
Money (M1)	18.1	19.3	-6.6
Real effective exchange rate[b]	-1.4	0.6	-0.4
Terms of trade	-3.5	17.0	-8.8
	Percentages		
Urban unemployment rate	8.0	9.2	9.0
Fiscal balance/GDP	-1.0	0.0	-0.1
Real deposit rate	-1.4	3.6	2.7
Real lending rate	17.6	23.0	22.2
	Millions of dollars		
Exports of goods and services	7 312	8 354	7 415
Imports of goods and services	9 985	10 840	10 690
Current account	-3 619	-3 408	-4 120
Capital and financial account	4 579	5 865	3 045
Overall balance	960	2 457	-1 075

Source: See the statistical appendix.
[a] Preliminary estimates.
[b] A negative rate signifies an appreciation of the currency in real terms.

international reserves, which gathered pace from September onward, was compensated for by an expansion in domestic sources of money creation, so that the monetary base grew by 11% over 12 months. However, this increase was not enough to prevent a 6.6% contraction in the money supply (M1), although quasi-money in national currency posted an expansion of 7%. The 16% increase in foreign currency deposits enabled the total liquidity of the system to increase by 11%.

Although Peru has a policy of free capital movement, until June it applied a marginal reserve requirement of 45%, reduced to 35% from July onward in an attempt to encourage foreign capital to remain in the country and thus alleviate the illiquidity of the financial system. The average reserve requirement was also lowered by 1.5% in October and by a similar amount in November, thereby freeing up US$ 280 million, which flowed to banks whose credit lines abroad had not been renewed. The illiquidity of the financial system led to a sharp rise in the interbank interest rate, which in September climbed to 35% but dropped back in subsequent months to between 10% and 12%.

The **productive sectors** hardest hit by the Asian crisis included fishing, where output plummeted to less than half that of a normal year. Sharp reverses were also seen in the agricultural sector and in industrial raw material processing activities. In contrast, the construction and basic services sector showed considerable vigour.

The components underpinning expenditure growth were gross fixed capital formation and exports, whose dynamism was concentrated in the second half of the year. The investment ratio rose to 25%, nearly one percentage point higher than in 1997, and this was financed almost three to one by domestic saving.

The slowdown in growth was not reflected in the **labour market** in 1998. The second quarter measurement of open unemployment, at the national level, yielded a rate similar to that a year earlier, together with a slight fall in the real wage.

The damage caused by the El Niño climatic phenomenon and the effects of the Asian crisis had a negative effect on export performance, the first by shrinking supply, the second by lowering prices. On top of the marked deterioration in the international price of copper and other metals, which account for two fifths of Peru's exports, came a drastic decline in the volume of products derived from fishing. As a result, the value of merchandise exports fell by about US$ 1.2 billion, whereas imports were down by US$ 200 million, and the merchandise trade balance thus worsened by nearly US$ 1 billion compared to the previous year. Lower payments for services and factor incomes moderated the increase in the current

UNITED NATIONS - ECONOMIC COMMISSION FOR LATIN AMERICA AND THE CARIBBEAN

PRELIMINARY OVERVIEW OF THE ECONOMIES OF LATIN AMERICA AND THE CARIBBEAN 1998

QUESTIONNAIRE

In the interest of improving the quality and increasing the circulation of this document, you are kindly requested to complete this questionnaire and return it to the address shown on the back by 31 March 1999.

1. Area of professional interest:	2. Sector of activity in which you are employed:
❑ Economics, business and finance	❑ Corporate and business
❑ Political and social sciences	❑ Public administration
❑ Social development	❑ Teaching and research
❑ History	❑ International organization
❑ Other: ______________	❑ Non-governmental organization
	❑ Communications media
	❑ Other: ______________

3. For what purpose and how frequently do you refer to the Preliminary Overview? (Kindly circle the relevant frequency ratings.)

	Very high	High	Average	Low	Do not use it
As a reference for decision-making purposes	5	4	3	2	1
As a reference for purposes of research, study and/or teaching	5	4	3	2	1
As a basis for comparison with other studies	5	4	3	2	1
As a source of material for use in other publications	5	4	3	2	1
As a source of data for processing	5	4	3	2	1
For information of general interest	5	4	3	2	1
Other (specify)______________________	5	4	3	2	1

4. How would you rate the usefulness of each of the sections of the Preliminary Overview?

	Very useful	Useful	Not very useful	Not useful	Do not use it
a. Regional panorama	5	4	3	2	1
b. Notes on the countries	5	4	3	2	1
c. Statistical appendix	5	4	3	2	1

5. How would you rate the Preliminary Overview with respect to the following criteria?

	Excellent	Very good	Good	Average	Poor
Relevance of topical issues	5	4	3	2	1
Subject coverage	5	4	3	2	1
Statistical coverage	5	4	3	2	1
Format	5	4	3	2	1
Readability	5	4	3	2	1
Overall quality	5	4	3	2	1

(See overleaf)

6. Do you use **publications** of other institutions dealing with the economy of Latin America and the Caribbean?	**7.** How would you rate the quality of the Preliminary Overview in comparison with the publications you listed under question 6?
❑ Yes If so, which ones? ____________ ____________ ____________ ____________ ❑ No	The Preliminary Overview ❑ is of a higher quality ❑ is of a similar quality ❑ is of a lower quality ❑ is not comparable

8. What do you think about the length of the different sections of the Preliminary Overview?

❑ Satisfactory ❑ Unsatisfactory

Other suggestions (kindly choose one option from (a) and another from (b))

(a)
- ○ **More** analysis of economic trends in **the region** as a whole and **less** information on the situation in each **country**
- ○ **More** information on the situation in the **individual countries** and **less** analysis of **regional** trends

(b)
- ○ **More** analysis of a topical **issue** and **less description** of the situation in countries and the region
- ○ **More statistical** information and **graphs** on the region and countries and **less text**

9. What other subjects would you like to see covered in the Preliminary Overview?	**10.** Additional comments or suggestions

11. What other ECLAC publication do you use?

❑ Economic Survey ❑ Social Panorama ❑ Statistical Yearbook ❑ Other____________

12. Optional information

Name____________________________

Institution or company name____________________________

Address____________________________

Telephone______________________ Fax ______________________

e-mail address______________________

THANK YOU

Please mail the completed questionnaire to: ECLAC, Economic Development Division, Casilla 179-D, Santiago, CHILE; fax it to us at: 56-2-208-1946 or 56-2-208-0252; **or** e-mail it to us by completing this questionnaire, available on the Internet at the ECLAC homepage: <http://www.eclac.cl> next to the full text of the Preliminary Overview.

account deficit, which widened to just over US$ 4.1 billion, equivalent to 6.5% of GDP.

The international financial crisis basically affected portfolio investment and some short-term capital flows. However, flows of medium and long-term financing, both foreign direct investment and commercial bank loans held up well. Nonetheless, moderate recourse to **international reserves** was needed to finance the current account deficit.

The Asian crisis also led to the postponement of some importing investment projects in the mining sector. These included a request by the Shell-Mobil consortium to defer a decision on carrying out the Camisea gas project, in order to strengthen its profitability and improve bargaining conditions with the Government. In the hope of an upturn in copper prices and the resumption of credit lines, feasibility studies were also postponed on the La Granja and Quellaveco copper projects being promoted by the Cambior and Mantos Blancos companies. For the same reasons, Rio Algom and the Inmet Mining Corporation both put off development of the Antamina copper and zinc deposits.

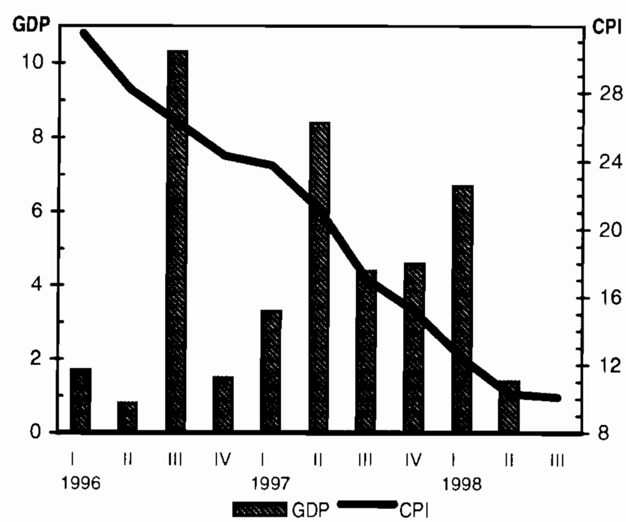
URUGUAY

The momentum of the Uruguayan economy weakened during the course of 1998. After remaining in the 5% range during the two preceding years, growth picked up to nearly 7% in the first quarter, but later cooled, so that the 1998 growth figure will fail to reach 3%. Against this backdrop, and under a tight fiscal policy, inflation was on the order of 9% for the year, its lowest level in 30 years.

Despite the uncertainty prevailing in international financial markets, deposits in the banking system continued to rise, while the flow of capital from abroad more than covered a widening of the external deficit to the equivalent of 2% of output. The fall in the international oil price brought an improvement in the terms of trade, so that income grew by more than output. By year's end, domestic demand was seen to weaken, unemployment was threatening to breach the 10% level, and a slackening of international trade flows was also in evidence.

URUGUAY: GROSS DOMESTIC PRODUCT AND INFLATION

(Percentage variation)



Source: ECLAC, on the basis of official figures.

Economic policy continued to be focused on bringing about a gradual lowering of inflation, through fiscal policy aimed at balancing public-sector accounts, accompanied by a slowdown in the monthly rate of devaluation. In anticipation of a deterioration in the external scenario, the authorities took further precautionary measures. First they sought to strengthen the banking system and check the expansion of credit to the private sector, which had grown rapidly as from 1992. Second, initial steps were taken to set up a US$ 450 million precautionary fund financed by international lending institutions.

Fiscal policy sought to stabilize real expenditure at the previous year's level, in an effort to keep the deficit in 1998 below 1% of output. Fulfilment of this target was satisfactory up to September, although real

URUGUAY: MAIN ECONOMIC INDICATORS

	1996	1997	1998[a]
	Annual rate of variation		
Gross domestic product	5.0	5.1	2.5
Consumer prices	24.3	15.2	9.4
Real wages	0.6	0.2	1.9
Money (M1)	26.4	16.9	24.4
Real effective exchange rate[b]	-0.9	-2.0	-0.6
Terms of trade	-6.1	-1.2	4.9
	Percentages		
Urban unemployment rate	11.9	11.5	10.0
Fiscal balance/GDP	-1.2	-1.3	-1.2
Real deposit rate	3.1	3.9	5.7
Real lending rate	54.0	48.9	47.2
	Millions of dollars		
Exports of goods and services	3 847	4 256	4 310
Imports of goods and services	3 974	4 450	4 590
Current account	-233	-321	-430
Capital and financial account	386	721	580
Overall balance	153	400	150

Source: See the statistical appendix.
[a] Preliminary estimates.
[b] A negative rate signifies an appreciation of the currency in real terms.

expenditure turned out to be slightly higher than anticipated.

Central government revenue was up by 8% in real terms during the first seven months of the year. The expansion of credit facilities bolstered private consumption, especially automobile purchases, and this contributed to increased revenues from value added tax, specific taxes and customs duties. The contribution of public-sector enterprises was also considerable. Meanwhile, expenditure increased less than revenue.

The economic programme called for a drop in the rate of devaluation of the national **currency** to a range of 7%-9% annually. In line with this target, the monthly devaluation rate was cut from 0.8% to 0.6% in April, and at the same time the width of the exchange-rate flotation band was narrowed from 7% to 3%.

Under this exchange rate system, monetary growth depended on the quantity of money demanded by the public, who increased their real balances. In the 12 months ending September, money expanded by 16%, including a real increase of about 6%. There was a larger real increase in local currency deposits (10%), with that of foreign currency deposits (17%) in dollars more vigorous still.

After initial rapid growth, **gross domestic product** lost momentum beginning in the second quarter. Final demand continued to expand actively in the first quarter, in the context of a rise in real family income, an expansion of bank credit and solid demand for non-traditional exports. But later, consumption slowed, discouraged by the rise in interest rates, uncertainty as to the future trend of the economy and the application of Central Bank provisions aimed at strengthening the solvency of the banking system. In this regard, capital and asset requirements were raised and loan oversight requirements were tightened. Exports, already harmed by the downturn in certain international prices, began to feel the effects of lower demand from abroad.

Generally speaking, following a first quarter of active expansion **productive sectors** experienced ups and downs which were felt in nearly all services and in industry, although the performance of the various subsectors differed. Construction grew moderately, boosted by significant public infrastructure investment. In the second half agricultural output managed to recover from the setback suffered as a result of weather problems in the first half of the year; the output of beef cattle increased, as did milk production. Transport and communications, meanwhile, continued to expand.

In early 1998 the **unemployment rate** fell to 10%, a figure one and a half percentage points below its mid-year level in 1997. Recent measurements, however, have detected an upward trend in unemployment with simultaneous rises in activity and employment rates. Real wages posted accumulated growth of about 2% in the first nine months of the year.

Strict compliance with the goals of the financial programme helped to ensure that the main economic policy target was met by bringing **inflation** down to a single-digit annualized rate. As in previous years, consumer prices in private education and health services rose most rapidly, whereas textile and clothing prices fell back, under strong competition from imports. The stability of fuel and lubricant prices helped to keep transport price hikes below average.

The **external deficit** widened slightly, to 2% of GDP. The balance-of-payments current account deficit was slightly larger than anticipated, owing in particular to a decline in revenues from tourism. Despite the international financial turbulence, Uruguay had no problem financing this deficit and continuing to build up its international reserves, for which it had the support of an investment grade rating granted to its sovereign debt. In a recent US$ 150 million bond issue the risk premium went up slightly to 345 basis points.

Merchandise exports increased by 4.5%. Trends in the different categories varied: while traditional products fell back, sales of non-traditional goods grew strongly. There was a significant increase in gross automobile exports to the region; sales of rice, meat and fish were also substantial, the improvement reflecting chiefly to the rise in their prices. In contrast, the value of exports of wool and textile products and of leather and leather products suffered sharp contractions. The impact of the international crisis on buyer countries affected Uruguayan exports to Asia, which fell back by one third, and those destined for Brazil, which stagnated, while sales to Argentina increased significantly.

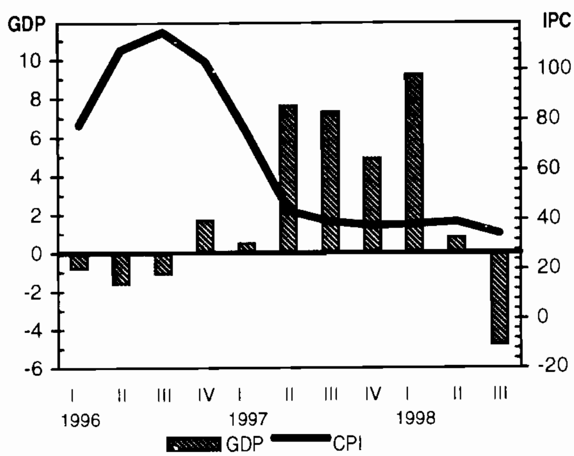
Merchandise imports also grew, albeit more slowly. The purchase of consumer and capital goods continued to expand at a rapid pace (10%), while the value of oil and gas imports declined by 40%, owing to the sharp drop in the international price of petroleum.

VENEZUELA

In 1998 the Venezuelan economy suffered the full impact of the drop in the price of oil, the country's main source of income, a trend aggravated by the repercussions of the international financial crisis. As a result, deficits were generated in the fiscal accounts and on the current account equivalent to over 4% and to 1.5% of GDP, respectively, in contrast to the surpluses achieved the previous year. These imbalances created pressure on the bolívar, which the Central Bank of Venezuela successfully countered by using its abundant international reserves and raising domestic interest rates. The higher cost of money, the public spending cuts undertaken to rein back the fiscal deficit, a slackening of exports and the uncertainty aroused by legislative and presidential elections at the end of the year all combined to erode the economic upturn that had begun the previous year and turned it into

VENEZUELA: GROSS DOMESTIC PRODUCT AND INFLATION

(Percentage variation)



Source: ECLAC, on the basis of official figures.

recession. It is estimated that gross domestic product for the year as a whole will suffer a decline on the order of 1%. Inflation continued to slow, held in check by the recessionary climate and by the scant nominal depreciation of the bolívar, although annualized inflation remained above 30%.

Economic policy was directed towards dealing with the impact of external events by trying to moderate their effects on macroeconomic equilibria. The fight against inflation took priority, at the expense of the economic recovery that had begun the year before. In the sphere of structural reforms, Congress approved the establishment of a macroeconomic stabilization fund to help administer oil earning. On the other hand, the previously announced and important privatization of the aluminium industry had to be postponed.

The **implementation of the budget** was constrained by the sharp contraction in fiscal revenues caused by the collapse in oil prices on the world market. The 1998 budget had been initially estimated on the assumption that the average price of oil exported by Venezuela would be US$ 15.50 per barrel, down from the average of nearly US$ 16.50 obtained in 1997. However, the drop in prices lowered the 1998 average to about US$ 11 per barrel.

Successive downward adjustments to the estimated price were accompanied by drastic budget cuts amounting in all to some US$ 2.3 billion. Attempts to strengthen ordinary revenue from other sources also met with little success, with Congress rejecting a proposal to raise the sales tax rate. On the other hand, the state oil company PDVSA made larger dividend transfers than initially anticipated. In the end, fiscal accounts closed 1998 with an estimated central government deficit equivalent to 4.2% of GDP and a deficit of 5.7% for the public sector as a whole.

To bridge the gap, the authorities resorted to the issuance of debt instruments on international financial markets. However, the onset of the Russian financial crisis in August closed those markets, and it was necessary to wait till November to place bond issues in the German market. In these circumstances, the Government made use of excess funds that had accumulated thanks to the high crude oil prices registered the previous year. PDVSA, in turn, had to cut its budget and issue bonds on world markets.

VENEZUELA: MAIN ECONOMIC INDICATORS

	1996	1997	1998[a]
	Annual rate of variation		
Gross domestic product	-1.3	5.1	-1.0
Consumer prices	103.2	37.6	31.2
Real wages	-23.3	25.6	...
Money (M1)	88.5	58.4	18.8
Real effective exchange rate[b]	19.2	-22.3	-16.6
Terms of trade	15.6	3.5	-22.8
	Percentages		
Unemployment rate	11.8	11.4	11.2
Fiscal balance/GDP	7.6	2.3	-5.7
Real deposit rate	-34.6	-16.1	8.1
Real lending rate	-26.7	-9.6	19.6
	Millions of dollars		
Exports of goods and services	25 280	25 120	19 225
Imports of goods and services	14 779	18 282	18 570
Current account	8 914	4 684	-1 560
Capital and financial account	-2 230	-1 434	-3 600
Overall balance	6 684	3 250	-5 160

Source: See the statistical appendix.
[a] Preliminary estimates.
[b] A negative rate signifies an appreciation of the currency in real terms.

The Central Bank's **policy of containing inflation** continued to rest on keeping the exchange rate within a band with a central parity devalued as from January at a rate of 1.28% per month, in line with the target set for inflation. This policy was facilitated by the high level of international reserves, particularly when the currency came under speculative attack, especially in May and August. The Central Bank supplemented its intervention in the foreign currency market by placing credit instruments in the money market.

As a result, the exchange rate underwent a nominal devaluation substantially below the inflation rate, which in the end turned out to be higher than anticipated. Another effect of the policy applied by the Central Bank was the gradual raising of interest rates, so that they went up from 15% and 24% on deposits and loans, respectively, at the close of 1997, to as much as 60% and 75% in mid-September, easing down moderately thereafter. This trend finally resulted in positive real rates, after a lengthy period of heavily negative ones.

The use of international reserves, together with lower demand for money, made it possible to contain monetary expansion, which amounted to 12% over the 12 months to the end of November 1998. This partially offset the expansionary effects of the public sector's use of funds accumulated at the Central Bank to make up for the reduction in current revenues. Higher interest rates encouraged placements in savings and time deposits, so that broad money (M2) increased twice as fast as the money supply (M1), but still less than inflation.

Early in the year, the economy kept up the momentum that had enabled it to recover by more than 5% in 1997. In the first quarter of 1998 **gross domestic product** was 9% greater than a year before. In the second quarter, however, growth began to be undermined by cuts in oil exports and public spending following the collapse of oil prices and agreements among producer countries to restrict supply. Private expenditure was also increasingly affected by the downturn, while the real appreciation of the currency and expectations of devaluation diverted a growing fraction of demand toward imports. The result for the year as a whole was that GDP shrank by at least 1%, with similar declines in the oil sector and in the rest of the economy.

Unemployment declined in the first and second quarters, rose again in the third to about 11% and by the end of the year was heading for over 12%. This occurred despite an increase in employment in the informal sector, which in the third quarter accounted for 49% of the actively employed population.

The same factors that adversely affected activity and employment, including the modest nominal depreciation of the currency, helped to moderate **price increases.** This made it possible to end the year with an accumulated annual rate on the order of 31% –still high, but nearly seven points lower than the 1997 figure.

In the first half of 1998 Venezuelan **exports**, affected by the fall in oil prices and shipments, shed one quarter of their previous year's value, and this deterioration persisted during the second half. **Imports**, on the other hand, were up by 10%, driven by the dynamism of the economy at the beginning of the year and by the real appreciation of the currency. The latter factor, reinforced by expectations of devaluation, continued to influence foreign purchases during the second semester and made it possible to smooth out the adverse effect of the economic recession.

These developments eroded Venezuela's typically surplus merchandise trade balance, which shrank to a third, falling below US$ 4 billion. The balance-of-payments current account moved into deficit by nearly US$ 1.5 billion, equivalent to 1.5% of GDP.

In addition to the decline in current earnings there were episodes of capital flight due to lack of confidence in the value of the currency and difficulties in obtaining financing on international capital markets. However, foreign direct investment continued to arrive, totalling about US$ 3.3 billion, thanks to the opening up of the oil industry and the previous year's sale of the State-owned iron and steel company. In the end, the financial account was in deficit by US$ 3.6 billion, and the balance of payments closed with a deficit of over US$ 5 billion. The consequent loss of reserves was staunched by the addition of collateral freed up by the previous year's Brady Bond swap operation. At the beginning of December, reserves amounted to over US$ 14.5 billion, enough to cover more than one year's goods imports.