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Statement by Ms. Costa
Chile

On behalf of
Argentina, Bolivia, Chile, Paraguay, Peru, and Uruguay

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On behalf of the Southern Cone Constituency

(Argentina, Bolivia, Chile, Paraguay, Peru, and Uruguay)

Global outlook, economic policies, and multilateral cooperation

The recent upheaval in the banking industry has increased uncertainty and complexity regarding global economic prospects. Although global activity had performed better than anticipated since last October, the recent strain on the banking sector of some advanced economies could have broader implications for the world economy and global financial conditions. Additionally, core inflation rates continue to exceed previous projections. Global economic growth is expected to experience a further decline, while international interest rates remain relatively high amid increased debt levels, making it a challenging landscape for all members to navigate.

Countries need to implement appropriate domestic policies that support macroeconomic and financial stability, boost potential growth, strengthen social cohesion, and build resilience in a world that is increasingly prone to shocks. It is critical that monetary and fiscal policies work hand in hand, with central banks maintaining their focus to restore price stability and anchor inflation expectations. To support monetary policy and ensure debt sustainability, normalizing fiscal policy while safeguarding the most vulnerable should remain a top priority. For highly-indebted countries experiencing distress, timely restructuring should be considered. Targeted liquidity and prudential actions should be the primary tools to address focused financial stability concerns, promptly addressing risk management gaps and monitoring the consequences of market stress on the broader economy and financial system. Policymakers must also tackle the secular decline in medium-term global prospects. Structural transformations and supply-side policies towards more dynamic, greener, and more inclusive economies must remain at the heart of the policy response to the current challenges.

Multilateral action is vital to address shared challenges, support the most vulnerable members, and overcome the increasing geopolitical fragmentation. To provide timely and adequate support to vulnerable countries navigating a complex global landscape, it is necessary to have a strong, well-resourced, and readily accessible Global Financial Safety Net. It is also crucial to establish comprehensive collaboration between official creditors and the private sector to strengthen the debt resolution framework and extend its reach to vulnerable middle-income countries. Moreover, addressing long-term challenges such as climate change, pandemic management, migration, and digitalization, and reviving trade as a key engine of development requires global cooperation.

IMF priorities

The IMF must continue in its role as trusted advisor and supporter of its members during these challenging times, while also promoting the transition to a more resilient future. The world economy needs a nimble and well-resourced Fund capable of providing real-time support to its members through tailored policy guidance, catalytic financial assistance, and integrated capacity building.

Surveillance

We appreciate the IMF's focus on critical issues, such as achieving a well-balanced policy mix that is tailored to country-specific circumstances, addressing emerging macro-financial vulnerabilities, and responding to economic and financial shocks. The Integrated Policy Framework will provide guidance on effectively using multiple tools to address shocks, while considering the long-term benefits of financial integration and exchange rate flexibility, in line with the Institutional View. The integration of new strategies, including climate change, governance, trade, digital, and fragile and conflict states, into surveillance is welcomed. It is essential to maintain a disciplined focus on macro-critical aspects that complement the Fund's core mandate and skills while working closely with other international organizations.

We endorse the emphasis on multilateral surveillance and analytical work on key issues, including inflation, interactions between monetary and fiscal policies, financial vulnerabilities, and the interplay between capital flows, capital flow management measures (CFMs), and crises. A clear and balanced policy adjustment across systemically important economies can help limit adverse spillovers across the global economy and financial system. It is important to monitor the spillover effects of geopolitical fragmentation and raise awareness of the macroeconomic consequences of detrimental unilateral actions.

Lending and debt

We applaud the increased support provided by the Fund to emerging market and developing economies during a period of heightened uncertainty. This includes the availability of rapid financing instruments and the transition to upper-credit tranche quality programs. The Resiliency and Sustainability Trust (RST) has already assisted five members, and there is considerable interest in this initiative across the membership. We encourage the Fund to expand its coverage to encompass a broader range of long-term structural issues with macroeconomic implications. Additionally, urgently addressing the funding gaps in the Poverty Reduction and Growth Trust (PRGT) and RST is necessary to ensure that they can fulfill their important mandates in a timely manner and with adequate terms.

We recognize the importance of the Fund, as a critical part of the Global Financial Safety Net, to continuously adapt and expand its lending toolkit to ensure a stable international monetary system and world economy. Recent measures, such as the Food Shock Window, Program monitoring with Board involvement, temporary increase in normal access limits in the General Resources Account (GRA), and changes in financing assurances policy, have created new tools to support member countries. However, we urge the Fund to continue developing initiatives that can reach a broader group of countries affected by other difficult problems, such as protracted debt restructuring processes, significant exposure to climate change, fragile and conflict-affected states, and countries facing large waves of emergency migration. As we look ahead, we support a broad, ambitious, and holistic medium-term review of the Fund’s lending toolkit and policies to help countries cope with global shocks, including precautionary arrangements.

We recognize the growing number of low-income and middle-income countries that are facing debt distress. Therefore, we support the efforts to strengthen and accelerate the implementation of the common framework for debt resolution and other initiatives aimed at enhancing debt transparency and improving the contractual approach for debt restructuring. We also hope that the Global Sovereign Debt

Roundtable will promote a common understanding that can facilitate the swift resolution of individual cases and improve the effectiveness, predictability, and coverage of the common framework.

Capacity development

We support strengthening the integration of capacity development (CD) with lending and surveillance. The focus should be on building strong macroeconomic and financial policy institutions to ensure sustainable and resilient policies that support prosperity in the long term. We look forward to the CD strategy review and the implementation of the Independent Evaluation Office recommendations.

IMF resources

We strongly support a timely and successful completion of the 16th General Review of Quotas. In this time of unprecedented challenges and the risk of global fragmentation, it is imperative to have a representative, well-resourced, and quota-based IMF at the center of the international financial safety net. Under plausible stress scenarios, the Fund's current lending capacity may be inadequate to ensure a stable global financial system. Therefore, we consider it a priority to increase the Fund's lending capacity and rebalance the role of quotas and borrowed resources. The Fund must remain adequately resourced and at the forefront of the Global Financial Safety Net.

We welcome the strengthening of the Fund’s Enterprise Risk Management (ERM) framework and the implementation of the recommendations of the Institutional Safeguards Review.

Economic and Policy Outlook for the Southern Cone Economies

Argentina

Argentina's 2022 IMF´s Extended Fund Facility has gone through the 3rd and 4th reviews

On March 25, 2022, the IMF Executive Board unanimously approved an EFF program for Argentina. This new program was carefully calibrated to meet Argentina's specific circumstances, notably to address large balance-of-payment needs –which mostly reflect the schedule of payments of the 2018 SBA–, and to address the challenging economic and social situation caused by the two-year recession of 2018-2019 and the COVID-19 pandemic. The 3rd quarterly review was approved by the IMF Executive Board on December 22, 2022, and the 4th quarterly review on March 31, 2023.

An increasingly complex scenario

Against the backdrop of the already severe consequences of the war in Ukraine, notably the sharp increase in the cost of imported energy in 2022, the Argentine economy is facing–particularly during last summer– a major hardship stemming from an unprecedented drought. Not only is this drought having a strong impact on our external position –which calls for the modified Program NIR target path–, but it also has significant repercussions on the economy more broadly and in the social fabric, with effects as wide as straining the fiscal position and building inflationary pressures.

Notwithstanding an ever-increasing complex scenario, we continue to take the necessary steps to ensure program implementation and adapt to changing and challenging circumstances. Despite the increased difficulties and against all the odds, the program remains on track, and we remain confident that we will be able to take the necessary steps to attain a strong, inclusive, resilient, and sustainable economy. We emphasize again that the Program policies are a key anchor for our economy.

Macroeconomic framework

Economic activity remained robust throughout 2022 and GDP grew at an annual rate of 5.2 percent, taking real GDP well above pre-pandemic levels, while unemployment fell to 6.3 percent –a record low–, with employment levels standing at 44.6 percent. Capacity utilization is currently at 63.8 percent.

While inflation reached an annual rate of 102 percent in February due to a set of supply shocks, we continue to take all action to tackle it decisively. Our policy mix of curbing the fiscal deficit, the limit on the monetary financing, and the interest rate and exchange rate policy, show a relentless commitment to addressing this problem. We are confident that a path of gradual but consistent disinflation will ensue.

On the fiscal front, our authorities remain committed to consolidation through measures to ensure an appropriate targeting and prioritization of the benefits of the pension moratorium, improving the effectiveness and targeting of energy subsidies and social assistance, while maintaining space to prioritize social and infrastructure spending.

As to the fiscal challenges posed by the pension moratorium, it is important to bear in mind that this year's cost is estimated at 0.2 percent of GDP. The Government is fully prepared to address this challenge both through regulation, in order to have a fair targeting of beneficiaries and compensatory measures, ranging from transfers to energy subsidies.

As for the energy effectiveness, we are hastily improving the progressivity of the subsidies scheme by removing the most regressive components. By May we will have eliminated subsidies for high-income residential consumers, ending a process that started in February 2022. Also, the boosting of domestic energy production, transportation, and distribution, remain on schedule and one of the main priorities, as is the reduction of reliance on imports.

On the financing front, we will continue to undertake proactive domestic debt management schemes to extend peso maturities, while continuing to mobilize domestic net financing and improving local debt and FX markets stability.

We have been successful both in our domestic liability operations, including the recent domestic debt swap to extend maturities beyond the elections –currently, non-bank private holders of short-term maturities stand at a very manageable 1.5 percent of GDP–, as well as in ensuring net financing from external official sources (in December and January it amounted to more than USD 1.5 billion in the aggregate).

Ensuring that real interest rates remain in positive terrain continues to be key and keeps being thoroughly implemented. This key factor joins the fiscal commitments, the financing strategy, and the well-calibrated wage price coordination in being the elements that underscore what we see as the path of inflation reduction and lessened need for the central bank's financing assistance to the Treasury.

As for the reserve coverage, we are facing an unprecedented challenge due to the most severe drought Argentina has ever suffered. To face such challenge, we are implementing a multi-pronged strategy to mitigate, halt and reverse, as much as possible, the effects on reserves accumulation that mostly stem from the drought. This includes mobilization of international reserves through international financing, the reaffirmation of a strong macro-economic framework, the enhancement of the effectiveness of our FX control schemes, and the improvement of the incentive's alignment.

Final considerations

It is important to realize that the current unprecedented challenges we are facing stem from a climate change related issue; such is the case of the drought. Droughts pose a challenge for global food security, and we firmly believe that addressing this issue is a global public good.

In the current circumstances, commitment and implementation capabilities require that the Program itself, and as per its own design, also adapts to the reality we face. This in turn will help us renew and strengthen our own capabilities of execution.

Bolivia

The Bolivian economy remains resilient despite the complex global economic scenario. During 2022 and so far in 2023, the country has shown significant dynamism in economic activity, along with price stability. The national government continues to be committed and working to consolidate the recovery of the economy and guarantee macroeconomic stability, having as one of its priorities the protection of the population's livelihoods, in a context of external pressures on prices, the threat of a severe slowdown in the global economy, tighter financial conditions, and recent signs of fragility in global financial stability.

Recent developments of the economy

The Bolivian economy continued with important growth in 2022. Economic activity recorded a cumulative expansion of 4.3 percent in the third quarter of 2022, driven mainly by transportation and storage, agriculture, other services, industry, and financial establishments sectors, which persisted in recovering after their sharp drop in 2020. Domestic demand played a significant role in this result and the contribution of external demand was also noteworthy in the year. Furthermore, in line with economic activity dynamism, unemployment continued to decline, reaching a rate of 4.5 percent at the end of 2022, well below the peak of close to 12 percent recorded in July 2020.

Price stability was one of the most outstanding features of the Bolivian economy in 2022, which remains in the first months of 2023. At the end of last year, inflation reached 3.1 percent, the lowest rate in the South American region and one of the smallest in the world. The national government made the necessary efforts to preserve price stability and mitigate an impact on the population, especially the most vulnerable. In this vein, supply support and fuel and food subsidy policies continued, while exchange rate stability maintained its role as a nominal anchor for inflationary expectations and attenuated imported inflationary pressures.

The external sector indicators showed strong momentum last year. On the one hand, exports reached a record level in 2022, with an increase of 23 percent and a significant contribution from sales of the manufacturing and agricultural sectors, not only in terms of value but also in volume. On the other hand, imports grew by 36 percent driven by purchases of raw materials and intermediate and capital goods, reflecting domestic output dynamics and the increase in imported good prices. As a result, a trade surplus was recorded for a new year, totaling US$ 626 million. Similarly, as of the third quarter of 2022, the current account balance was positive, reflecting the continued improvement in the country's external position.

Financial activity was more dynamic. Deposits increased by 6 percent in 2022, highlighting the rise in the number of deposit accounts by 9 percent. Loans expanded by 8 percent, above the rate recorded in 2021. The growth of productive and social-interest-housing loans was relevant in the positive performance of total loans. These credits, prioritized by the Bolivian economic policy, allow to improve productive capacity, and facilitate the population's access to housing. Non-performing loans remained contained at 2.2 percent, among the lowest rates in South America. In addition, the level of Bolivianization of the financial system, that is, the share of operations in local currency, was also highlighted, with 99 percent of loans and 86 percent of deposits in local currency. The commitment to exchange rate stability, the strength of the economy, and a set of measures contributed to the government's effective response to the speculative outbreak at end-February of this year, which caused an unusual demand for foreign currency. The situation is currently being addressed.

Regarding fiscal accounts, the fiscal deficit continued the downward path. After a deficit of 12.7 percent of GDP in 2020 and 9.3 percent in 2021, this decreased to 7.2 percent of GDP in 2022. Similarly, the current fiscal balance showed a relevant improvement, by reducing the deficit observed in previous years to a balanced result in 2022. The significant increase in revenues contributed to the lower deficit. They expanded by 20 percent in the year, in line with the dynamism of economic activity, reaching levels close to the records achieved in 2013-2015. On spending, public investment remained promoted in 2022 and the country was among those with the highest public investment as a percentage of GDP in the region. Moreover, the government continued to guarantee social transfer payments to vulnerable sectors of the population. Furthermore, the strong increase in international oil prices generated a higher cost of fuel subsidies that weighed on fiscal accounts. However, it is important to note that despite this impact, the country managed to preserve the downward trend of fiscal deficit.

Economic policy to consolidate the recovery

The economic policy implemented under the Economic Social Communitarian Productive Model contributed significantly to the positive performance of the economy and to contain the external pressures. One of the government's priorities in 2022, within the framework of income redistribution and enhancement of the population's quality of life, was the fight against international price pressures. In this vein, all efforts were made to preserve price stability and mitigate its impact on Bolivian households' real income. Furthermore, actions against the COVID-19 pandemic continued in 2022, which remained instrumental in the process of economic recovery and in protecting the lives and health of the population.

Similarly, efforts to boost demand and supply continued. Regarding the measures to reinforce demand, stimulating public investment and supporting subnational governments with funds to ensure local public investment projects financing were important.

Policies to strengthen the country's productive capacity were also essential. Therefore, within the framework of the import substitution strategy, which represents one of the pillars of the Bolivian economic policy for productive reinforcement, efforts persisted to grant loans to sectors related to import substitution under the SIBOLIVIA program, with a preferential interest rate of 0.5 percent. Additionally, industrialization projects remained critical for the economy, such as the zinc refining plant, Mutún steel plant, biodiesel plants, and industrialization of lithium, whose process was underpinned with the recent agreement with a foreign company recognized in the area. Some of these projects will start operations this year. Tax exemptions for capital goods imports and sales, and financing programs for microenterprises and other sectors were also relevant measures to help boost the productive sector.

Economic outlook

Despite the challenging international environment, the Bolivian economy is expected to continue its recovery process and preserve macroeconomic stability. Hence, a growth rate of 4.9 percent and end-of-period inflation of 3.3 percent are estimated for 2023. International organizations' forecasts place the country among those with the highest growth rates in the region in 2023. As in previous years, a relevant level of public investment is expected, especially directed at the productive and infrastructure sectors, which will keep contributing to country's growth and employment. Furthermore, the productive sector will continue to be supported through accessible credits and low interest rates, preserving the financial system stability. The significant investment projects underway and a swift start of operations of several of them, within the import substitution industrialization strategy and the national government's set of policies, will allow to continue strengthening the resilience of the Bolivian economy, guarantee sustainable growth and price stability, and improve the population's well-being.

Chile

In the context of lower external demand, more restrictive financial conditions, and high degrees of uncertainty, Chile's monetary and fiscal policies are focused on closing macroeconomic imbalances accumulated during the pandemic, stabilizing inflation, and restoring buffers. In the near term, tight monetary and fiscal policies are necessary to safeguard macroeconomic stability, while structural reforms have been introduced to improve growth prospects and strengthen fiscal, social, financial and climate resilience. The recent financial turmoil had a limited impact on local financial markets. To date, local banks have shown no signs of stress. Initially the peso depreciated against the dollar and dollar financing conditions tightened; however, movements were limited and rapidly reversed.

Recent economic developments and projections

The Chilean economy continues the process of correcting the macroeconomic imbalances that built up during the pandemic. Nevertheless, the adjustment has been more gradual than anticipated as private demand has proven more resilient, amid a stronger labor market and a reduction in domestic political and economic uncertainty. After peaking in 2021Q3, economic activity has gradually slowed down in line with more sustainable demand levels, but further adjustments are needed to close the remaining positive output gap. Moving forward, GDP is expected to grow between -0.5 and 0.5 percent in 2023, and between 1.0 and 2.0 percent in 2024. Towards 2025, once macroeconomic imbalances are resolved, expectations are that activity will resume growth rates between 2.0 and 3.0 percent. After reaching a deficit of 9.0 percent of GDP in 2022, the current account started to show signs of consolidation in 20224Q. Moving forward, it is expected to continue narrowing, reaching 4 percent of GDP by the end of this year, reflecting the decline of domestic demand and the depreciated level of the real exchange rate.

The banking sector in Chile remains liquid, solvent, and well capitalized, supported by an effective regulatory and supervisory framework that aligns with Basel III standards for capital and liquidity, without distinctions based on bank size. Currently 17 banks operate in the Chilean market, six of them are classified as domestic systemically important banks accounting for almost 87 percent of the system's total assets. It is worth noting that in Chile banks are less exposed to held-to-maturity securities, as most of the banking sector follows a traditional business model focused on granting credit based on diversified financing sources and adequate management of maturity and currency mismatches. Additionally, the Central Bank of Chile (CBC) and the Financial Market Commission (CMF) regularly conduct and publish stress tests. According to the latest Financial Stability Report, the banking system in Chile has sufficient provisions and capital to withstand severe stress scenarios. Nevertheless, the authorities remain vigilant to developments in the global and local financial sectors that could pose risks to financial stability and the macroeconomic outlook.

Macroeconomic policies

The monetary stance has remained tight as inflation remain high and above the 3 percent target. Since mid-2021 to October 2022, the CBC has increased its monetary policy rate (MPR) from 0.5 to 11.25 percent, well above its neutral rate. The benchmark yield curve has shifted upward and credit conditions for firms and households have become more restrictive. Although headline inflation has receded in recent months, core inflation has remained persistently high. Against this backdrop, the CBC has revised upward its inflation forecast. Headline inflation is expected to continue declining in the coming quarters, to converge to 3 percent in 20244Q and core inflation to decline more gradually, reaching 3 percent at the beginning of 2025. In the latest monetary policy report, the CBC reinforced that it would maintain a tight policy stance until macroeconomic conditions indicate that the process of inflation convergence to the 3 percent inflation target consolidates, while acting with flexibility in case internal or external risks materialize.

After the exceptional foreign exchange intervention (FXI) last year, the peso stabilized and since October it has appreciated around 15 percent, as domestic uncertainty receded from last year's peak. The authorities remain firmly committed to a flexible exchange rate, as it is a key shock absorber for the Chilean economy.

The authorities are fully committed to fiscal responsibility and maintaining macroeconomic stability. In 2022, the extraordinary universal support programs implemented during the pandemic were gradually wound down while targeted support was provided to lagged sectors and the most vulnerable to cushion

the increase in the cost of living. The overall headline position resulted in a fiscal surplus of 1.1 percent of GDP, representing the first surplus since 2012 and one of the largest post-COVID fiscal consolidations in the world.

In line with this, the government committed to a multi-year consolidation plan in 2021 to achieve a structural equilibrium position by 2026 (-0.3 percent of GDP) and keep public debt below 45 percent of GDP. The 2023 budget envisions a 2.4 percent of GDP deficit, consistent with a structural fiscal deficit of 2.1 percent of GDP, and a 1.2 percent increase in expenditures from 2022 levels. Expenditure increases will be focused on public investment, social spending, and productivity. Permanent expenditure proposals will only be financed by permanent income in compliance with the fiscal rule.

Gross public debt is projected to rise to 38.7 percent of GDP by the end of 2023 and peak at 41.7 percent in 2025 before declining to 40.4 percent in 2027. To continue strengthening the fiscal framework, a bill to improve the Fiscal Responsibility Law was presented to congress last year. The bill leverages the lessons learned from Chile's experience with the fiscal rule and includes a well-defined debt ceiling, escape clauses, convergence paths, and an insurance framework against natural disasters. The bill is now under discussion in Congress.

Paraguay

The current projection of GDP growth by the end of 2023 stands at around 4.5 percent, in line with the recovery of the agricultural sector, following a meager performance in 2022. In addition, greater dynamism is foreseen for the electricity and water sector and moderate expansions are expected for the services and manufacturing sectors. On the expenditure side, greater dynamism of net external demand and, to a lesser extent, of domestic demand is foreseen.

In the fourth quarter of 2022, GDP verified 1.7 percent y/y growth, driven mainly by the rebound effect in agriculture (with the beginning of the new 2022/2023 campaign in the second semester of the year), and the upswing in the production of electrical energy at the bi-national hydro-electric entities, and to a lesser extent, services and livestock sectors. However, the negative result of manufacturing and construction attenuated the rebound in economic activity. On the expenditure side, private consumption continued to expand and there was also a rebound in net external demand due to the more favorable dynamics of exports of goods and services and a contraction in imports. Nevertheless, gross capital formation and government consumption had a negative impact, the latter in line with the fiscal convergence plan. In cumulative terms, GDP grew 0.1 percent at the end of 2022.

At the beginning of this year (January 2023), the Monthly Indicator of Economic Activity (IMAEP) presented a 4.5 percent y/y variation, driven mainly by the positive performances registered for the agriculture and electricity and water sectors, and to a lesser extent by the services and livestock sectors, which was mitigated by the negative results of the construction and manufacturing sectors. These results are in line with projections.

As regards the labor market, the results in terms of employment and unemployment were slightly favorable in the fourth quarter 2022. In this period, employment grew by 11,959 positions as compared to the same period in 2021, representing an increase of 0.3 percent y/y. By economic sector, the increase of the percentage of the population employed within the tertiary sector (particularly communal, social, and personal services, and other services) stood out, while a reduction was observed in the primary and secondary sectors. By occupational category, there was an improvement in the number of salaried employees and domestic workers, although this was offset by the decrease in self-employment. On the

other hand, the number of unemployed persons decreased by 44,595, whereby the unemployment rate dropped from 6.8 percent registered in the fourth quarter of 2021 to 5.7 percent in the same period of 2022.

Total inflation has continued to decrease, in accordance with lesser pressures of external prices, the moderate dynamism of domestic demand (negative product gap), and the transmission of monetary policy rate adjustments to key macroeconomic variables that contributed to contain the acceleration of domestic inflation in the last few months. The annual inflation rate stood at 6.9 percent in February, below the rate observed in the previous year (9.3 percent). As regards inflation forecasts, a rate of 4.1 percent is foreseen for the year 2023, converging gradually to the target (4 percent).

Regarding monetary policy, the Central Bank of Paraguay (BCP) has decided to maintain the reference rate at 8.50 percent annually since September 2022, considering that the main inflation measures have continued above the range and given that a high degree of uncertainty persists. This uncertainty stems mainly from the external environment and has been exacerbated by the recent shocks in the international financial market, although, in general, such events have not had repercussions within the domestic financial system.

As regards the financial system, in the domestic market, it has remained stable, with capital adequacy indicators that easily surpass the minimum requirements at the local and international levels. The system's profitability has continued to recover during the post pandemic period and both the Non-Performing Loan ratio and liquidity of the system remain at adequate levels. Total credit presented a deceleration in its pace of annual expansion in the last semester of 2022 and has remained stable so far this year. Meanwhile, deposits have registered moderate growth.

Peru

Recent economic developments and projections

Peru grew 2.7 percent in 2022. Growth in primary sectors slowed down to 0.6 percent due to lower fishing and mining production. Non-primary sectors, mainly commerce and services, grew 3.2 percent in a context of improved health conditions relative to 2021. Continued momentum in private consumption reflected favorable labor market developments and pension fund withdrawals (although inflation and political unrest affected household confidence). Export volumes and public investment also expanded; but private investment fell 0.5 percent due to the impact of political uncertainty on business expectations.

Growth is expected to be somewhat lower (2.6 percent) in 2023, mainly in connection with political disturbances and adverse climate events affecting agriculture and fishing. However, economic activity is expected to pick up as political tensions recede. By 2024 the economy is forecast to expand by 3.0 percent, with domestic demand as the main engine; and growth is expected to remain close to potential over the medium term.

Inflation in Peru has been one of the lowest and less volatile in LAC since 2001 (3.0 percent on average in 2001-2022). However, under the current scenario of high global inflation, annual inflation stood at 8.4 percent in March 2023, below the 8.8 percent peak in June 2022; and inflation excluding food and energy was 5.9 percent, above the 1-3 percent band targeted by the Central Reserve Bank of Peru (BCRP). Twelve-month inflation expectations reached 4.29 percent in February, down from 4.62 percent in January. Inflation is expected to return within the target band at the end of 2023, assuming a reversal of transitory factors (international food and fuel price increases), with growth close to potential.

Credit to the private sector increased 2.8 percent y/y in February 2023 due to higher household loans. After a significant increase in the credit-to-GDP ratio in 2020 (mainly driven by a large government-guaranteed loan program launched in response to the pandemic), credit demand growth is expected to moderate to 4.5 percent in 2023.

As a percentage of GDP, the current account deficit increased from 2.3 percent in 2021 to 4.3 percent in 2022, resulting from a terms-of-trade deterioration; but is forecast to decrease to 1.4 percent of GDP in 2023 due to higher mining export volumes, a correction in transportation costs, and a recovery in the terms of trade (the current account deficit already declined to 2.8 percent in the last quarter of 2022). The balance of payments will continue to be sustainable and financed by long-term capital inflows.

Macroeconomic policies

The cumulative fiscal deficit over the last twelve months increased from 1.6 percent to 1.8 percent of GDP between December 2022 and February 2023, reflecting lower current revenues and higher capital expenditure, although it remains below the cap established by the fiscal rule (2.4 percent for 2023). Public debt as of end-2023 is expected at 32.8 percent of GDP, one of the lowest in LAC. Going forward, fiscal consolidation will continue as the economy recovers from the pandemic shock.

Starting in August 2021, the BCRP began to raise its policy rate from a historic low of 0.25 percent in July 2021 to 7.75 percent in January 2023 (18 rate hikes). Between February and March, the BCRP decided to keep the policy rate unchanged. This pause does not necessarily imply an end to the BCRP's monetary tightening cycle, as the Board will continue to take the necessary steps to ensure that inflation returns within the target band over the forecast horizon.

Additionally, the BCRP maintains an FX buffer of around five times the country's short-term obligations and 30 percent of GDP due to a precautionary accumulation of international reserves. Additionally, Peru has access to contingent funds, notably USD 5.4 billion from a successor Flexible Credit Line arrangement with the Fund. With sound fundamentals and high FX reserves, Peru's external position is one of the strongest among emerging market economies. This enables the authorities to considerably limit the risks from exogenous financial shocks.

Peru's strong and coordinated fiscal and monetary response under the pandemic was possible due to solid macroeconomic fundamentals, including low debt ratios, one the largest fiscal spaces in LAC, and significant external buffers. In a context of unprecedented challenges, the country's solid policy management over the past three decades is being validated.

Uruguay

Recent economic developments and projections

After expanding 5.3 percent in 2021, Uruguay's economy grew by 4.9 percent in 2022 led by exports, private consumption, and investment. In the fourth quarter of 2022, the Gross Domestic Product (GDP) fell 0.1 percent compared to the same period in 2021 and contracted by 1.3 percent compared to the third quarter. The fourth quarter contraction reflects the impact of the severe drought on some sectors of the Uruguayan economy, particularly agricultural activities. Slower growth is foreseen for 2023 as a consequence of the drought.

The labor market improved on average during 2022. The unemployment rate for the year stood at 7.9 percent, down 1.5 percentage points from 2021. The improvement in the labor market was also

reflected in the ongoing reduction of workers in the unemployment insurance system. Meanwhile, real wages recovered.

Macroeconomic and financial policies

In February 2023, the Monetary Policy Committee of the Central Bank of Uruguay (BCU) maintained the policy rate unchanged at 11.50 percent as inflation expectations had begun a convergence process. The monetary policy rate had had a cumulative rise of 700 basis points since August 2021 when the BCU started a tightening stance. The BCU's survey shows that the median of inflation expectations within the monetary policy horizon (next 24 months) declined to 6.7 percent in March 2023. Going forward the BCU remains committed to continue advancing its de-dollarization strategy and rebuilding the Uruguayan peso markets, aiming to enhance monetary policy transmission.

The financial sector remains sound, resilient, and profitable. The solvency situation of the banking system continued to exhibit a remarkable strength as of the third quarter of 2022. The aggregate capital buffer reached 1.9 times the minimum regulatory requirement. Regarding liquidity risk of the banking system, the ratio of liquid assets to total assets remained at a healthy 58.1 percent. The profitability of banks (measured in nominal pesos) represented a return on assets of 1.2 percent and a return on equity of 12.7 percent as of September 2022. The general delinquency of credit stood at 1.62 percent, slightly above the record low of 1.5 percent. Stress tests of the banking system carried out by the Superintendence of Financial Services (SFS) of the Central Bank, showed that the banking system would withstand a severe recession scenario, and the regulatory capital of the banking system on average would remain above the minimum requirement.

The authorities remain fully committed to fiscal discipline. Underpinning fiscal credibility, all three pillars of the fiscal rule were met in 2022 for the third year in a row: the structural deficit was 2.5 percent of GDP, below the 2.6 percent GDP target; real primary spending growth was 0.5 percent lower than the 2.1 percent target cap, in line with estimated potential real GDP growth; the Central Government's net indebtedness was USD 1.8 billion below the legally binding limit of USD 2.1 billion for 2022. The responsible and prudent fiscal management facilitated the implementation of well targeted and effective measures in support of vulnerable groups. Moreover, the authorities advanced a series of adjustments in personal income tax (IRPF) and social security assistance tax (IASS) that benefits lower-income taxpayers and workers with dependent children. Likewise, several tax measures changes deepened the support to micro and small firms.

The steady improvement in public finances is reflected in declining fiscal deficit and indebtedness. The fiscal deficit of the Central Government stood at 3.2 percent of GDP (excluding the overall effect of inflows to the Social Security Trust Fund of 0.2 percent of GDP, improving 0.9 percentage point of GDP relative to 2021. In turn, gross debt of the Central Government stood at 57.3 percent of GDP as of December 2022, while net debt was 53.2 percent of GDP, implying a reduction of 2.6 percentage points and 2.1 percentage points of GDP respectively relative to 2021.

The authorities have continued pursuing proactive debt management strategies aiming to de-risk the debt portfolio while keeping borrowing costs contained. Liability management transactions, conducted in domestic and international markets, have sustained a robust debt maturing profile, thus reducing the rollover risk. By the end of 2022, the share of debt coming due during 2023 represented 4.4 percent of the total debt stock and the average time to maturity of the debt portfolio was 12.3 years. Moreover, the authorities continue to align the country's national financing strategy with its climate and nature commitments as established under the Paris Agreement. In 2022, Uruguay issued a new dollar-

denominated Sovereign Sustainability-Linked Bond (SSLB) maturing in 2034, linking the bond's coupon interest rate to the achievement of climate and nature conservation performance targets: reduction of the intensity of greenhouse gas emissions as a share of GDP and preservation of the native forest area in the country. The financial instrument introduced an innovative two-way step-up/step-down interest rate structure.