

# Executive Summary

Global economic activity exhibited moderate growth rates in 2017 (as part of the cyclical rebound) with figures below those reached before the international financial crisis. Although contained, industrial production, manufacturing activity and world trade maintained a positive performance. Moreover, international prices of commodities improved but remained below the levels expected at the beginning of the year. In this context, the slow increase in wages in advanced economies and the differentiated pace of economic recovery between countries are some of the main reasons why the global activity would be slacking off.

The performance in advanced economies improved; however, it is still fragile and growth rates observed in these countries are lower than the ones of emerging and developing economies (which still present mixed behaviors). In South America, after two continuous years of contraction, a weak recovery is expected for 2017 (although slower than the initial projections, with bounded growth rates in most countries). In this setting, once again Bolivia stands out as one of the economies with the lowest inflation rates and the highest growth figures in the region (for the fourth year in a row), despite the external shock originated by the decrease of Brazil's demand for natural gas.

Conditions of international financial markets remained favorable, exhibiting low volatility. This fact, along with the moderate recovery of world economy and low interest rates, favored the net inflow of funds to emerging and developing markets. In this scenario, the US dollar depreciated, meanwhile most currencies of the Latin America region showed appreciations, in contrast to the stability of the nominal exchange rate in Bolivia.

The appreciation of currencies contributed to decrease inflation rates in countries of the region, making more suitable conditions to implement monetary impulses. In the meantime, the Central Bank of Bolivia (BCB) maintained its accommodative monetary stance, which was initiated in mid-2014 in response to the fall in terms of trade and the global economic slowdown.

This event implied very low monetary and financial intermediation rates which, along with fiscal impulses, helped to boost credit and economic activity. In this sense, fiscal and monetary policies followed a countercyclical orientation, with the aim of sustaining the dynamism of economic activity while preserving social protection programs and tackling poverty and inequality.

In 2017, the BCB continued its accommodative monetary stance and, in the second quarter, intensified this orientation with additional policy actions in the face of an exceptional liquidity decrease. Among the actions that allowed liquidity to be restored to adequate levels, were the decrease in supply of BCB Bonds, the preservation of low monetary interest rates, the early redemption of callable bonds, the reduction in legal reserve requirements, and the decrease in interest rates for repo operations and for credits supported by the Fund of Liquid Assets Requirement (RAL).

With these measures, monetary and financial markets were normalized and interest rates corrected downwards after a temporary increase. This contributed to sustain the dynamism of the credit of the financial system to firms and households, contributing to the fulfillment of conditions established by the Law of Financial Services (provided the main destination of these resources were the productive sector and social housing).

While the exchange rates of countries in the region were volatile, the exchange rate stability in Bolivia continued to anchor public expectations regarding the level of the nominal exchange rate. This contributed to keep imported inflation under control and to deepen the dedollarization process, relieving pressures on international reserves. It is noteworthy that the stability of nominal exchange rate allowed to obtain a sizable real depreciation of the Bolivian currency in 2017 (5.1%), mostly due to low domestic inflation and the appreciation of currencies of trading partners. Within this setting, no persistent misalignments of the real exchange rate with respect to its long-term level (explained by its fundamentals) were observed.

Furthermore, the BCB, in coordination with the National Government, continued contributing directly to the economic and social development of the country by financing Strategic Public National Enterprises (EPNE, for its acronym in Spanish), granting credits to regional Governments and municipalities through the National Fund for Regional Development (FNDR), as well as by providing the required funds for the Juana Azurduy cash transfer program.

In 2017, inflation rate reflected a stable behavior with slight fluctuations, ending up at 2.7%, the second lowest rate in the last twelve years and, as noted, among the lowest in the region. This behavior was mainly explained by the good performance of the agricultural sector, exchange rate stability that contributed to reduce imported inflation and the careful management of monetary policy (reflected in moderate indicators of inflationary trends and anchored inflationary expectations).

Likewise, economic activity reflected a dynamic behavior, mainly due to non-extractive sectors. As a consequence, once again Bolivia registered one of the highest growth rates in the region as a result of the strength of domestic demand in line with impulses generated through fiscal and monetary policies.

Among the productive sectors, the good performance of economic activity was based mainly on agricultural production, transport and communications, and financial establishments. Up to the third quarter of 2017, the cumulative growth of real activity was 3.8%, close to the projection range for the year (between 4% and 4.5%). The growth rate would have been equal to 4.7%, if the negative shocks which affected

hydrocarbons and mining sectors would not have taken place (i.e. exogenous shocks such as the lower natural gas demand by Brazil; lower purity of some minerals and productive stoppages due to maintenance tasks in mid-size mining).

International reserves increased as a result of high net inflows of capital (which correspond to the financial account), regional currencies appreciation and the increase in the international price of gold. These movements counterbalanced the deficit in the current account of the Balance of Payments. At the end of 2017, foreign exchange international reserves reached USD10,261 million, equivalent to eleven months of imports and 27% of GDP, ratio above reference levels considered adequate. These aspects reflect country's external strength which stands out in the region and throughout the world.

On the other hand, there were significant increases in loans and deposits of the financial system, stimulated by policy actions which held liquidity in adequate levels and by improvements in national income due to the domestic activity dynamism. The growth rate of deposits in the financial system showed a considerable recovery, with an annual rate for 2017 among the highest in recent years.

Moreover, as a result of the actions implemented in a coordinated way by the BCB and the National Government, the financial system credit to the private sector continued growing notably. The annual flow was similar to the historic records presented in the two previous years. These loans were mainly devoted to the productive sector and to funding social interest housing, in accordance with the priorities established by the Law of Financial Services. Financial dedollarization of credits and savings continued to deepen to levels of participation of the domestic currency close to 100%. This is a remarkable result that no other country in the region with partial dollarization has achieved in such a short time.

Los agregados monetarios, incluyendo al circulante, mostraron mayores tasas de crecimiento interanual, reflejando la orientación expansiva de las políticas sin que ello se haya traducido en desequilibrios del mercado de dinero como muestra la baja inflación registrada y el incremento de las reservas internacionales.

Monetary aggregates (including the currency), showed higher year-on-year growth rates, reflecting the accommodative stance of policies without affecting the equilibrium in the money market, as evidenced by the low inflation and the increase in international reserves observed by the end of the year.

In terms of economic outlook, in 2018 a greater dynamism of world economy is expected, driven mainly by the good performance of emerging and developing economies. In South America, the pace of growth is expected to accelerate in most economies, although fiscal challenges and internal political processes (i.e. election campaigns) are still pending in some of these countries. On the contrary, growth projections of the main advanced economies, with the exception of the United States, reflect lower dynamism. In this framework, the external GDP relevant to Bolivia would register a rebound in this year, although this is not exempt from risks that could affect its expected behavior downwards.

In turn, international commodities prices would tend, on average, to stabilize in 2018. In the case of the price of oil, although it is expected to continue recovering, the increase would be lower than the one registered in 2017. In part, this result would explain the lowest rates of world inflation expected by the end of the year.

As for monetary policy, normalization would remain gradual in main advanced economies; while in most countries of the region the orientation would continue to be accommodative although at a slower pace (except in Argentina where a contraction bias would remain). In this context, although the liquidity forecast remains high, there are risks that could trigger reversals of financial flows and lower investment levels in emerging and developing markets.

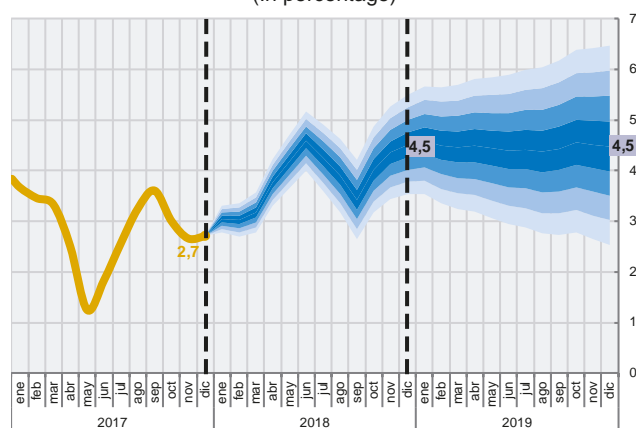
Regarding domestic economic activity, the outlook is favorable for 2018. Bolivia would accelerate its growth rate, reaching a rate around 4.7% by the end of the year. This performance would be supported by the dynamics of the extractive sectors and, especially, the non-extractive ones. In the first case of extractive sectors, the recovery of regional economic growth

would be decisive; while regarding the non-extractive sectors, the impulses provided by monetary and fiscal authorities will be important.

The expansion of Gross Domestic Product would be led by the following sectors: Electricity, Gas and Water; Construction and Public Works, Public Administration Services; and Agriculture, Forestry, Hunting and Fishing. On the expenditure side, the strength of domestic demand would continue to boost growth, while external demand would reduce its negative impact.

In terms of domestic inflation outlook, the baseline scenario forecast indicates that at the end of the 2018 the inflation rate would be around 4.5%, in a range between 3.5% and 5.5%; a similar inflation rate of 4.5 is also expected by the end of 2019.

**Year on year inflation, observed and projected**  
(In percentage)



Source: Central Bank of Bolivia

Note: The chart includes confidence intervals around the central scenario. The lightest coloured area on the graphic is consistent with a 90% interval

While preserving a careful balance between its objectives of preserving price stability and supporting economic dynamism, the BCB will maintain the accommodative stance of monetary policy, albeit to a lesser extent than in previous years provided the external sector reflects signals of further recovery. On the other hand, the exchange rate policy will be aimed at preserving price stability, financial dedollarization as well as the stability of the financial system. Finally, it should be noted that Bolivia still possesses important financial buffers to continue with the counter-cyclical orientation of the economic policies.