

Executive Summary

During the first half of 2017, the global economic activity presented a modest recovery, although below expectations; the manufacturing industry and services sector performance stood out along with international trade and confidence indicators. The recovery of international commodity prices was moderate, affected by the oil price behavior whose perspectives were reduced. Meanwhile, the financial market condition remained favorable with net capital inflows to emerging markets and developing economies and a volatile behavior of regional exchange rates.

In this context, developed countries showed signs of continuing their recovery after a period of political uncertainty earlier this year, although United States growth forecast was revised downward mainly due to a lack of advances and the not yet defined fiscal stimulus policies. Inflation in the major advanced economies is below the target set by its central banks, after a rebound at the beginning of the year which led to the rise of the United States interest rates and the reduction of the asset purchase program in the Euro Area.

On the other hand, emerging and developing countries had mixed behaviors. In South America, the contraction of the last two years is expected to reverse, growth projections have been revised downward before weaker international commodities prices and domestic political risk in some economies. In the meantime, inflationary pressures in the region were reduced, allowing central banks to adopt monetary policies to stimulate economic activity. Bolivia stands out as one of the largest expansions expected for 2017 and the lowest accumulated inflation in the region during the first half of the year.

In this regional framework of weak recovery and moderate increases in international commodities prices during the first half of 2017, the national authorities decided to maintain countercyclical policies aimed at sustaining the dynamism of economic activity and the fight against poverty, preserving the price stability.

In this regard, during the first part of the year the BCB maintained its accommodative monetary policy stance initiated in mid-2014, ensuring adequate liquidity levels as well as holding interest rates of public securities close to zero. The actions of the Central Bank have been conducted with the aim of supporting the dynamism of credit from the financial system to the private sector, mainly to productive and housing segments in accordance with the Financial Services Law. Actually, the weekly supply of securities of the Central Bank was reduced by the end of February and net redemptions took place since March in response to the fall in liquidity levels. Afterwards, due to more pronounced reductions of liquidity in April and May, additional policy measures have been implemented: the supply of securities was reduced and the option of early redemptions of callable bonds was exerted. Furthermore, the access of financial intermediaries to loans of the Central Bank was expedited, providing resources to financial agents for repurchase agreements and credits guaranteed by the RAL Fund (the interest rates of the latter two instruments were reduced). Likewise, modifications to the Reserve Requirements scheme of the BCB were carried out, providing resources for the creation of the Fund for Credits for the Productive Sector and Housing of Social Interest (FCPVIS, for its acronym in Spanish); this fact allowed financial intermediaries to obtain funds under more advantageous conditions,

so that they can increase their credit supply in accordance with requirements established by the Financial Services Law.

With regard to the exchange rate policy, given the context of high volatility of exchange rates in the region, the policy of exchange-rate stability of the BCB anchored depreciation expectations, and also contributed to maintain the low levels of inflation observed in the Bolivian economy; in that way, it provided support for the expansionary orientation of monetary policy. Moreover, the exchange rate policy also helped strengthening the financial de-dollarization process. These positive results have been achieved without generating persistent misalignments of the real exchange rate with respect to its long-term level. Likewise, additional measures have been implemented to complement the accommodative stance of monetary policy and to reduce the flow of foreign currencies abroad.

In coordination with the National Government, the BCB continued to contribute to the economic and social development of the country by funding Strategic Public National Enterprises (EPNE, for its acronym in Spanish); these resources were mainly aimed at supporting energy security projects and the industrialization of natural resources. Even more, loans granted to Regional Governments and municipalities through the trust fund established with the National Fund for Regional Development were mainly allocated to infrastructure projects. Moreover, the Fund for Productive Industrial Revolution (FINPRO, for its acronym in Spanish) continued supplying resources to productive enterprises. Finally, funds provided to the Juana Azurduy Program were also maintained; this is a conditional cash transfer program which is nowadays one of the main pillars of social protection and income redistribution policies in the country.

With regard to the prices behavior, the monthly year-on-year inflation was in line with the expectations until March. However, from April onwards there was a drop in the inflation trend below the projection range. This result was explained by: the good agricultural performance and a greater supply of products that allowed a decrease of the prices of perishable items, especially of potato and tomato; inflation expectations within the projection range; exchange rate stability; and moderate price variations of services. In this

context, the first semester accumulated inflation (0.14%) registered the lowest level since 2009 even at a regional level.

In this panorama of slight global recovery and regional growth prospects revised downward, Bolivia maintained a sustained growth based on the sectors related to the impulses of fiscal and monetary policies and, therefore, on the domestic demand. In the first quarter of 2017, economic activity grew 3.3%, one of the highest rates in the region, highlighting the dynamism of the agricultural sector due to the outstanding production performance. Likewise, there were significant increases in the non-extractive sectors rates, which were driven by expansive fiscal and monetary policies, including financial establishments, transport, public administration services, and food industry among others. However, the sectors related to external demand showed contractions: in hydrocarbons sector caused by the lower Brazilian demand for natural gas and in mining sector due to temporary delays in production.

In the first quarter of 2017, the balance of payments presented a current account deficit offset by higher net inflows of capital resulting in a lower need of International Reserves. In the current account, the increase in the value of exports and the higher inflows of foreign remittances among others highlighted starkly. Similarly, in the financial account, the issuance of sovereign bonds by Bolivia and the direct investment translated into significant foreign currency inflows.

As for the financial intermediation in the first half of 2017, public deposits in the financial system evidenced a recovery in its growth rate, supported by the national income growth. Likewise, the credit of the financial system to the private sector registered a significant flow, particularly to the productive and housing of social interest sectors; this increase is linked to the Financial Services Law and the measures coordinated by the National Government and the BCB to provide liquidity to the economy. On the other hand, the de-dollarization process of the financial system has continued to deepen representing the most remarkable achievement in the regional context.

With respect to monetary aggregates, the monetary base registered a significant reversal during the first half of the year displaying from negative rates greater

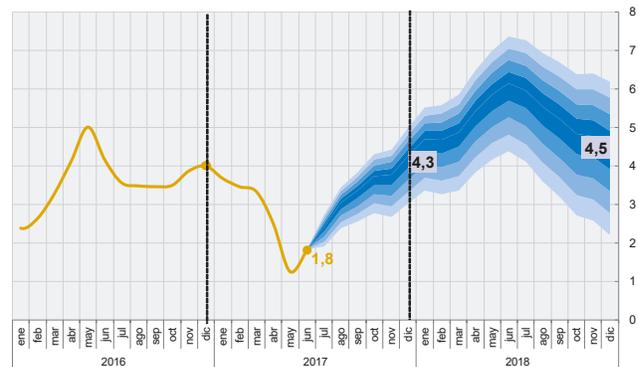
than 10% to positive rates at the end of June; this result is associated with the improvement in liquidity indicators. Monetary aggregates are showing higher growth rates than in December 2016, mainly due to the behavior of deposits.

In relation to the global growth prospects for 2017, they remain in line with expectations; however, the risks are downward biased. In fact, advanced economies will continue to slightly recover, while emerging and developing economies continue to drive global dynamics, albeit heterogeneous performances among those countries. In South America, the higher levels of political uncertainty in the main economies and a slower recovery in the terms of trade led to the downward revision of the recovery prospects. However, Bolivia would again achieve one of the highest growth rates and one of the lowest inflation in the region in 2017.

With regard to the national economy and before these external environment, the most likely scenario of the expected growth for 2017 is in the range of 4% to 4.5%, which implies a slight downward correction to the central scenario projected in the January 2017 IPM (4.7%) due to the revision of the estimates of the domestic hydrocarbons sector and the economic performance of foreign commercial partners economies. The growth of this year would be based on the good agriculture performance, the recovery in mining and the dynamism of the sectors with the greatest link to monetary and fiscal expansion. On the expenditure side, economic growth is sustained mainly by the domestic demand.

The base inflation projection for 2017 was revised downwards from 5.0% to 4.3%, ranging from 3.0% to 5.0%. It should be noted that there is a greater probability that inflation will end below the base projection.

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



Source: Banco Central de Bolivia

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

With regard to the economic policies, the BCB is aiming carefully at two goals at the same time: the preservation of the price stability and the fostering of the economic dynamism. To do so, it will maintain the accommodative stance of the monetary policy. On the other hand, the exchange rate policy will be aimed at strengthening price stability, de-dollarization and stability of the financial system. Finally, it should be noted that Bolivia has important financial buffers to continue with the counter-cyclical orientation of the economic policies.