

Executive Summary

Global economic activity remains in a recovery phase although at moderate levels during the first half of 2018, while a sluggish pace in both manufacturing activity and international trade is due to the uncertainty generated by trade negotiations and the escalation of protectionist policies. Stable growth is expected in the advanced economies during this year, characterized by the US economic acceleration driven by the pro-cyclical fiscal policy that would cause a normalization of its monetary policy faster than anticipated. On the other hand, there are signs of slowdown in other economies of the group of advanced, such as Japan and the Euro Zone. In these countries, output gaps tend to close, implying risks in inflation and, therefore, in interest rates.

The emerging and developing economies maintained their dynamism, but with a stark heterogeneity growing within. Although the increases in commodities prices, especially oil, are favorable for those commodity exporting countries, external and internal risks have affected their economic performance. These factors include lower foreign capital inflows, higher costs of international financing, negative effects of exchange rate depreciation and uncertainty related to gubernatorial elections and the consequent adjustment policies. Compared to 2017, further expansion in South America is expected, although this year's outlook was revised downward, while inflationary pressures remained subdued in most economies. Still, monetary stimuli may be stopped in some countries in the face of depreciation and volatility of several exchange rates in the region. In this environment, Bolivia stands out with the highest growth expected for 2018, the lowest inflation

accumulated in the first half of the year and the stability of its exchange rate.

In particular, the Bolivian monetary policy stance during the first part of 2018 continued to be accommodative, keeping low monetary interest rates and improving the levels of the financial system liquidity through various instruments, such as: reducing the supply of monetary regulation bonds, alleviating the legal reserve requirements for deposits in foreign currency and other measures in coordination with the National Government. These policies helped to address the expected second quarter seasonal liquidity decrease better, so the financial system did not experience strong shocks and consequently behaved well in 2018.

Contrary to these results and to the policy efforts implemented, the fixed term deposits interest rates had sustained increases due to transactions agreed with some depositors. Such behavior determined the Reference Interest Rate (RIR) to rise, with the following impact on the payment of all loans at a variable rate determined by it, threatening the financial stability and the economic growth. In this context, using its attributions, the Central Bank modified the RIR calculation in order to stabilize its behavior, mitigate credit risk and better reflect the cost of funding.

Also, despite the high volatility in foreign exchange markets of neighbor economies, Bolivia's exchange rate stability allowed keeping inflation subdued while supporting the expansionary orientation of monetary policy. Likewise, it continued contributing to the de-dollarization process without registering persistent misalignments of the real exchange rate

with respect to its long term level explained by its fundamentals. Similarly, the BCB guaranteed economic agents access to foreign currency through various mechanisms which contributes to enhance confidence in the country's external strength.

In coordination with the National Government, the BCB continued to support social and economic development through the National Strategic Public Enterprises financing mainly oriented to upkeep the natural resources industrialization and the food security strengthening. Similarly, the BCB granted loans to the local governments through National Fund for Regional Development trust and gave resources to the Juana Azurduy transfer program, one of the social protection fundamental programs that preserve the wellbeing of the population.

On the other hand, the purchasing power of the national currency was maintained, since the accumulated inflation registered 0.6% in the first six months (3.2% year-on-year), being one of the lowest inflation country record in recent years and the lowest in the region in the first half of 2018. This important result is explained by the exchange rate stability, the good agricultural year and the anchored inflation expectations, among others. Likewise, inflation trend indicators remained below total inflation, indicating low and controlled pressures on the demand side.

On the other hand, Bolivia's economic growth in the first quarter of the year was 1.1pp higher than the one registered in the same period in 2017. On the supply side, almost all sectors supported growth positively, highlighting agriculture, financial services, industry, and construction, among others. On the expenditure side, although the strength of domestic demand stands out in line with the fiscal and monetary impulse policy, there was also a positive impact on the external demand which fostered Bolivian exports.

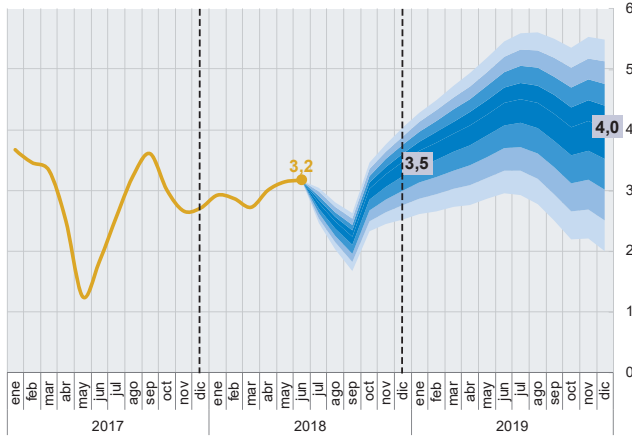
The balance of payments current account deficit decreased in the first quarter of 2018 due to the improvement in the Secondary Income account and the trade balance due to higher exports. In the financial account, the use of external assets offsets the lower external financing, except for the net issuance of direct investment liabilities.

Specifically, the trade balance, accumulated to June, showed a surplus after two years of deficit in similar period. This result is due to a significant exports recovery determined by the terms of trade increase. On the other hand, family remittances received in the national economy achieved a record flow in the first half of the year. In this sense, important levels of international reserves remain above the theoretical levels recommended by international organizations. At the same time, public external debt remains at sustainable levels of solvency and liquidity.

In terms of financial intermediation, the public deposits growth rate showed a considerable recovery reflecting improvements in national income due to domestic activity, mainly in non-extractive sectors and the expansionary economic policies implemented. Likewise, the financial system credit to the private sector registered the highest historical flow, mainly due to the expansionary monetary policy stance, and was directed mostly to the productive and housing sector of social interest within the framework of the Financial Services Law. The internationally recognized financial system de-dollarization continued to deepen, becoming one of the greatest achievements of the economy.

About the global outlook, although the world economic growth prospect for 2018 remains unchanged compared to the beginning of the year, the risks balance is tilted to the downside due to the international financial tightened conditions, the protectionist measures escalation, the geopolitical instability, the political uncertainty and the local economic policies applied internally. In this context, the national economic growth prospects for 2018 remain close to 4.7% and are based, on the supply side, in the greater dynamism of a large part of the productive sectors and, on the demand side, mainly in the internal component important contribution. On the other hand, the baseline scenario of the inflation projection has been revised downwards, which at the end of the period, would be around 3.5% in a range between 2.5% and 4.0%. It is important to notice that there is a high 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

In relation to economic policies, the BCB will maintain the monetary policy expansionary stance, making a careful balance between preserving price stability and propping up economic dynamism, albeit to a lesser extent than previous efforts as long as external sector correction continues. For its part, the exchange policy will be aimed at strengthening price stability, de-dollarization and the financial system stability. Finally, it should be noted that Bolivia has important financial buffers to continue with the countercyclical economic policies.