

# Executive Summary

During the first half of 2020, the COVID-19 pandemic severely affected the world economy. To reduce mortality, contagion and the burden on health systems, physical confinement and distancing measures were applied. Although, those measures reduced supply and demand in the aggregate economy. As a result, activity contracted and international trade, remittances and tourism weakened. This economic recession is projected to be even deeper than the Great Depression.

The restricted supply and demand behavior around the world impacted the productive and service sectors, which reacted by restructuring its working conditions and, thus, deteriorating employment indicators. In addition, goods and services prices were affected, which led to the recomposition of the conditions of the global economy. Due to the uncertainty developed, the financial markets suffered high levels of volatility and risk aversion of its incumbents, who chose to withdraw their capital from emerging economies and shifted it to safe assets. Therefore, world currencies, especially in emerging and developing economies, depreciated. Likewise, the international gold and silver prices rose because of its role as reserve assets, while the rest of the commodities prices fell even below zero as for the oil.

To mitigate the economic and social damage the limited mobility and confinement produced, the countries of the world adopted monetary and fiscal stimuli in a low inflation context. In this sense, the central banks reacted accommodatively. As South America became the pandemic epicenter, these orientation was deepened with the use of traditional and unconventional instruments.

It is noteworthy that, in this adverse economic context and lower net external disbursements throughout the first half of the year, the levels of the International Net Reserves (RIN) of Bolivia remained stable. Compared to recent years same period, the considerable

decrease in demand for dollars by the local economy was a determining factor to maintain the RIN levels. Moreover, this normalization in the dollars demand is a result to the exchange rate stability through the expectations anchoring. Additionally, the current account deficit in the balance of payments decreased as the value of imports and outbound tourism reduced. That drop was steeper than the one experienced by the exports, inbound tourism and family remittances. On the other hand, the financial account recorded capital outflows and lower net external disbursements, which were offset by the result in the current account. Consequently, the balance of international reserves remained stable, and at the end of the semester it was within the acceptable range according to international criteria and the external debt is sustainable in terms of solvency and liquidity.

The sudden expansion of the pandemic in Bolivia was faced by the government declaring it a health emergency. The consequent negative effects of the disease and the economy slowdown due to quarantine determined a new policy approach aimed to mitigate these challenging conditions.

Facing this situation, the BCB became the first source of liquidity for both the public sector and the financial system. Within the BCB law framework, important liquidity and emergency loans were granted to the General Treasury while the Juana Azurduy bond financing was continued. The monetary policy assumed through the use of conventional and unconventional instruments deepened its accommodative orientation to maintain liquidity, the chain of payments and the economic stability of the country. The internal and external inflationary pressures were low, which gave enough space to maintain this monetary orientation. Among the main policies exerted are the acquisition of public securities held by the AFPs; the creation of an extraordinary legal reserve fund to increase financial system resources to borrow if needed; the expansion of DPF collaterals for repos with the BCB;

the reduction of the legal reserve rates to create a Fund to help reactivate local goods and service consumption; and the percentage increase of national currency in custody.

On the other hand, the stability of the nominal exchange rate allowed anchoring expectations on the dollar price keeping imported inflation levels low and supporting the accommodative monetary policy. In addition, the exchange rate stability continued to preserve the bolivianization process and to maintain the preference for deposits and credits in national currency. Likewise, during this period, after the social and political events that occurred in October and November 2019, the foreign currency commercialization from the BCB to the EIF and from these to the public decreased, while net transfers abroad were lower. However, due to the depreciation of exchange rates in the region, the real exchange rate of Bolivia appreciated at the end of the first semester.

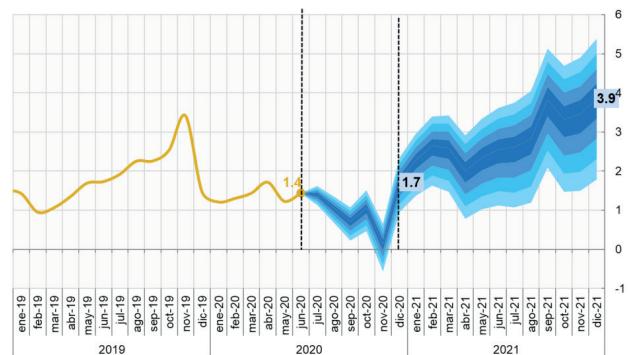
During the first half of 2020, inflation in Bolivia registered a trend biased downward. The effects of the pandemic, and the measures adopted to contain it, determined this behavior. The health emergency affected both supply and demand, which was reflected in a lower goods and services prices. Additionally, unprocessed food prices were low due to the good agricultural performance and steady supply. On the contrary, imported health and hygiene products were highly demanded, while the restrictions on trade flows resulted in a weak supply of them; therefore, these prices registered increases, although these pikes had no impact on the total result of inflation. Expectations on this variable remained in the lower range of the projection announced by the BCB.

The policies executed by the BCB managed to maintain liquidity at high levels and allowed the money market and financial intermediation interest rates to be corrected downwards. An important characteristic to highlight is that the measures helped to increase the deposits in the financial system in national currency. These resources were redirected as lending to the private sector. The chain of payments was preserved, as the stability of the country's financial system was also. Despite these efforts, the adverse effects of COVID-19 were significant in the real sector. By April of this year, the economy contracted 5.6% mainly due to the suspension of activities determined by the national quarantine and the weak external demand. The agricultural, communications and public administration services sectors were the only ones that partially offset the fall on the other sectors.

The world economy gradual recovery determined by the evolution of COVID-19 is not entirely encouraging. The unfinished aftermath keeps the uncertainty levels high. While recovery is expected to begin in the second half of this year, it is anticipated that it will be slow and subject to the pandemic evolution in each specific context. In most countries, the low inflation and wide output gap indicates the need to apply accommodative policies, which will continue to be implemented in the second part of the year. The main objective is to sustain the aggregate demand and to create conditions to reactivate the supply. However, the main limitation for a small and open economy like Bolivia is to gather the resources needed to support the economic reactivation. It is not possible to finance it all through BCB's credit since it may weaken the international reserves. Therefore, the international prices evolution and external demand for our products are relevant. However, the recovery forecasts on these variables are weak and may not reach the past years levels. In addition, South America, where most of Bolivia's main trading partners are, is expected to be the most affected region and with the most pronounced drop in economic performance.

In this context, the estimated inflation for the end of 2020 is around 1.7% within a slightly downward biased range between 0.9% and 2.3%. The revised growth projection is also downward biased and the economy is estimated to contract approximately 6.2%, ranging between -7.9% and -5.1%. As usual, these forecasts face risks that could cause deviations on their expected behaviors. Moreover, the pandemic evolution adds an important aspect of uncertainty, which generate an extraordinarily volatile and difficult context.

**Observed and forecasted inflation**  
(In percentage)



Source: Banco Central de Bolivia

Note: The graphic includes confidence intervals around the central scenario. The lightest part represents 90% of probability

Therefore, the monetary policy will continue its accommodative stance. A careful balance between preserving price stability and fostering economic growth will always be the priority. Meanwhile, the exchange rate will continue to be stable with the purpose of anchoring expectations and reinforcing the process of stabilization of inflation, promoting the Bolivianization of the economy to maintain the stability and development of the financial system.