EXECUTIVE SUMMARY

In 2011 the world economy exhibited once again economic slowdown and financial fragility, particularly in advanced countries. This situation was more evident in the second half of the year, with a deeper debt crisis in some countries of the Eurozone, with consequences in other developed countries and to a lesser extent to many emerging and developing countries. There was also a contagion effect with harmful effects in financial markets and amplified investor uncertainty. This leaded to a reduction in some capital inflows to emerging countries.

Economic growth in emerging and developing economies remained above advanced ones, nevertheless it slowed in 2011 due primarily to i) tighter macroeconomic policies taken in late 2010 and early 2011 to ease inflationary pressures, ii) worse external context due European debt crisis concern and iii) worries about a hard landing in China.

Even though Latin America and the Caribbean economic growth declined in 2011, it remained strong, mainly in South American countries. At the beginning of the year, external environment was beneficial for the region according to recovery of export commodities prices, lagged effects of expansionary economic policies applied in the middle of the international crisis of 2008 and 2009, and larger capital inflows. However, it was followed by a period of adverse external environment and uncertainty regarding region growth outlook.

Commodity prices rose in the first half of 2011, and then declined in the second one. On average, they remained above those recorded in 2010. According to this pattern, global inflation increased first and declined after in the year, ending with higher annual variations than previous year ones.

On international monetary policy issues, the Federal Reserve (Fed) kept unchanged its monetary interest rate at its record lowest range, 0.00% to 0.25%. This was a result of fragile economic recovery, despite inflation upsurge. In order to reduce long term interest rates, in September the Fed increased the average duration of asset holdings.

The European Central Bank (ECB) raised twice its reference policy rate until July 2011 to reduce inflationary pressures. Nevertheless, ECB diminished this rate in the last two months of the year, returning to the earlier rate of 1%. This easing was applied to react to deteriorated regional economic activity, underpinning debt crisis and less inflationary pressures.

To prevent negative effects of global slowdown, emerging economies concluded their tighter monetary policy stance in mid-year through cuts or maintenance of interest rates. Between January and July 2011, some Latin American economies (Chile, Brazil, Colombia and Peru) increased their monetary rates to moderate inflation upturn. Then, interest rates remained constant or even decreased (Brazil) due to the imminent external slowdown.

International financial markets showed increased volatility due: i) changing global economic outlook, ii) growing debt crisis in Greece and its contagion to major economies in the Eurozone, and iii) debt unsustainability and fiscal deficit in the U.S. joined to the lack of political consensus to solve them. This last issue caused U.S. dollar depreciation till August, followed by a period of greater volatility.

In Bolivia, the economic activity had a positive performance; in fact, the gross domestic product (GDP) reported an increase of 5.2%. Once again, the domestic demand has supported this accomplishment through important public investment in strategic sectors, in line to the New Plural Economy Model. The outstanding sectors were transportation, financial services, manufacturing and public administration services. At the same time, nonrenewable extractive activities boosted GDP growth. The principal activities in this sector were mining and hydrocarbon. In the last case, the increase in gas demand from Argentina played an important role.

For the sixth consecutive year, fiscal accounts attained a surplus of 0.8% of GDP. The income tax revenues improved significantly, while current expenditure performed moderately. At the same time, the highest rate of public investment was observed mainly headed for strategic productive sectors and infrastructure, as well as social protection programs.

As a result of positive balance on current account 2.2% of GDP (by remittances and increased exports) and a surplus of 6.3% of GDP in capital and financial account (for foreign direct investment and debt payments), the balance of payments again recorded an overall balance surplus. Therefore, the Net Foreign Exchange Reserves (NFER) of the Central Bank of Bolivia (BCB for its acronym in Spanish) increased. At December 2011, they represented 50% of GDP, the highest level among the countries of Latin America. This level, along with the proper foreign debt administration, involved a creditor international investment position, for four years straight, of 17% of GDP.

Total public debt sustainability and solvency, both internal and external, improved. Indeed, debt indicators were below the threshold reference. These indicators as a ratio of the GDP were lower than other countries in the region.

Growth of many money indicators replied to its fundamentals (activity, inflation and "dedollarization"). The increase in monetary base was the result of the rise of NFER partially offset by a significant accumulation of deposits of Non-Financial Public Sector (NFPS). At the end of the year, the money supply grew moderately, as monetary aggregates did. In addition, the remonetization process was revealed through higher rates of means of payment in local currency (M1, M2 and M3).

Financial intermediation reached record levels of loans and deposits encouraged by economic activity and regulation reforms, specially focused on the productive sector These reforms, taken by the Executive Branch and the BCB, had the aim to strength the "dedollarization" process, whose speed was higher than that observed in other partially dollarized economies. Since the beginning of this process in 2005, remonetization had a relevant improve reaching by the end of 2011, 69.5% in loans and 64.0% in deposits.

Deposits grew at a rate of 19% and loans at a rate of 23%. It should be noted the increase in time deposits in national currency and the higher annual variations in productive loans. Meanwhile, the financial indicators of asset quality, solvency, efficiency and liquidity continued to show a strong and stable financial system.

At the end of 2011, the cumulative inflation was 6.9%, most of it (60%) was recorded in the first quarter of the year. The next three quarters, the monthly variation was lower than the historical average, therefore, the year-over-year rate of growth was below to the one observed in 2010 (7.2%), in line with the projections of the BCB.

The smoothed out inflation was accomplished by three main factors: i) the ease of external inflationary pressures ii) government policies to balance the domestic food supply and demand and to contract liquidity, and iii) decreasing inflation expectations.

These policies were coordinated between the Executive Branch and the BCB, including timely liquidity regulation .

BCB policies, coordinated with the Executive Branch, were prudent and countercyclical, responding proactively to the negative effects of economic cycles. Likewise, monetary policy was innovative and unorthodox. Indeed, the financial system liquidity was regulated through open market transactions according the needs of the economy,

Following the lead of 2010, monetary stimulus was gradually reduced in the first quarter of 2011. Further, in the next two quarters, the reduction in inflationary pressures, accumulation of NFPS deposits and signs of weakening global economic activity for 2012, became into a constant supply of bonds to provide an adequate level of liquidity. To provide room to monetary policy, the last quarter registered an increase in the supply of regulatory instruments. In the money market, Interest rates augmented slightly balancing the objective of controlling inflation with boosting the economic activity.

Among the heterodox elements we can highlight: i) revisions to the legal reserve requirements to improve the internalization of dollarization costs, promote the “bolivianization” process in financial institutions and to contribute to credit growth, particularly to the productive sector and ii) the promotion of direct supply open market operation to natural persons, who can obtain higher interest rates and expanded benefits with the introduction of “Christmas holiday season” Bond.

Regarding the exchange rate policy in 2011, it was focused toward the appreciation of the Bolivian currency. During the first half of the year, the fast pace of appreciation was oriented to control the changes in import prices as well as contribute to the deepening of the “bolivianization”. In the second half, the rate of appreciation decreased as the world economy growth slowed, international prices moderated and domestic inflation fell. Moreover, exchange rate policy tried maintained a real exchange rate around its fundamentals.

For 2012, it is expected economic slowdown in advanced economies in the international context, and even recession in several European countries. In emerging and developing countries, growth will be slower than in 2011; although, it would be sufficient to support commodity prices at high levels. It is important to note the geopolitical hazard for the hydrocarbons production in the Middle East, that could increase the oil prices.

In the domestic context, the bolivian economy will continue with a sustained growth path. GDP growth would be leaded by the increase in public investment in productive sectors and infrastructure, as well as the dynamism of non-extractive activities highly related to the domestic demand. It is estimated that GDP growth in 2012 would be in the range of 5% and 6%. As well, productive private investment would continue to be enhanced by good financial conditions and government policies effects. Finally, the hydrocarbon sector would underpin extractive activities in response to its higher investment and to growing sales to foreign markets.

Inflation projections show a stable behavior during the biennium 2012-2013. It is awaited that inflation would be around 5% in 2012. Later, in 2013, it would converge to the medium-term target (4%).

The dynamism of the public investment would require additional imported inputs and capital. This scenery would determine a current account deficit in the balance of payments and a loss of exchange reserves. According to public capital formation, these projections are consistent with an estimated deficit on the NFPS of 3.9% of GDP and are part of the Decision Agreement on Implementation of the Fiscal – Financial Programme 2012 signed on February 7th, 2012 between the MEFP and the BCB.

Regarding the BCB governance, in 2011, the Committee for Systemic Risk Analysis was created in order to be able to provide an appropriate and coordinated response to possible adverse events in the financial system, through the evaluation of the economic, political and social situation. This Committee is under the President power. Besides, some amendments were introduced to the Internal Statute of the BCB.

Furthermore, the BCB strengthened its relations with the public and private national sector, and with those international organizations which promote the regional integration under the line of the new Plurinational State of Bolivia. It highlighted the "Agreement for Cooperation and Technical Assistance" with the Plurinational Legislative Assembly and the participation of the BCB in meetings related to UNASUR, Banco del Sur and CEPAL.

Some surveillance actions were performed in order to ensure safety and efficiency on the system of payments. Moreover, the entities that provide clearing and settlement service of operations with paying cards continued incorporating to the High Value Payment System (SIPAV for its acronym in Spanish). It is worth to mention that the Regulation for Monetary Material and Values Transportation was created to ensure more efficient distribution of them. The national payment system processed an amount equal to 3.3 times the GDP in 2011. On the other hand, the weight of national currency operations and dematerialized instruments has increased.

In 2011 the investment of exchange reserves remained in line with the rules, limits and guidelines established by the Board of BCB and the Reserves Committee (IRC). The portfolio was diversified into Canadian Dollars (CAD) and Australian Dollars (AUD) investments, through modifying the "Regulation for the Administration of the Exchange Reserves". It is worth to mention that the working and investment capital showed a significant increase, while the acquisition of gold determined the increase of the reserves in this denomination. Finally, the returns reached for the investment capital was higher than their benchmarks, showing the correct administration of these funds.

During 2011, the increased in monetary material demand was a result of the growth of monetary issue and the strengthening of the "bolivianization". In order to have enough availability of this material and adequately provision of fractionated material, the printing of 152 MM additional currency bills of the series "I" and the minting of 464 MM coins was tendered.

Moreover, the BCB carried out activities that strengthened the mechanisms of participation, transparency, social control and access to information. The three major themes for the Social Control Session in 2011 were: Credits to National Public Enterprises, Strategic Education Program and the Monetary Policy Report.

Among the most important permanent economic and financial education activities, it was organized the Fifth Monetary and the Second Financial Conferences, the Forth Meeting of Bolivian Economists, the Thirteenth National Research Award and the Forth School Essay Contest. It was organized also the First School Theater Tournament regarding the subject: Inflation Control. There were also conducted academic seminars and internal workshops concerning plural economy and other subjects.

New budget management control mechanisms were implemented, which allowed obtaining an excellent evaluation by the MEFP, achieving an efficient and effective administration. The organizational structure was adapted in order to timely respond to authorities' demands and the Integrated Risk Management was implemented into BCB processes.

Ruzmier Company present fairly the BCB audited financial statements at December 31st, 2010 and 2011.

Finally, the BCB reaffirms its commitment to fulfilling its mission, assigned by constitutional mandate, and the process of strengthening the new model, in order to achieve a greater economic and social development.