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Statement by Ms. Felisa Miceli
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On behalf of Argentina, Bolivia, Chile, Paraguay, Peru, Uruguay

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Minister of Economy and Production of Argentina
Speaking on behalf of the Southern Cone Countries of Latin America
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I. The Global Economy and Financial Markets—Outlook, Risks, and Policy Responses

1. We note with satisfaction that, even in the presence of a slowdown in the U.S. economy, the projected world economic growth has moved upwards vis-à-vis our Spring Meetings. The continued strength in emerging markets, in particular China and India, is now helping to drive, due to their sheer size, world economic growth. The economic expansion in Latin America has remained strong while the Euro area and Japan are also showing a revival. It would appear, therefore, that a non-traumatic unwinding of the global imbalances is more likely than before. However, it is too premature to be optimistic in this regard, particularly since global imbalances have not subsided but are in fact still growing.

2. Persistent and mounting external imbalances represent a serious threat to global sustainable growth perspectives and this risk should be addressed sooner rather than later. In the short-term, external imbalances and global economic growth appear to be synergetic; however, in the medium-term they are not. The real policy challenge for all of us is to set our macro-policies in a cooperative dynamic in order to prevent global imbalances from increasing even further without impairing the strength of global growth. **The multifaceted strategy proposed by the Fund in the context of the recently instituted multilateral consultations procedures is a welcome beginning.** We should pursue that strategy and keep its implementation under continuous review.

3. A critical component of the policy agenda should be to achieve a more equitable distribution of the fruits of the high global growth we are experiencing in the present context of globalized markets and impressive gains in productivity. This is, indeed, a major challenge in itself and should be done not only for moral reasons but also as a fundamental ingredient of the strategy to solve external imbalances. Rather than putting too much hope in the capacity of wealthy consumers residing in countries other than the U.S. to step into the American consumers' shoes, **we need to promote income distribution policies to incorporate currently disfavored populations, mostly but not exclusively from developing countries, into the consumer goods markets. This would be an effective driver of world growth, helping to reverse global imbalances and also helping the Fund in its search for legitimacy**.

4. However, before a scenario like the one just described comes to pass, the world economy needs to overcome two immediate threats, those coming from recessionary as well as those from inflationary pressures. Regarding the former, the scope that the slowdown in the U.S. economy will reach is key. A sharper downturn than expected may have important

ripple effects on the world economy. The extent of the plunge in the real estate market in the U.S. and the reaction of consumers to this event is, in turn, central to the assessment of this risk, since consumption in the U.S. has been supported largely by the wealth effect of high real estate prices. These developments are presently unfolding and we are concerned that the high indebtedness of consumers may compound the recessionary impact of falling house prices.

5. It is important to factor in, that even in the event of a mild slowdown in the U.S. economy, it may still affect negatively the growth dynamism in the rest of the world, particularly in China, Japan and other Asian countries where export-driven growth is very much present. It is clear that because of that, growth, as such, in countries other than the U.S. does not suffice to unwind global imbalances. Not even a revamp of domestic demand would be sufficient if it is mainly connected to the accumulation of export-led growth type of investment, as it is occurring in China. What is really needed to alleviate external imbalances is a domestic absorption -led growth in surplus countries. Hence, the importance of an equitable distribution of income, an aspect that we have not found explicitly mentioned in the present package of policies advanced by the Fund. This is unfortunate. **It is self-defeating to expect balanced growth of the world economy if an increasing number of people are unable to reach acceptable standards of living**. It is not conducive, in this regard, to systematically advocate for labor market flexibility, as the staff documents usually do while forgetting to press for the need to flexibilization product markets, which remain quite rigid in many countries, leading to a continued fall in the share of labor in income while depressing growth prospects. As mentioned in my Spring Meetings statement, it is important that the IFIs request the opinion of the International Labor Organization (ILO) before giving policy advice on labor matters.

6. We see compliance with core labor standards not only as ethically imperative but also as necessary to avoid a race to the bottom to attract investment. Investment naturally seeks the maximization of profits and those countries that do not comply with ILO core labor standards have an unfair competitive advantage over those which do. This is unacceptable and the Fund should not be instrumental to it. **Before advocating for additional labor "flexibility" (frequently just an elegant way of asking for less protection and retribution for workers) staff should request compliance with domestic labor legislation (a matter of "good governance") and consult the ILO.** Again, **this would also help the Fund in its search for additional legitimacy.** If we honestly mind about overcoming resistance to globalization, we should take this seriously.

7. Another aspect of the present policy framework that we regard as unbalanced is the role assigned to **the depreciation of the U.S. dollar**. Of course, the policy package that the Fund proposes calls for an orderly depreciation of the U.S. dollar to avoid a disorderly one. This, no doubt, should be the preferred route. However, in today's globalized financial markets it is not always possible to engineer orderly devaluations. Moreover, is not clear to us whether a dollar devaluation could unleash demand for U.S. exports. **Who will buy more**

American products if absorption-led domestic demand policies are not first in place? Such an avenue would require the parallel implementation of policies aimed at beefing-up domestic demand in countries where export-led policies are currently in vogue.

8. We are less concerned regarding the second risk facing the world economy, that is, **inflationary pressures**. In fact, they are very mild in the U.S. and in the world at large, particularly considering the extraordinary rates of growth of the world economy, sustained already over four years and the sharp increase in the price of oil and of non-fuel commodities. The continued high price of oil remains without doubt a matter of concern, particularly when it is also influenced by geopolitical risks. However, **if geopolitical risks are contained and handled within the rule of international law**, the current oil price levels will eventually improve efficiency in consumption, underpin the expansion of production capacity and boost efforts to substitute oil by alternatives source of energy. Moreover, the lagged effects of the tightening cycle implemented by the Federal Reserve Board (FED) and other major central banks can also contribute to reduce inflationary expectations. More importantly, we have to factor in the impact of globalization on prices which, if sustained, will continue to overshadow the effect on inflation of high non-agricultural commodity prices as well as the high rates of capacity utilization that are being reported in several countries, including the U.S.

9. The low inflation risk is largely an attribute of the opening of global markets to low-cost producers in emerging markets. This, in a context of the impressive pace of technological progress, has kept wages from benefiting from the associated increases in productivity; in short, raising the opposite risk to that of inflationary pressures, that is, worldwide deflationary pressures. Central banks have proved, so far, able to counteract this latter risk through expansionary monetary policies. These policies have, however, contributed to finance ever increasing global imbalances while strengthening economic activity through their impact on asset prices, particularly, but not only, in the U.S. There is a serious risk here that financial markets may start losing confidence in the ability of central bankers to pump growth, particularly if asset prices bust. The policy advice that could be drawn from this is two-fold. First, **it is necessary to decouple growth from asset price bubbles and base it, instead, on strong effective demand from labor-generated income**. This entails, in turn, that monetary policy should be used with extreme caution both in terms of avoiding excessive tightening that could exacerbate deflationary trend, or excessive loosening which could pump self-defeating asset price bubbles and exacerbate global imbalances.

10. **In sum, we would like to see in the Fund's policy advice on global imbalances more emphasis on the need to promote income distribution policies, so as to boost the consumption capacity of those low-income sectors in developing and advanced economies, that currently feel deprived from the benefits of globalization.** Beyond that, it seems to us that the Fund's diagnosis of the causes of global imbalances contains some weaknesses, as it is not backed by a complete explanation of the causes of the external

imbalances. Consequently, prudence, a broad mind-set and progressive implementation of redressing policies should be part and parcel of our menu of recommendations.

11. The regrettable outcome of the negotiations of the Doha Round, thus far, raises the risk of further weakening the multilateral system as a whole. This is particularly disappointing for developing countries since the Round's initial intention was to make trade rules fairer for them as an effective road for development. Resumption of the negotiations as soon as possible and with a new compromising spirit, particularly with regard to setting a Doha Development Agenda that truly helps developing countries, is called for. Limiting ourselves to highlight domestic trade reforms and aid for trade is not the recommended way to achieve this goal. **What developing countries mostly need is more effective access to markets and fair prices for their products, namely prices that would reflect actual costs of production and not the advanced countries' lobby-effectiveness to harvest subsidies**. It is noteworthy that contrary to the existing rhetoric on "preferential treatment", low-income countries face more trade restrictions than other countries to access OECD and other high-income markets. Having said this, we believe that notwithstanding the suspension of the Doha Round, the Aid for Trade agenda and the financing of trade-related regional projects should move forward as a minimum signal that a spirit of cooperation remains alight. At the same time, at the Fund we must ask ourselves whether we have done our best to contribute to a successful Round. **The sheer volumes of the trade imbalances that we witness today speak volumes of the lack of effectiveness of the Fund's surveillance on exchange rates**. If we do not adequately address this problem, somebody else will propose solutions to it. **No wonder then that protectionism sentiments have been stirred up around the world, particularly in countries that hold the key to a successful Round.** We also expect the Fund to take a more forceful stance regarding trade reforms in advanced countries which could have done much more to bring the Doha Development Round to a satisfactory conclusion. If we allow this situation to become entrenched, the perspectives are gloomy for multilateralism, global growth could result compromised and geopolitical pressures could mount even further. World leaders committed to preserve multilateralism are therefore much needed

II. The IMF's Medium-Term Strategy

12. On the quota and voice issue, we welcome the initial intention of making the Fund a more relevant institution for its entire membership which should contribute to finding cooperative responses to the many challenges facing the world economy. **A reform that is meant to increase the Fund's legitimacy naturally requires the highest consensus**, otherwise may result frustrated from the start.

13. We need to agree on a more transparent and simple quota formula. It should both capture the countries' capacity to contribute to the Fund and their potential need to borrow. We also believe that **if reform in quotas is to help the Fund's legitimacy, it should result in an increase in the voting power of the developing world as a group**.

14. Unfortunately, the new quota formula that is foreshadowed in the proposed decision is pointing in the opposite direction. This is at odds with the objective of increasing the Fund's legitimacy. The definition of the variables for a new formula and of the weights given to them is of the essence. In this regard, **if the measurement of the GDP is made in nominal terms (rather than on a purchasing power parity basis) and if intra-Euro trade is factored to measure the "openness" of European Union countries, it is highly likely that a new revised formula will result in an even more skewed representation of advanced economies in the Fund's decision making process**.

15. Particularly worrisome is the fact that while the initial understanding reached contains the commitment to maintain the present voting power of the low-income countries unaffected, **no commitment was reached regarding the capping of advanced economy countries to their present levels of representation**, notwithstanding the promises heard on this idea in the recent past. This is regrettable since we consider that a self-restraint on the part of advanced countries is essential for the purpose of this whole exercise to maintain its initial and important meaning.

16. Lastly, it goes without saying that a better representativeness of developing countries in the Fund should not be reduced to the introduction of a new formula that may reflect their importance in the global economy but that other elements should also be introduced, such as a greater participation of their nationals in the managerial and staff levels of the institution.

17. **We welcome the discussion on a new liquidity instrument** for countries with market access. It could add an important element of strength to the ones that emerging market economies have been introducing on their own through improvements in public sector balance sheets, accumulation of foreign exchange reserves and the strengthening of fiscal and monetary policies. **The intrinsic volatility of globalized capital flows fully justifies the creation by the Fund of a new instrument to provide reliable, automatic and front-loaded access to countries committed to strong macroeconomic policies**. We give great importance to such an instrument which could provide benefits not only to individual members but also to the financial system as a whole and expect that the discussion will continue to reach an agreement at the earliest possible time. In this regard, we consider important that **the selection criteria, while objective and transparent, should not be too stringent to allow for a critical mass of members to benefit from the facility, thus multiplying its positive externalities**. Another important factor to make the new instrument appealing is that the level of automatic access be commensurate with the usually large amount that is needed at times of balance of payment crises stemming from sudden reversals of capital flows.

18. In addition, the positive signaling to markets should be unambiguous to help countries overcome the potential stigma risk associated with the facility. In this regard, the proposal to subject the facility to semi-annual reviews by the Board would introduce a level of uncertainty that would rob it of its intended impact of building up credibility. Thus, we

strongly favor that the reviews be limited to the time of the Article IV consultation and that the facility be extended from the beginning for a period of at least two to three years. It is critical to establish a clear differentiation between this facility, aimed at strong performers, and those applicable to regular Fund programs.

19. On the critical matter of surveillance over exchange rate policies in the context of a possible revision of the 1977 Decision, including the analysis of a proposal on setting a new surveillance remit, not significant progress has been reached. In this regard, it is important to be clear on what our intentions are when pursuing this revision. If it is to enhance the role of the Fund as an enforcer of members' obligations under Article IV, we doubt that it is a worthwhile attempt. **The Fund's effectiveness of its surveillance activity can only rest on the power of persuasion and not through a policing role, which has already caused a significant reputational cost for the Fund, and a consequent lost of effectiveness in those countries that were under Fund-supported programs.** It is important that the IMFC remains abreast of these developments as the ideal forum for discussing the policy advice drawn from the surveillance work of the Fund particularly in the multilateral front, as well as discussing the best ways to implement it through a coordinated policy package and to monitor each other's progress toward achieving the desired goal.

20. One important aspect of the proposed revision of the 1977 Surveillance Decision that needs to be clarified is the one related to the member countries' commitment made under Article IV regarding exchange rate issues. The commitment refers to the pursuance of stability of exchange rate systems as a way to consolidate the stability of the world economy at large. As we have mentioned above, it seems to us that the Fund should have a more active surveillance role on exchange rates **where trade imbalances are persistent and affect global stability**. However, in approaching the problem the Fund should be extremely careful, as the concept of equilibrium exchange rates is quite unassailable and highly dependent on the methodology being used. More importantly, exchange rates are subservient to the underlying economic conditions of any given economy and what really matters is that fiscal and monetary policies be consistent with the exchange rate policy in place. We think if we are going to review the 1977 Surveillance Decision, this understanding should be clearly stated. In this connection, we do not have any objection to the Fund's staff strengthening its analytical work in the area of measuring equilibrium exchange rates, but we do object to any attempt to issue regular bulletins on what staff may consider to be adequate exchange rates, due to the reasons expressed above and the risks of unleashing disruptive market reactions.

21. Finally, on surveillance, we welcome the intention to focus the staff's efforts on financial sector issues, which are increasingly important, both at the national and global levels. At the same time, we should not lose sight of the fact that financial sectors operate and are largely influenced by the given economic environments which, in turn, are foremost influenced by the macroeconomic policies in place. These policies should remain the main focus of the Fund's work.

22. We support the close engagement of the Fund with low-income countries and the efforts being done to achieve the MDGs with the successful implementation of the Heavily Indebted Poor Countries (HIPC) and the Multilateral Debt Relief (MRDI) initiatives.

III. Outlook for countries in our constituency

23. **Argentina's** recent Article IV consultation was the first carried out since 1984 without a Fund arrangement in place and, even more importantly, without any outstanding credit to the Fund. This has helped to improve the quality of the policy dialogue both with the Fund staff and within the country. The foremost goal of the Argentine government is to bring as many people as possible out of poverty and to lay the foundations for a socially inclusive society. After **16 quarters of uninterrupted strong growth, at an average rate close to 9 percent a year, unemployment rate fell to 10,4 percent by 2006 from 17,8 percent en 2003 and poverty declined** to 33,8 percent from a peak of 57 percent in 2002. The government is fully aware that growth is a necessary but not a sufficient condition to reduce poverty and inequality. Thus, it is committed to use active public policies effectively to further progress on this front. With this goal in mind, it has introduced programs of direct support and training for the unemployed, it has increased, inter alia, the minimum pension benefits as well as introduced subsidies for public transportation and education, which help the most needed in the population. Perhaps **education is the most relevant sector to ensure equal opportunities for all and the capacity of the economy to sustain growth overtime**. In this respect, **the government has steadily increased the budget devoted to education and is bound, by law, to bring it up to a 6 percent of the Gross Domestic Product by 2010** (from a 3 percent or less in 2002).

24. Strong and sustainable growth has been accompanied by an overall macroeconomic stance that is rendering significant primary and overall fiscal surpluses, 4.4 percent and 2.4 percent respectively in 2005, as well as external current account surpluses (1.9 percent in 2005) consistent with our financial needs. **The combination of strong growth with fiscal and current account surpluses is an unprecedented feat in Argentina's economic history**. On the monetary policy front, the **Central Bank is carrying out a gradual and progressive tightening policy and has complied with the quantitative targets contained in its monetary program for 12 consecutive quarters now**. The Central Bank, after the repayment in full and in advance the country's debt to the Fund, is taking advantage of the favorable circumstances in the international capital markets to rebuild its reserves, a policy fully justifiable given the sizable debt burden still present. Such foreign exchange market intervention by the Central Bank is being duly sterilized by three channels: a public sector which is a net saver, a financial system that pays off its debts to the Central Bank in advance, and a Central Bank with a solid balance sheet. The Central Bank has implemented a deep policy of monetary absorption by means of a variety of tools such as the issuance of Central Bank securities, the cancellation of rediscounts, and repo and open market operations with Treasury securities. The early payback of liquidity assistance granted during the crisis due to the incentives provided by the Central bank, was one of the main sources of monetary

contraction in 2005 and 2006, evidencing both the strengthening of the banks' financial statements and the monetary authority's care for its capital.

25. All this, in the context of an unambiguous commitment by the government to contain inflation at tolerable levels, namely, those that would not jeopardize growth by prompting the practice of indexation. In sum, the government has all available macroeconomic instruments at hand and is using them in appropriate combination, as circumstances evolve. In the meantime, inflation expectation is on a clear downward trend and is now below the 11 percent inflation projected in the budget for the current year.

26. Finally, it is worth mentioning that **the current level of investment, largely oriented to the tradable sector, is at record levels and supported by high domestic savings**. At a year over year measurement, growth in investment at the end of the first quarter of this year has been 24.6 percent – another exceptional performance. As a percentage of GDP in nominal terms, investment reached 22 percent, exceeding the peak levels of the Convertibility years. In sum, the Argentine government feels, and the population confirms it with its support, that it is on the right track and remains committed to maintain responsible policies and to make its contribution to further a sustainable and equitable growth of the world economy.

27. During 2006, there were significant political and economic developments in **Bolivia**. On the political front, the election of constituents for the Constitutional Assembly and the referendum on departmental autonomy were held on July 2 and the Constitutional Assembly was installed on August 6 with the objective of discussing autonomy and elaborating a new constitution in the coming twelve months. On the economic front, the satisfactory economic performance observed last year is continuing in 2006, helped in part by favorable external conditions. Real GDP growth was 4.3 percent in the first quarter; inflation is low and is expected to stay within the band envisaged by the central bank in the period ahead; international reserves increased strongly; fiscal surplus rose to 3.9 percent of GDP in the first half of 2006; and the public debt-to-GDP ratio reduced, reflecting relief under the MDRI. The government nationalized the hydrocarbon sector in May and reached a new agreement with Argentina to increase the price and volume of natural gas exports. Negotiations with Brazil on the new price are underway and the authorities are conducting audits on the projects involved to establish whether companies fulfilled their investment commitments in order to evaluate the value of the nationalized assets and determine possible new participations in the new contracts. Furthermore, the government announced a land reform which will involve the redistribution of land that is unproductive or was obtained illegally and launched its National Development Plan which covers the next five years and is aimed to increase productivity and competitiveness; to improve living conditions and reduce poverty; to improve the external sector in economic, political, and cultural ambits; and to strengthen democracy through promoting social inclusion.

28. The Bolivian authorities highlight the need to attain greater equity, transparency, and accountability underpinned by cautious macroeconomic policies. They are assigning a greater state role in mining and hydrocarbons activities and the receipts from these sectors will be used to improve education, health, and sanitation to reduce poverty and inequality and strengthen infrastructure to enhance competitiveness. The authorities are aware that private investment is important for growth and job creation. At the same time, they emphasize that public investment should pay a complementary role to private investment. In this vein, the Bolivian government attaches great importance to the diversification of the economy to gradually reduce its high dependence on the hydrocarbon and mining sectors and, consequently, to lessen the vulnerability of external shocks.

29. During the first half of 2006, **Chile**'s economy expanded at around 5 percent, supported by a generally favorable external environment and still accommodating monetary policy. Domestic demand growth rate declined to 7.7 percent in the second quarter from above 12 percent in the first semester of 2005, mainly due to a normalization of an elevated investment rate last year. Consumption still expands rapidly, despite higher energy prices, with consumption credit growing at high rates. Salaried employment continues to grow vigorously, thus giving support for ongoing consumption growth. One-off events in mining will weigh on output growth during the second half of this year. The favorable external environment, still supportive financial conditions, and a more expansionary fiscal policy are expected to increase output growth next year, when the output gap is now expected to close. The risks to this central outlook remain broadly balanced and largely external. The main downside risks are the uncertainty in commodity prices, abrupt increases in international interest rates, and the uncertainty about the evolution of some important industrial economies, which would be offset by a stronger growth of the global economy and the continuation of high copper prices.

30. Although CPI inflation has been on the upper limit of the 2-4 percent target range, due mainly to the incidence of higher fuel prices, core inflation measures have fluctuated around 2½-3 percent. Inflation expectations remain well anchored around 3 percent while cost pressures are well contained. CPI inflation is expected to gradually move down toward the mid-point of the target range. To maintain projected annual inflation around 3 percent over the normal policy horizon, further interest rate increases will likely be needed, but the timing of these adjustments might take rather long, depending on incoming information and its implications on projected inflation.

31. Coherent with its continued adherence to the structural budget surplus of 1 percent of GDP, and in line with projected copper prices, the central government is expected to register an overall surplus of around 6.3 percent of annual GDP in 2006, and the public expenditures are estimated to grow by 5.3 percent. This strong position of public finances provides enough flexibility to adjust quickly in case of a deterioration of the external environment. The government authorities are mindful of the expansive effect on spending of high copper prices in 2007 and are committed to manage this revenue windfall prudently. In this direction, the

2007 Budget Law, to be sent to Congress in late September, forecasts an overall surplus with expenditures expanding at one-digit real rate, and prioritizes social spending in areas like health, education and social housing.

32. On structural reforms, Congress approved the Law of Fiscal Responsibility in August. This legal body establishes the obligation for future governments to set forth the basis for their fiscal policy during the first 90 days of their administration, the creation of an Economic and Social Stabilization Fund and a Pension Reserve Fund, and the authorization for the government to make capital contributions to the Central Bank on account of actual surplus. The government announced a 15-initiative package called *Plan Chile Compite*, which aims at promoting the economy's competitiveness, productivity and job creation by facilitating access to technology and financing, and fostering free competition, and a stable environment for investment. This plan, to which special priority has been given in the congressional discussion, is based on four pillars: entrepreneurship, technology and competitiveness, capital market, and governance for growth. Among others, two initiatives currently under discussion in Congress are expected to be approved during this year: (i) the bill that eliminates payment of stamp tax in all refinancing operations, and gradually reduces its current rate from 1.6 to 1.2 percent for new operations, and (ii) the bill that reduces and uniforms at 15 percent the tax rate applied on the import of software, new technologies and knowledge. Likewise, an agreement with Congress was recently reached to ensure a fast legislative deliberation on the Capital Market Reform II bill, which establishes appropriate conditions for the development of the risk and venture capital industry.

33. **Paraguay**'s economic performance under the Fund-supported program continues to be broadly satisfactory. Although adverse weather conditions reduced agricultural output, GDP grew by 3 percent in 2005, and inflation remained in the single digits. The macroeconomic framework for 2006 includes a growth objective of 3½ percent and a significant reduction in the inflation rate. Unpredicted flows of private capital, mainly foreign direct investment, led to higher than targeted international reserves and towards a significant real exchange rate appreciation. The accumulation of international reserves was necessary in order to establish a limit to the domestic money appreciation avoiding a potential deflationary and recessionary position of the economy. Given that the accumulation of international reserves created a domestic money supply, the monetary policy stance was defined by increasing short-term interest rates in order to "sterilize" the resulted money creation and contain the consequent inflationary pressures. Despite a reduction in the rate of advances on corporate income tax, the authorities managed to achieve a small surplus in 2005, and are introducing appropriate policies to reach the fiscal balance objective for the consolidated public sector in 2006. The structural reform agenda for 2006 includes the strengthening of the institutional framework for tax collection, the National Development Bank (BNF), the financial system to reduce vulnerabilities of the sector, the financial position of the Central Bank to improve its operational capacity, the efficiency and the quality of public enterprises, and finally, the design of an action plan to improve the country's investment climate economy and facilitate higher sustainable growth.

34. Under the Stand-by Arrangement that expired on August 16, **Peru**'s output grew by about 6½ percent in 2005, the fastest this decade, spurred by booming exports and private investment, and the momentum is being maintained in 2006. Fiscal prudence led to a further decline in the debt burden, to about 38 percent of GDP at end-2005. The central bank focuses on keeping inflation within the target band established under the inflation-targeting scheme, and a comfortable level of net international reserves provides an adequate buffer against external shocks. Structural reform efforts have been concentrated on improving the business climate, enhancing public financial management, and strengthening banking supervision and regulation to help reduce the risks associated with polarization. The 2006 electoral process concluded with a smooth transition to a newly elected government. The new authorities are committed to sustaining rapid economic growth and stepping up the fight against poverty, while maintaining prudent macroeconomic policies and intensifying structural reforms. In particular, they will ensure that the needed increase in social spending will be consistent with keeping in place a strict fiscal framework, preserving low inflation, and fostering a supportive investment environment. In view of the valuable contribution of past Fund-supported programs to macroeconomic stability and structural reform, shortly they will start discussions with the staff toward a new precautionary arrangement.

35. **Uruguay**'s economy continues to show a satisfactory performance. Although the country suffered an important shock due to the combination of a severe drought and high oil prices, the authorities' policies, as well as their agenda of structural reforms and proper incentives established by the government's measures, allows Uruguay to present a higher economic growth rate than originally projected, subdued inflation in line with the authorities' target range, and a primary surplus fully consistent with the authorities' objective. Moreover, unemployment rates have substantially decreased as a result of a sharp rise in employment. Therefore, even though there is still a considerable way to go, the Uruguayan government has shown significant progress in achieving its objectives of reaching a high level and better quality of employment, more social equity, and reducing poverty conditions, which are compatible and synergetic with higher and sustainable growth rates. Moreover, the strong fiscal performance has allowed Uruguay to substantially reduce its debt-to-GDP ratio, which, according to the Fund's projections, will conclude 2006 almost 40-percentage points below the figures Uruguay presented just three years ago, while the international reserve assets remain over the levels they had before the 2002 crisis. The Uruguayan authorities have taken advantage of the market confidence in the country, having had significant success in further reducing debt costs, increasing maturities, and diminishing rate risks. The last issuance of sixteen-year bonds in international markets at a favorable yield, and the prepayment of about half of Uruguay's outstanding debt to the Fund clearly demonstrated the authorities' skilful debt management.