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SM/03/217
Correction 1

August 18, 2003

To: Members of the Executive Board

From: The Acting Secretary

Subject: **Bolivia—Selected Issues and Statistical Appendix**

The attached corrections SM/03/217 (6/23/03) have been provided by the staff:

**Page 15, para. 28, third sentence**: "and their maturity is generally less than one year" removed

**Page 19, footnote 18, last sentence:** for "low imported inflation from"
read "low imported inflation (or even deflation, during certain periods, of import prices in domestic currency terms) from"

Questions may be referred to Mr. W. Lewis (ext. 37115) and Mr. Cueva (ext. 36516) in WHD.

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## II. Dollarization Issues[11]

24. This section describes the main characteristics of dollarization in Bolivia; the implications for monetary and exchange rate policy and the soundness of the financial system; and the challenges as the authorities adapt the policy environment and regulatory framework to dollarization and introduce incentives for a gradual and voluntary shift away from it.

### A. Dollarization in the Bolivian Financial System

25. **The dollarization of the financial system has its roots in the traumatic experience with inflation in the 1980s, culminating in the hyperinflation of 1984-85.** The episode of high inflation included administrative decisions to freeze dollar deposits—that represented about 20 percent of total deposits—in 1982, and convert them to local currency. After a three-year ban, dollar deposits were allowed again in 1985.

26. **Bolivia is probably the most highly dollarized economy among those that have stopped short of full dollarization.** Financial dollarization—defined as the dollar denomination of financial transactions—has grown to very high levels. The degree of deposit dollarization in the banking system rose from 15 percent in early 1986 to about 92 percent by May 2003, when dollar-denominated deposits accounted for 77 percent of broad money, and bank credit to the private sector in U.S. dollars was close to 97 percent of total credit.

27. **Local currency deposits are held mainly for transaction purposes.** The dollar is the currency of choice for storing value: in May 2003, boliviano-denominated deposits represented about a quarter of total demand deposits, less than 7 percent of total savings accounts, and just 2 percent of total time deposits. Demand deposits account for almost two thirds of total deposits in bolivianos, but just above one quarter of total deposits in U.S. dollars (Figure II.1 and Table II.1).

28. **Bank credit in bolivianos is scarce and most government securities are denominated in U.S. dollars.** Banks tend not to provide much credit in local currency because they lack financing in bolivianos. Despite repeated efforts by the Bolivian authorities to expand the issue of boliviano-denominated public debt instruments and extend their maturity, their volume remains small~~ and their maturity is generally less than one year~~.[12] In turn, the boliviano money market is shallow and volatile. Interbank credit in bolivianos has a large seasonal component associated with specific transactions in local currency, such as tax payments.

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[11] Prepared by S. Cueva, drawing from work by a technical assistance mission to Bolivia in May 2002, led by A. Ize.

[12] About 83 percent of nonfinancial public sector domestic debt was indexed to the U.S. dollars as of end-2002. The authorities plan to swap about half of the bonds held by the private pension funds—that represent about 53 percent of domestic debt—to inflation-indexed bonds in 2003.