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IMF Executive Board Concludes 2008 Article IV Consultation with Bolivia

On January 14, 2009, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with Bolivia.[1]

Background

In recent years, Bolivia experienced an export boom led by the hydrocarbons and mining sectors, which supported an improvement in the growth performance and a strengthening of the external and fiscal positions, but inflation accelerated and investment remained low in the context of persistent political tensions. The rise in export prices through mid-2008 led to exceptionally high external current account surpluses and reserve accumulation. Changes in the hydrocarbons taxation regime in 2005-06 further boosted fiscal revenue, shifting the public sector accounts from deficits into substantial surpluses. Increases in food prices combined with external surpluses that fueled demand pressures, caused inflation to rise to double digits in 2007-08. As part of its policy response, the central bank gradually allowed the Boliviano to appreciate, which contributed to a significant reduction in deposit dollarization. However, despite the predominantly positive trends, private investment rates remain among the lowest in the region.

[1] Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board. At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities.

In 2008, strong hydrocarbons and mining exports have continued to support Bolivia's growth performance as well as its fiscal and external positions. Real GDP growth has picked up to an estimated 5.9 percent (from an average of 4.7 percent in 2006-07), boosted in part by the start of production at a large mining project. The external current account has recorded a surplus of 11 percent of GDP, and central bank reserves have risen to historical highs. The combined public sector has also remained in surplus, benefiting from continued high export-based revenues.

Following an increase of inflation to 17 percent in the first half of 2008, twelve-month inflation declined to 12 percent at the end of the year. While the earlier increase was driven partly by food inflation, external developments generated demand pressures, compounding the effects of the supply shock. The external developments and associated partial monetization of the increase in reserves have contributed to double-digit inflation, which peaked in mid-year and has since eased somewhat. The role of excess aggregate demand in the inflationary process is evidenced by increases in non-food inflation. The deceleration in recent months reflects moderation in food prices, slower monetary expansion as reserves stabilized, a modest appreciation of the Boliviano, and substantial depreciations of trading partners' currencies.

Bolivia's overall fiscal position has improved in 2008, benefiting from high hydrocarbons-based revenue. The overall fiscal surplus is estimated to rise to 3.5 percent of GDP (from 2.6 percent of GDP in 2007), reflecting in part a strong increase in the surplus of the state energy company YPFB, which benefited from high natural gas export prices and the incorporation of activities such as refining and distribution, previously carried out by private sector enterprises. However, the non-hydrocarbon deficit has risen to an estimated 8.5 percent of GDP—reflecting, among other things, outlays on new social programs and higher fuel subsidies. Net public debt has continued to fall, with the overall fiscal surplus reflected in rising public sector deposits at the central bank.

Booming hydrocarbon and mining exports, together with high remittance inflows, led to a record-high current account surplus and large reserve accumulation, with major pressures on monetary/exchange rate policy during the first three quarters of 2008. In the period through September, the central bank stepped up open market operations, mainly through greater placement of indexed instruments. However, foreign exchange inflows were only partially sterilized, so that monetary expansion remained strong. Meanwhile, the authorities continued to implement small nominal upward adjustments to the exchange rate under the crawling peg regime. Since September, central bank reserves have declined somewhat, in part as a result of lower foreign exchange inflows and greater demand for foreign assets, resulting in a significant slowdown of monetary expansion. As a result, the growth rates of broad money and currency in circulation declined somewhat to, respectively, 24 percent and 35 percent for the year as a whole. During the last three months, the exchange rate has been stable, following about three years of gradual nominal increases. In real effective terms, the Boliviano has appreciated markedly over the past year, reflecting mainly the high inflation in Bolivia and significant currency depreciations in trading partners.

The banking system appears to be stable and liquid, although some vulnerable areas require special attention. Mainly reflecting sluggish demand in the context of political uncertainties, credit to the private sector has continued to expand at a very low pace, contributing to high levels of bank liquidity. Bank capitalization stands at 14 percent, and nonperforming loans have fallen to 5 percent of total loans. However, the level of restructured loans (about 9 percent of total loans or 40 percent of equity) still raises concerns. In addition, the system remains exposed to exchange-rate-induced credit risk, as loan dollarization remains high.

As Bolivia’s integration with international capital markets is very limited, the current global crisis affects Bolivia mainly through declines in commodity prices and remittances. Capital inflows have been negligible for many years, except for foreign direct investment (FDI) in hydrocarbons and mining, thereby largely insulating Bolivia’s financial system from the external turmoil. However, current trends in commodity prices will have a major impact on export receipts and related fiscal revenue—starting in 2009, because of the lagged response of contractual gas export prices.

Executive Board Assessment

Executive Directors noted that strong hydrocarbons and mining exports have continued to support Bolivia’s growth and macroeconomic performance. In 2008, real GDP growth picked up, the external current account surplus remained large, and international reserves reached record levels. The combined public sector balance remained in surplus, benefiting from continued high export-based revenues. The currency strengthened, which contributed to a further significant reduction in deposit dollarization.

Directors noted that risks to Bolivia’s outlook have increased because of the sharp deterioration of the global economic environment. Lower energy and mineral prices and an expected decline in remittances could slow GDP growth and push both the fiscal and external current accounts into deficits. Key policy challenges for the authorities will be to maintain sound fiscal and external positions, to consolidate the decline in inflation observed in recent months, and to reduce widespread poverty through increased investment.

Directors stressed that the increase in risks to the outlook requires a proactive fiscal response. They welcomed the authorities’ fiscal strategy, which includes cuts in lower-priority capital expenditure while preserving social spending. To reduce dependency on volatile export-based revenue and ensure inter-generational sharing of hydrocarbon wealth, Directors saw a need to target a reduction in the non-hydrocarbons fiscal deficit over the medium term. They encouraged the authorities to seize the opportunity of declining oil prices to reduce gradually hydrocarbons subsidies, while using part of the resulting fiscal savings to protect vulnerable groups. Appropriate wage restraint, and a rigorous prioritization of investment projects will also be important.

Directors emphasized the importance of well-designed structural reforms for further strengthening Bolivia's fiscal position. They considered that the tax system could be simplified to improve its efficiency and equity, including through streamlining the value added tax framework and closing loopholes in the corporate income tax. They noted the need to better balance expenditure allocations and available resources at each level of government, and to improve the budget process.

While recognizing the role of supply shocks in raising inflationary pressures, most Directors saw merit in a more active monetary policy to help speed up the decline in inflation to single digits. In particular, they encouraged the central bank to conduct open market operations in a manner consistent with bringing about positive real interest rates on non-indexed bonds, and thereby eliminate the incentive for indexation. Higher real interest rates and lower inflation would also help consolidate the reduction in dollarization achieved in recent years. A few Directors cautioned against proposals that could affect the independence of the central bank.

Executive Directors considered the real effective exchange rate level to be broadly appropriate. Many Directors believed that greater exchange rate flexibility, supported by an appropriate monetary policy framework, would help absorb possible negative external shocks stemming from adverse movements in commodity prices. A few Directors, however, noted that greater flexibility in the current environment could rekindle inflationary pressures and risk reversing the de-dollarization trend of recent years.

Directors noted that Bolivia's financial sector appears to be stable and highly liquid, and is unaffected by the global financial crisis. Nonetheless, efforts to reduce vulnerabilities need to continue. Directors welcomed plans to fully adopt international accounting standards and the ongoing efforts to improve risk management practices in banks. They encouraged the authorities to introduce prudential regulations that mitigate market risks and credit risks from dollarization. Other pending reforms to be addressed include the introduction of a deposit insurance scheme, the adoption of legislation governing corporate bankruptcy and restructuring. A few Directors called for the strengthening of the anti-money laundering regime. Directors supported the proposed FSAP update in 2010.

Directors stressed the importance of improving the investment climate—including constructive negotiations with investors in disputed contracts—as Bolivia's private investment rate remains significantly below the levels observed in the past decade and well below the regional average. This will be the key to fostering broad-based economic growth and reducing poverty.

Public Information Notices (PINs) form part of the IMF's efforts to promote transparency of the IMF's views and analysis of economic developments and policies. With the consent of the country (or countries) concerned, PINs are issued after Executive Board discussions of Article IV consultations with member countries, of its surveillance of developments at the regional level, of post-program monitoring, and of ex post assessments of member countries with longer-term program engagements. PINs are also issued after Executive Board discussions of general policy matters, unless otherwise decided by the Executive Board in a particular case. The staff report (use the free Adobe Acrobat Reader to view this pdf file) for the **2008** Article IV Consultation with **Bolivia** is also available.

Bolivia: Selected Economic Indicators

	2005	2006	2007	Est. 2008	Proj. 2009
	(Annual percentage changes)				
Income and prices					
Real GDP	4.4	4.8	4.6	5.9	4.0
GDP deflator	5.9	13.7	9.3	12.0	-2.3
CPI inflation (period average)	5.4	4.3	8.7	14.0	8.9
CPI inflation (end of period)	4.9	4.9	11.7	12.0	8.0
	(In percent of GDP)				
Combined public sector					
Revenues and grants	30.9	34.3	34.6	36.3	34.0
Of which: Royalties on hydrocarbons	6.5	9.4	9.0	8.3	6.9
Expenditure	33.2	29.8	32.9	34.0	35.2
Overall balance	-2.2	4.5	1.7	2.4	-1.2
Total net public debt	71.1	41.9	26.8	17.0	17.9
External sector					
Current account	6.5	11.3	13.2	11.0	-0.4
Merchandise exports	29.2	33.6	33.8	35.7	26.6
Of which: Natural gas	11.3	14.5	15.0	17.2	12.2
Merchandise imports	24.4	24.4	25.9	29.3	29.5
Gross international reserves					
In millions of U.S. dollars	2,042	3,385	5,587	7,796	8,304
In percent of broad money	47.0	65.9	78.9	84.5	90.1
	(Changes in percent of broad money at the beginning of the period)				
Money and credit					
NFA of the financial system	20.7	31.3	35.4	28.0	5.6
NDA of the financial system	-6.6	-12.9	-3.7	-4.4	2.0
Of which: Credit to the private sector (in percent of GDP)	39.6	34.7	33.1	31.8	32.5
Broad money	14.1	18.5	31.7	23.6	7.6
Interest rates (percent, end of period)					
Yield on treasury bills in local currency	7.9	5.4	6.2	...	...
Yield on treasury bills in U.S. dollars	7.4	4.9	4.6	...	...

Sources: Bolivian authorities; and IMF staff estimates and projections.