Annual Report Summary

2002

BANCO DE MEXICO

APRIL 2003

I. Introduction

In 2002, the Mexican economy performed less favorable than expected at the onset of the year: output grew at a slower rate while annual CPI inflation increased compared to the previous year and was above the set target.

Mexico's GDP grew only 0.9 percent in 2002. This modest increase responded mainly to the weakness of industrial output in the United States. Consequently, Mexican exports registered only a modest recovery.

The lack of strength of industrial output during 2002 was also reflected in scant job creation. At the end of the year, the number of workers insured by the Social Security Institute (*Instituto Mexicano del Seguro Social*, *IMSS*) rose by only 51,018. The weakness in the labor market caused the average open unemployment rate (*Tasa de Desempleo Abierto*, *TDA*) in urban areas to go up from 2.5 percent in 2001 to 2.7 percent in 2002. The increase in earnings and contractual wages were an additional factor that curbed job creation.

In 2002, for the first time in four years, annual headline inflation was above target (4.5 percent). Annual CPI inflation rose from 4.4 percent at year-end 2001 to 5.7 percent in December 2002. The difference between annual inflation and the target mainly responds to the significant increases during the year in prices administered and regulated by the public sector, and in agricultural prices. A comparison of the performance of headline and core inflation confirms such results. Annual core merchandise inflation decreased considerably during the year and was not affected by the depreciation of the exchange rate. Annual core inflation of services also declined, but at a slower rate than core merchandise inflation due to the rebound in annual inflation of housing services and the downward rigidity exhibited by contractual wage increases throughout most of the year.

In 2002, monetary policy focused on preventing headline inflation from contaminating both inflation expectations and core inflation. Efforts in both the inflation and fiscal fronts implemented over the last few years have made real interest rates decline to historically low levels. This has had a significant impact on the recovery of consumer credit and, thereby, on consumer spending. During the past two years economic growth has mainly been sustained by this type of expenditure.

II. International Environment

Since early 2002, a cyclical rebound in the world economy brought to an end a brief period of output contraction in the main industrialized economies. For Mexico, this implied a weak recovery of its export markets, which lost steam in the second half of the year.

The pace of recovery in the U.S. economy was uneven throughout the year. During the first quarter, GDP growth in the U.S. was reflected in a rebound of world trade and of the manufacturing sector, thus nurturing expectations of a quick upturn of the global economy. However, this optimism was tempered by the poor results in some of the most important indicators during the second quarter and by a wave of corporate bankruptcies of unprecedented scale.

The recovery in Japan and in the euro area continued to depend to a large extent on the strengthening of external demand.

For Latin American countries, 2002 was a difficult year due both to the weakness of the world economy and to domestic factors. The region's GDP contracted during the year, albeit showing a more favorable performance in the last few months. Furthermore, during the last quarter the deterioration of financial markets was contained, after the EMBI+ Latin spreads had reached their highest levels since 1998 in the previous quarter. This outcome was due, to a large extent, to the high levels of the subindex for Argentina and to the rise in that for Brazil. Chile's economy, like that of Mexico, managed to decouple from the financial volatility that swept the region, despite being also affected by the feeble world economy and experiencing a downturn in GDP growth with respect to the previous year.

III. Evolution of the Economy: General Overview

Economic Activity

The main aspects that characterized the evolution of economic activity in 2002 were as follows:

a) After having fallen during 2001, real GDP rose 0.9 percent. GDP growth in 2002 was below authorities and private sector economic analysts' forecasts.

b) Aggregate demand also went up slightly due to increases in consumer spending and in exports of merchandise and services.

c) Consumption continued to contribute positively to GDP growth (despite registering its lowest level since 1996).

d) Private consumption, the main component of aggregate demand, contributed once more to the expansion of economic activity throughout the year. However, seasonally adjusted figures show this type of expenditure declined in the second half of the year.

e) For a second year in a row, investment contracted in relation to 2001, thus making a negative contribution to economic growth.

f) Total public expenditure rose as reduced consumption was offset by the expansion of investment.

g) Despite the weakness of external markets, Mexico's exports of merchandise and services increased slightly, after having declined in the preceding year.

h) Domestic saving as a proportion of GDP remained unchanged compared to 2001.

i) The monthly business climate and confidence indicators from Banco de México's surveys of private sector analysts and manufacturing firms lost strength in the second half of the year.

j) The only sector that made a considerable contribution to modest GDP growth was that of services as industrial activity remained unchanged and the agricultural sector contracted.

k) For a second year in a row, both the level of GDP and its annual percentage change were lower in real terms than potential GDP figures for that year.

Employment, Wages and Productivity

The slow expansion of the Mexican economy was accompanied by a modest recovery of demand for labor. The increase in earnings and contractual wages also added to such conditions.

The following were the most outstanding aspects of Mexico's labor market in 2002:

(a) A modest recovery of employment (after a substantial reduction in 2001), notwithstanding the falls registered in a significant number of sectors.

(b) Regional differences in formal job creation, with cuts in the number of workers in northern frontier states and in the center region. The contraction of employment in the northern states stemmed from the loss of strength in the maquiladora industry and other export-related activities.

(c) A rise of open unemployment in urban areas. In fact, this increase turned out to be lower than expected because some displaced workers took informal jobs.

(d) Moderate increases in nominal contractual wages, although these remained above expected and observed inflation. The spread between both indicators narrowed towards the end of the year.

(e) Reduced growth of average real wages in the manufacturing sector, including the maquiladora industry.

(f) Gains in labor productivity in the maquiladora and non-maquiladora industries. These results mostly stemmed from cyclical factors and reflected a decline in employment more than a recovery of output.

(g) Higher productivity in the non-maquiladora manufacturing sector due to the fact that labor productivity gains exceeded increases in real average earnings.

(h) Higher unit labor costs in the maquiladora industry, thus leading to a loss of competitiveness in that sector against other countries.

External Sector

During 2002, Mexico's external sector performance was influenced by the following factors: the weakness of external demand (particularly that of the United States); rising international oil prices; modest increases in domestic output and demand (which reduced demand for imports and, thereby, narrowed the current account deficit); and large capital inflows.

The most outstanding features of Mexico's external sector were as follows:

a) A slight increase in the value of both exports and imports of goods compared to the previous year.

b) Exports of non-oil goods fell slightly due to the weakness of the world economy, particularly that of the United States. Moreover, the reduction in this type of exports can also be attributed to the loss of competitiveness of the Mexican economy due to the lack of structural changes, while other economies that compete in the same external markets as Mexico have made progress in this field.

c) A substantial increase in oil exports due to rising international oil prices throughout the year.

d) A slightly higher share of Mexican products in U.S. imports, albeit having declined in the second half of 2002. This mainly responded to the slower expansion of non-oil exports. Furthermore, there were other countries whose exports performed better in that market.

e) A modest rise in merchandise imports set off by slight increases in output, domestic demand and manufacturing exports (which use imported inputs).

f) A narrower trade balance deficit due to the higher value of oil exports and the modest growth of merchandise imports.

g) A large inflow of resources from workers' remittances.

h) A contraction in the balance of payments' current account deficit mostly financed with long-term external resources.

i) A considerable amount of foreign direct investment accounting for 97 percent of the current account deficit.

j) A surplus in the balance of payments' capital account, mainly due to inflows of long-term FDI from the private sector and to a reduction of Mexican residents' assets held abroad.

k) A reduction in public sector and commercial banks' external debt.

l) A significant increase in international reserves.

Total trade deficit in 2002 was 7.997 billion US dollars, 19.7 percent less than in the previous year (9.954 billion). This result originated mostly from increased oil exports.

The average price of the Mexican crude oil-export mix was 21.58 US dollars per barrel, 3.01 dollars higher than in 2001. As a result, the total value of oil exports went up 13.1 percent.

From a regional perspective, the narrowing of Mexico's total trade deficit stemmed from the combination of a larger surplus with the members of the NAFTA region, a change from surplus to a slight deficit with other countries in the American continent, and a higher deficit with Europe and Asia. However, Mexico's rising trade surplus with the NAFTA members more than compensated the larger deficits with other regions.

The performance of Mexico's exports to the United States meant Mexican products slightly increased their share in U.S. imports, from 11.5 percent in 2001 to 11.6 percent in 2002.

Furthermore, Mexico maintained its position as the second most important exporter of goods to the United States behind Canada and ahead of Japan. Nonetheless, although the value of Mexican exports to the United States surpassed those of China throughout the year, this trend reverted in the second semester.

The current account deficit totaled 14.058 billion US dollars (2.2 percent of GDP). These figures compare favorably with those observed in 2000 and 2001, when the deficit reached 18.159 and 18.008 billion US dollars, and 3.1 and 2.9 percent as a proportion of GDP, respectively. The current account deficit was financed primarily with long-term external resources.

The capital account registered a surplus of 20.377 billion US dollars in 2002. This figure resulted from the combination of inflows of long-term resources from the private sector via FDI, and a reduction of foreign assets held by Mexican residents. Mexico received an inflow of foreign direct investment of 13.627 billion US dollars, a significant figure considering the prevailing uncertainty in the world economy during the year.

The other items of Mexico's balance of payments were characterized by the following results: a 770 million US dollar positive flow in the errors and omissions line item; and an accumulation of Banco de México's international reserves of 7.104 billion US dollars. Thus, the stock of international reserves totaled 47.984 billion US dollars in December 31, 2002.

Public Finances

Economic Balance

The non-financial public sector deficit totaled 75.6 thousand million pesos in 2002 (1.23 percent of GDP). The primary surplus, defined as the difference between revenues and expenditures excluding public sector's financial costs, was 108.9 thousand million pesos.

The above results include 37.9 thousand million pesos from the net cost of the winding up of BANRURAL (*Sistema BANRURAL*) and the creation of the Rural Finance Agency (*Financiera Rural*, *FR*), authorized by Congress in December 2002. Excluding this expenditure, the public sector had a deficit of

37.7 thousand million pesos and a primary surplus of 146.9 thousand million pesos.

Monetary and Credit Aggregates

Monetary Base, Net Domestic Credit and Net International Assets

At year-end 2002, the stock of the monetary base (mostly made up of bills and coins in circulation) was 263.9 thousand million pesos, hence implying an annual increase of 17 percent. This figure represents a 6.4 percent deviation from the forecast set out in the Monetary Program for 2002 (an average rate of 4.5 percent during the year).

The monetary base rose as a proportion of GDP, thus continuing the remonetization process that began in 1997. Remonetization was bolstered by microeconomic factors. The main cause was a change in credit institutions' revenue strategies destined to establish higher charges for the financial services offered by these entities. This banking policy led to an increased use of bills and coins by the public in order to reduce the costs of withdrawing cash from banks. The expansion of the informal economy might be another element that has brought about an unanticipated increase in the demand for base money.

Monetary Aggregates and Financing to the Private Sector

The annual real growth rate of the stock of circulating currency (M1) was 6.5 percent in 2002, figure below that of 2001 (15.4 percent). In particular, the expansion of checking accounts in domestic currency slowed considerably. The real annual growth rate of these accounts declined from 14 percent in December 2001 to 7 percent at the end of 2002.

The stock of bank financing to the private sector began to recover in 2002. Nonetheless, as a percentage of GDP, this type of credit is currently at its lowest level during the last decade.

The fall of interest rates to historically low levels has influenced the recovery of consumer credit granted by the banking and non-banking sectors significantly.

Flow of Funds

Public Sector Borrowing Requirements in 2002 (2.6 percent of GDP) were financed by external (2.2 percent of GDP) and private sector (0.4 percent of GDP) surpluses. The private sector was a net saver in the domestic market (3.3 percent of GDP) and a net borrower of external resources (2.9 percent of GDP). Both positions were below levels observed in 2001. In contrast, the public sector funded its large financing requirements mainly through the domestic market. Therefore, savings generated in the domestic financial system were channeled to the public sector, leaving limited resources for the private sector.

Inflation

After having attained the inflation target set forth in the monetary programs for three consecutive years, the inflation target for 2002 was not met. In December 2002, annual CPI growth was 5.7 percent, 1.2 percentage points above the 4.5 percent target. Meanwhile, annual core inflation, which is a more accurate indicator of medium-term inflationary pressures, recorded 3.77 percent at year-end, 1.31 percentage points lower than in 2001.

Among the factors that explain why the inflation target was not attained in 2002 are: i) prices of electricity for residential use and domestic gas rose substantially above levels consistent with the annual inflation target; and, ii) the considerable increases in prices of fruits and vegetables.

During 2002, annual core inflation remained on the same downward path followed since 1999 and ended below headline CPI inflation. Just as in previous years, merchandise prices decreased at a slower rate than services prices despite the depreciation of the exchange rate. Prices of services grew at a slower rate due to the sluggish convergence of nominal wage revisions. While core merchandise inflation fell 1.9 percentage points from December 2001 to December 2002, core services inflation did so by 0.64 percentage points.

IV. Monetary and Exchange Rate Policy

Monetary Policy

During the last few years, Banco de México's monetary policy regime has been adjusted to changing circumstances in Mexico's economy. This gradual process has led to a more efficient and transparent monetary policy.

As part of the inflation-targeting scheme, the Board of Governors of Banco de México made four important decisions in 2002: i) a long-term inflation objective was established for the CPI; ii) the adoption of a 3 percent target for 2003 and subsequent years; iii) a variability interval of plus/minus one percentage point was set around the inflation target; and iv) the announcement on predetermined dates of monetary policy decisions, accompanied by press releases explaining the reasons for such decisions.

Based on a careful analysis of its own and other countries' experiences, the Board of Governors of Banco de México considered that since inflation and uncertainty on the economy were significantly reduced, it was therefore convenient to announce monetary policy decisions on predetermined dates.

Among the advantages of adopting a calendar are the following:

a) It provides more certainty to the public regarding the monetary policy stance and the desirable path of interest rates in the short term.

b) It emphasizes the Board of Governor's medium-term outlook for monetary policy decisions.

c) It allows the monetary authority to inform the public in a regular and timely manner on the balance of risks behind the monetary policy stance.

Based on the above, the Board of Governors of Banco de México determined that as from January 2003 all announcements regarding monetary policy decisions would be made on preestablished dates. At the same time, the monetary authority decided to reserve to itself the right to alter the monetary policy stance on dates different from those set in the calendar, in the event of exceptional circumstances that might require the Central Bank's intervention.

As a result, twenty-three dates during the year were established to announce monetary policy decisions. Two types of announcements will be made on a monthly basis:

a) End-month announcement: an announcement on whether or not the monetary policy stance is modified, to be made on the Friday preceding the last Monday of every month, except in December, when it will be made ahead of time.

b) Mid-month announcement: eleven additional dates were established for intermediate announcements, to be made on the Fridays at the mid-point of the interval between end-month announcements. No intermediate announcements were programmed for December.

Meanwhile, the reasons behind the Board of Governors decision to adopt the CPI as its variable for evaluating the inflation target were as follows:

a) It is the best known and most widely used price indicator.

b) It is used as a reference in countless contracts and negotiations.

c) It is published in a timely and regular basis and is not subject to revisions.

The main elements considered by the Board of Governors of Banco de México in determining the 3 percent level for the long-term inflation target are:

a) Research indicates that price indexes tend to overestimate inflation due to measuring biases.

b) The adoption of a very low long-term inflation target could also imply deflation.

c) An overly ambitious low-inflation target could narrow the margin for monetary policy decisions in a scenario of deflation.

d) Inflation targets in almost all developing countries are set around 3 percent.

It should be emphasized that even when monetary policy is continually aimed towards attaining the inflation target, occasional deviations from the target must be expected. Accordingly, the Board of Governors decided to establish a variability interval of plus/minus one percentage point around the inflation target. This decision is based on the following considerations:

a) Monetary policy influences price behavior through different indirect channels known as monetary policy transmission mechanisms, which are subject to considerable lags and to some indeterminacy.

b) Some prices are highly volatile and undergo unpredictable changes.

c) Unanticipated changes in wages and in the exchange rate also affect inflation. Given the lags under which the transmission mechanism operates, monetary policy can only revert these effects after a relatively long period.

The above interval was determined based on historical experience regarding the atypical behavior of core inflation and those CPI subindexes excluded from core index calculations.

Starting December 2003, Banco de México will periodically evaluate the attainment of the long-term inflation target. This will strengthen the Central Bank's commitment to ensure overall price stability, offer society a useful reference regarding the future path of inflation, and contribute to more uniformly distributed price and wage adjustments throughout the year.

Elements of the Monetary Program

The following factors were considered in the Monetary Program for 2002:

a) Inflation targets.

b) Framework for monetary policy implementation.

c) Framework for assessing economic conditions and inflationary pressures.

d) Policy for communicating with the public.

Monetary Program Implementation

In 2002, Banco de México modified its monetary policy stance on three occasions: On February 8, the *corto* (short position) increased from 300 to 360 million pesos; on April 12, it was brought down to 300 million pesos; on September 23, it was raised to 400 million pesos and, finally, on September 16, it was raised to 475 million pesos.

Monetary policy tightened in February in order to forestall the deterioration of inflation expectations and its consequent contagion on prices that resulted from the partial elimination of the electricity subsidy announced by the Federal Government on January 29, and which went into effect on February 8. Unlike other factors that could have caused a rebound in inflation and which had been anticipated in the Monetary Program for 2002, the aforementioned measure was unexpected.

Monetary policy actions implemented in February, coupled with other factors, had the desired effect on inflation expectations. Meanwhile, annual core inflation went down in February and March. Although annual inflation of services had not declined significantly in the first few months of the year, there were factors pointing to a decrease. Among these were the moderation in contractual wage increases, lackluster economic activity, and the slack in the labor market.

In this context, on April 12, the Board of Governors of Banco de México decided to reduce the *corto* to 300 million pesos. Nevertheless, during the period following the implementation of this measure several negative external events arose. Throughout the third quarter emerging markets faced an adverse international environment as well as increased pessimism regarding the recovery of the United States economy. This had a negative impact on growth expectations for the Mexican economy. Furthermore, risk premiums on developing countries' sovereign bond issues increased considerably while the main stock market indexes in the United States continued to fall.

The adverse international environment influenced the behavior of the exchange rate and of yields on Mexican sovereign bonds. The latter led to a significant rise in domestic interest rates in September. Moreover, concerns regarding the possible effects of a depreciation of the peso on domestic inflation arose, in addition to doubts regarding the attainment of the annual inflation target due to the evolution of those prices that are not included in core inflation calculations.

The above factors, together with rigid inflation expectations during the year, suggested that monetary policy needed to tighten in order to reach the inflation target for 2003 and to send a clear message to the market of Banco de México's intentions to act in an appropriate manner by creating monetary conditions consistent with the target. Thus, on December 23, the Board of Governors of Banco de México decided to raise the level of the *corto* from 300 to 400 million pesos.

Inflation expectations continued on an upward trend during October and November 2002. On December 6, the level of the *corto* was raised from 400 to 475 million pesos. The decision to tighten monetary policy responded to the need to induce a downward movement on inflation expectations in the medium run and foster the monetary conditions so that the annual growth in consumer prices could converge to the 3 percent inflation target for 2003.

In 2002, the Board of Governors of Banco de México considered necessary for credit institutions to make a new mandatory deposit at the Central Bank amounting to 150,000 million pesos starting September 26. This deposit replaced the one then existing for 95,396 million pesos. This action was based on the fact that financial programming pointed to an expansion of liquidity in the next few months stemming from central bank operations with the Federal Government and from the amortization of monetary regulation bonds. The characteristics of the new deposit were as follows:

a) The term would be indefinite and the amount would be determined according to each bank's liabilities.

b) The interest rate would be linked to the bank funding rates published by Banco de México on a daily basis, capitalized daily and paid every 28 days.

The new deposit did not modify Banco de México's monetary policy stance.

Exchange Rate Policy

Mexico's exchange rate policy is conducted as per the guidelines established by the Foreign Exchange Commission. Mexico has operated under a floating exchange rate regime since 1995, which has proved to be very effective in partially absorbing the impact from external and domestic shocks.

The exchange rate appreciated during the first three months of the year, reaching 9.01 pesos per US dollar on April 1. From that date onwards it began to depreciate until it leveled at 10.40 pesos per US dollar at the end of 2002, thus accumulating a depreciation of 13.5 percent compared to its level at year-end 2001.

From March to September, the trajectory of the exchange rate was consistent with increased country risk perceptions during that period. However, in the last quarter of 2002 the net yield on Mexico's sovereign debt dropped nearly 96 basis points (UMS26 bonds), while the Mexican peso depreciated 1.8 percent vis-à-vis the US dollar. This contrasted with the positive correlation between peso exchange rates and country risk indicators for Mexico during previous quarters.

Among the factors that might explain the difference between exchange rate fluctuations and country risk indicators is the positive correlation between peso/US dollar and US dollar/euro exchange rates. The latter correlation continued until June and ceased in the third quarter of 2002. In this regard, the depreciation of the peso vis-à-vis the US dollar during the last quarter of 2002 was accompanied by a 6.3 percent depreciation of the US dollar against the euro. The correlation between the peso/US dollar and US dollar/euro rates could be associated with reduced capital flows from the United States to Mexico due to the economic slowdown in that country.

Nevertheless, the correlation between the Mexican peso and different financial variables has been unstable or short lived. Moreover, it could have also been sustained by speculative behavior, above all in episodes of reduced liquidity in exchange markets as occurred in the last few weeks of December 2002. Fluctuations in the peso/dollar exchange rate might have also responded to fundamental factors that affect the behavior of real variables, which in the long run, determine the equilibrium level of the real exchange rate. The most important of these factors are:

a) Uncertainty concerning the recovery of the United States economy in 2003.

b) A faltering belief among investors that the pending structural reforms needed by the Mexican economy to reach higher levels of productivity and economic growth would be implemented.

c) A disparity between productivity in the Mexican manufacturing exports sector and productivity in the United States' manufacturing sector in 2002.

d) A highly intense competition faced by Mexican exports in the United States.

During 2002, there was no evidence suggesting that exchange rate fluctuations might have caused an upward pressure on prices and, therefore, hampered the attainment of the inflation objective. However, Banco de México always remained cautious and ready to counter such pressures.

The weakening of the pass-through effect from exchange rate fluctuations to domestic prices may have responded to the following factors:

a) Today, economic agents are more prudent when modifying their prices, as the exchange rate usually undergoes unpredictable downward and upward movements.

b) Feeble aggregate demand does not contribute to an environment suited to pass fluctuations from the exchange rate on to consumers.

c) At the onset of the year thousands of contracts and prices were determined based on a higher depreciation rate.

Thus, the latter seems to have already been included in a large number of prices.

d) Interest rates have increased in tandem with the depreciation of the exchange rate.

V. Final Remarks

In 2002, the international environment continued to influence the performance of the Mexican economy. Although the international situation was not completely unfavorable during the year, the contraction of industrial output in the United States led to lackluster growth in output and employment in Mexico, especially in those sectors that are most closely linked to the export sector. Thus, annual GDP increased only by 0.9 percent in 2002. Moreover, the sluggish expansion of output resulted in equally modest job creation.

Real wages continued to improve in 2002. However, average nominal contractual wage increases remained above inflation expectations throughout the year and constituted an obstacle for the creation of employment and a source of inflationary pressures. The latter underlines the need for a labor reform which strengthens firms' ability to generate job opportunities for all Mexicans.

Annual CPI inflation was 5.7 percent in 2002, meaning that the inflation target was not met for the first time in four years. This result was due to substantial increases in the subindexes of administered and regulated prices and of agricultural prices. Meanwhile, core inflation, an indicator of the medium-term trend, continued on the downward path it has shown in recent years. In this respect the fact that the exchange rate depreciation did not forestall the decline in annual inflation of the merchandise subindex is noteworthy.

Inflation did not deviate further from the target because monetary policy centered on staving off any possible contagion from medium-term inflation expectations, and on bringing down services inflation.

The various strengths of Mexico's economy allowed orderly conditions in the country's financial markets and helped to avoid contagion from other economies in the region that experienced periods of high volatility. As a result, the effects of the global economic downturn on Mexico's economy have been less intense than in other countries.

Perseverance in monetary and fiscal discipline is crucial to return to the path of high and sustainable growth. In this regard, Banco de México reiterates its commitment to continue its implementation of firm and timely monetary policy in order to ensure an environment of low and stable inflation –3 percent within an interval of plus/minus one percent by 2003- in the context of today's inflation-targeting scheme. One feature of this regime is its emphasis on the transparency and communication of monetary policy actions. As a result, in 2002 the Board of Governors of Banco de México decided to implement additional communication mechanisms to improve the frequency and timeliness of information being released. Thus, as of 2003 monetary policy decisions are published on predetermined dates. This new element will help make monetary policy more effective and will strengthen the achievements in the abatement of inflation attained in the last few years.

The lack of political consensus regarding pending structural reforms continued to represent a serious obstacle for the country's modernization process and constitutes an additional element of uncertainty in the midst of a particularly complex international environment. Under such a scenario, interest rates and the exchange rate could become more volatile. This could hamper domestic and external capital flows, thus worsening current and future possibilities for the growth and modernization of the country's productive structure necessary to create the permanent and well paid jobs required by the country.