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Uruguay: 2009 Article IV Consultation—Staff Report; Staff Statement and Supplement; Public Information Notice on the Executive Board Discussion; and Statement by the Executive Director for Uruguay

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of the 2009 Article IV consultation with Uruguay, the following documents have been released and are included in this package:

- The staff report for the 2009 Article IV consultation, prepared by a staff team of the IMF, following discussions that ended on September 17, 2009, with the officials of Uruguay on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on November 9, 2009. The views expressed in the staff report are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF.

- A staff statement of November 9, 2009, updating information on recent developments.

- A Public Information Notice (PIN) summarizing the views of the Executive Board as expressed during its November 9, 2009 discussion of the staff report that concluded the Article IV consultation.

- A statement by the Executive Director for Uruguay.

The document listed below has will be separately released.

Selected Issues Paper

The policy of publication of staff reports and other documents allows for the deletion of market-sensitive information.

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URUGUAY

Staff Report for the 2009 Article IV Consultation

Prepared by the Staff Representatives for the 2009 Consultation with Uruguay

Approved by Rodrigo Valdés and Dhaneshwar Ghura

October 21, 2009

- **Mission**. A staff team comprising Mr. Gelos (head), Ms. Babihuga, and Mr. Sosa (all WHD); Mr. Zanna (SPR); and Mr. Wezel (MCM), conducted the 2009 Article IV consultation discussions during September 3–17, 2009. Staff met with Central Bank President Bergara, Minister of Finance García, Minister of Energy and Industry Sendic, other key senior officials, and representatives of the IDB, the World Bank, and the private sector. Mr. Vogel (OED) also participated in various meetings and Mr. Valdés (WHD) joined the mission for the concluding meetings.
- **Previous consultations**. The 2008 Article IV consultation was concluded by the Executive Board on October, 24, 2008. At that time, Directors noted that prudent macroeconomic policies, aided by favorable external conditions until mid-2008, had enabled Uruguay to maintain vigorous export and economic growth, lower unemployment, and significantly reduce vulnerability to shocks. However, they noted that the Uruguayan economy remained vulnerable. Most Directors considered that fiscal policy had been expansionary, with the primary balance deteriorating since 2006. They stressed that, with the gross public debt ratio still relatively high, it would be essential to maintain high primary surpluses to reduce the debt burden further. Directors welcomed the operations carried out to improve the debt profile and to reduce debt dollarization.
- **Analytical work**. Topics for selected issues papers were discussed with the authorities early in the process, and preliminary results were presented during the mission. The Selected Issues Papers include work on: (i) the impact of commodity prices on growth and the fiscal position in Uruguay; (ii) the role played by regional factors in driving output fluctuations in Uruguay, and the vulnerability of the Uruguayan economy to regional shocks; (iii) an assessment of the real exchange rate in Uruguay; and (iv) a discussion of the system of dynamic loan loss provisions in Uruguay.
- **Exchange system**. Uruguay has accepted the obligations of Article VIII and maintains a floating exchange rate system free of restrictions on current international payments and transfers, and there are no significant controls on capital inflows.
- **Statistical issues**. Uruguay subscribed to the Special Data Dissemination Standards (SDDS) in February 2004, and meets the SDDS specifications.

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I. Staff Appraisal and Executive Summary

1. **Uruguay entered the global recession with a more resilient economy than in past episodes.** Strengths stemmed from a more robust and well-regulated banking system, a solid external position, and a more flexible exchange rate regime. In addition, skillful public debt management had greatly reduced financing vulnerabilities. Generally sound policies had taken advantage of the benign external conditions prevalent up to the crisis to consolidate macroeconomic stability, reduce the debt-to-GDP ratio, and lower poverty levels. All these factors, together with low leverage levels by companies and households, underdeveloped capital markets, and banks' low exposure to foreign toxic assets, contributed to dampening the impact of the global crisis.

2. **The authorities' policy response adequately balanced different trade-offs in response to the global shock.** Fiscal policy was maintained at broadly keeping the significant increase in nominal expenditure growth as planned, allowing automatic stabilizers to work, and dampening the impact of lower export and private investment demand. Concerns about an overshooting of the exchange rate during the period of financial turbulence led to forceful but temporary intervention. Persistent inflationary pressures resulted in a more restrictive monetary stance than in other emerging markets. This policy mix was largely appropriate, partly because Uruguay's economy was still operating around potential.

3. **The economy is well positioned to benefit from the global recovery.** Considerable FDI in recent years has contributed to substantial productivity improvements in the tradable sectors, including in agriculture and agribusiness. Combined with a stable macroeconomic environment, this will help Uruguay to benefit from the recovery of global demand for its exports. Nevertheless, the near-term growth outlook still entails risks, and the Uruguayan economy remains significantly dependent on developments in the region.

4. **In the short term, there is no room for loosening monetary policy.** Inflation expectations remain clearly in the upper half of the target range, and most core inflation measures are above it. Looking forward, rising commodity prices, substantial recent wage increases, the (moderate) fiscal impulse, and the ongoing recovery will continue to push consumer prices upward. Currently, staff considers the real exchange rate to be broadly in equilibrium.

5. **Near-term fiscal policy should be cautious.** The authorities are encouraged to contain expenditure growth in non-priority areas while fully executing programs in the budget with higher multipliers, such as planned public investment and social programs. For next year, staff would advocate limiting the deficit to around 1 percent of GDP, in light of still relatively high debt levels. This would also help keep fiscal policy broadly neutral.

6. **Looking forward, planning for energy-related contingencies could be improved.** In light of recurrent droughts in recent years, staff encourages the authorities to consider

mechanisms to incorporate this risk into budgeting. This could be achieved through the adoption of insurance mechanisms or the establishment of a countercyclical energy fund.

7. **Reducing debt to more comfortable levels remains important**. Lower debt levels would further reduce financing costs, minimize the risk of conducting procyclical fiscal policy during downturns, and would lay the basis for adopting a rules-based countercyclical policy framework. For this reason, in the five-year budget to be adopted next year, the new authorities should seek to return to more ambitious targets. Specifically, staff proposes that the authorities target on average an overall deficit of at most 0.4 percent of GDP (equivalent to a primary surplus of around 2.3 percent of GDP) starting in 2011 in order to bring down gross debt to below 40 percent of GDP by 2014.

8. **Uruguay should aim for lower inflation rates**. Despite achieving single-digit inflation over the last several years, Uruguay's inflation record still compares unfavorably with that of many other successful emerging markets. Lower inflation levels would allow to reap associated growth benefits, protect the poor, promote de-dollarization, and avoid the need to recur to costly measures when inflation threatens to break the 10 percent barrier.

9. **The monetary policy framework could be strengthened further**. A stronger commitment to the inflation target range, possibly along with enhanced accountability, could play a key role in improving the credibility of monetary policy. In this context, consideration could be given to strengthening the central bank's autonomy. Exchange-rate intervention should remain consistent with and clearly subordinated to the inflation objective. Communicating monetary policy within an explicit, forward-looking framework (based on forecasts) could also enhance the credibility of monetary policy. Enhanced credibility, in turn, could play a key role in the de-dollarization process.

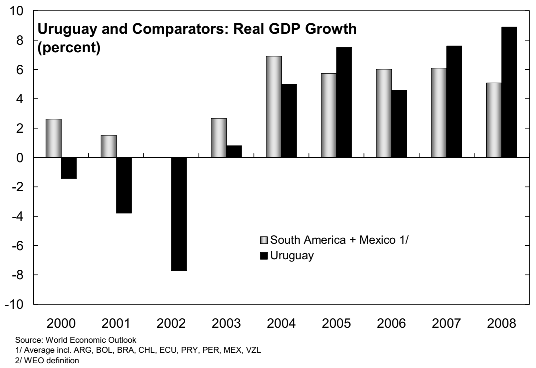
10. **Advances in the energy sector as well as in public sector reform would help raise potential growth**. Staff encourages the authorities to continue strengthening efforts in promoting private investment to expand power generation capacity as well as to improve infrastructure in other areas. An important challenge to enhancing the business climate further will be to continue promoting public sector efficiency, reducing red tape, and improving the governance of public enterprises.

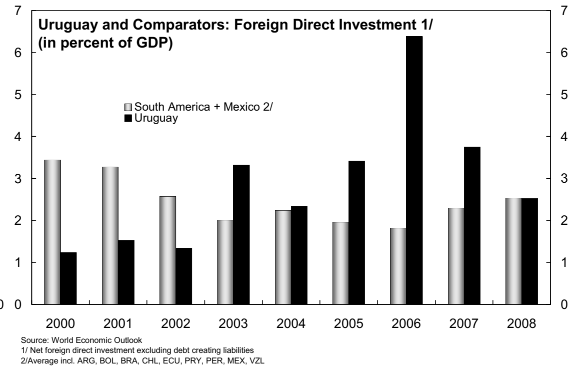
11. **Reducing poverty further remains a challenge**. Building on the significant progress achieved so far, further fostering social inclusion of disadvantaged segments of society remains a key goal in Uruguay. While private sector growth will continue to play the main role in this endeavor, the state needs to continue prioritizing budget resources to sustain and improve well-targeted social programs.

12. It is expected that the next Article IV Consultation with Uruguay will take place on the standard 12-month cycle.

II. BACKGROUND: A GLOBAL CRISIS BRINGS NEW CHALLENGES

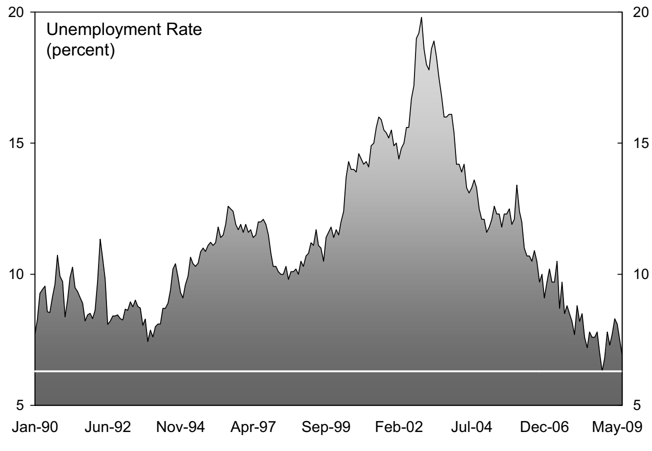
13. **In the run-up to the global crisis, Uruguay boasted one of the fastest growing economies in Latin America.** Supported by favorable global conditions and generally sound macroeconomic policies, real GDP growth averaged 7 percent in 2005–08, peaking at close to 9 percent in 2008, with activity running significantly above potential in the period before the international financial crisis. Private investment rose to record levels and unemployment fell to historic lows.





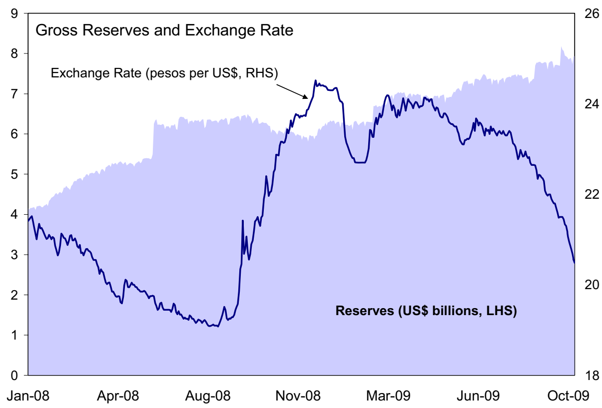
14. **The Uruguayan economy was better prepared to face the current global shock than in the past.** Improved fundamentals included single digit inflation, a more robust banking system, substantial international reserves, a more flexible exchange rate regime and external current account deficits more than financed by record levels of FDI. In addition, skillful public debt management had greatly reduced vulnerabilities in this area, in particular by improving the maturity structure of debt.

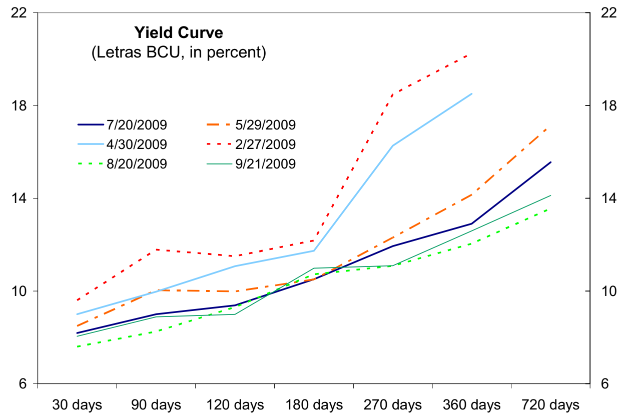
15. **While activity slowed down with the global recession, the impact appears to have been short-lived.** Before the crisis, real GDP growth had already been projected to moderate in 2009 to close to 5 percent as the temporary effects related to the start of operations of the Botnia pulp mill wore off. Overall, the impact has been milder than in many emerging market economies, and concentrated largely in some export-oriented sectors (Box 1); the agriculture, livestock, and energy sectors also suffered as a result of a severe drought. After contracting in the first quarter of 2009 by 2.3 percent (q/q SA), GDP expanded again in the second quarter (by 0.5 percent q/q SA) and is projected to grow by at least 0.6 percent this year. Private consumption growth decelerated from 7.5 percent in Q4 2007 to 0.8 percent in Q2 2009 (y/y), while inventories led the adjustment



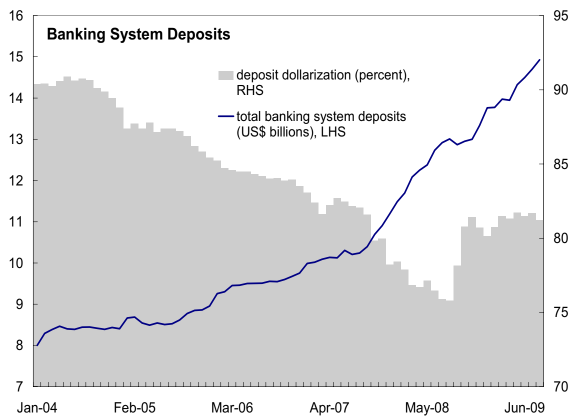
in capital formation. The unemployment rate rose temporarily but has fallen back to 7.2 percent in August, near historic lows. Overall, the economy does not seem to have developed any substantial slack.

16. **After coming under pressure during the period of financial turbulence, the peso has been appreciating again in recent months.** In the initial wake of the crisis, as foreign investors sold positions and domestic agents re-dollarized portfolios, the central bank (BCU) focused on preventing excessive exchange rate volatility, intervening forcefully while allowing the exchange rate to adjust. The peso depreciated by almost 30 percent against the US dollar between August and December 2008—the first time in recent decades that such a large nominal adjustment occurred without a financial crisis. More recently, the currency has recovered, and with capital inflows resuming, current pressures are again on the upside. In bond markets, after shooting up in line with other emerging markets, yields and country risk have stabilized near pre-crisis levels. Throughout this period, gross international reserves have continued to increase and net reserves (excluding private banks' holdings) are above their September 2008 levels. FDI contracted by 42 percent y/y in the first semester, but remained an important external financing source.





17. **The financial sector has held up considerably well.** Deposit growth has remained steady at about 15 percent, helping to maintain a strong level of liquidity in the banking sector. Part of this deposit growth has stemmed from the pick-up in non-resident deposits, which are up by 36 percent y/y, but remain low—at about 19 percent of total deposits—relative to pre-2002 crisis levels. Nonetheless, some re-dollarization of deposits occurred during the period of financial turbulence. Banks remain very liquid and well-capitalized, and the level of non-performing loans continues to be very low (1 percent of total loans). Credit growth has slowed from a peak of 45 percent in May 2008 but remains positive at around 6 percent (y/y), and private sector credit



levels are still low at 26 percent of GDP. The adverse impact of the currency depreciation on balance sheets (many companies but few households are indebted in dollars) has overall been limited in light of low leverage levels by the private sector.[1]

18. **Fiscal policy was maintained at broadly keeping the significant increase in nominal expenditure growth as planned.** The authorities have not implemented any major discretionary stimulus plans, besides specific, limited measures to reallocate resources and support the agricultural sector, which has been severely affected by the drought. However, they have allowed automatic stabilizers of about 1 percent of GDP to operate, with fiscal outlays growing at close to 18 percent, concentrated largely in permanent rises in wages, transfers and pensions (with these three components totaling ¾ of the increase). Nonetheless, the fiscal impulse this year is estimated to be moderate as structural revenues have risen, too.

Operations of the Non Financial Public Sector
(in percent of GDP)

	2008	2009	*2008-09*
Revenues	25.4	26.3	*0.9*
o/w:			
Central Government	19.4	19.8	*0.4*
BPS	5.2	5.7	*0.6*
Public Enterprises	0.8	0.8	*0.0*
Expenditures	24.3	26.2	*1.9*
o/w:			
Wages	4.3	4.8	*0.5*
Goods and Services	3.6	3.6	*0.0*
Social Security benefits	7.8	8.4	*0.6*
Transfer payments	5.4	5.9	*0.5*
Capital spending	3.1	3.6	*0.4*
Local government and BSE	0.2	0.1	*0.0*
Primary balance (NFPS)	1.4	0.4	*-1.0*
Memo item:			
Structural primary balance	2.1	1.3	*-0.7*
Fiscal Impulse 1/	1.2	0.7	

1/ Estimated as the change in the structural primary balance

19. **Due to inflation concerns, monetary policy has remained relatively tight.** As many countries were entering a marked easing cycle, the authorities tightened monetary policy amidst inflation concerns, raising policy rates by 225 basis points to 10 percent in January 2009. With inflationary pressures diminishing (headline CPI inflation fell from close to 10 percent in January to 6.3 percent in June) and economic activity deteriorating, the BCU cut rates—by 100 basis points in March and 100 basis points in June. Facing renewed upward pressures on the currency, the authorities have been intervening again to smooth the appreciation. In September, 12-month CPI inflation bounced back to 6.9 percent (compared to a target range of 3–7 percent).

20. **Presidential elections are scheduled for October 25th**. José Mujica, from within the ruling Frente Amplio (FA) coalition and former president Luis Alberto Lacalle, from the Partido Nacional (PN) are leading the polls in a highly contested election, and a second round on November 29 is likely. The new authorities will take over the administration in March 2010.

[1] Loan loss provisions are about seven times loan delinquencies, not least due to the cushion of statistical provisions that banks have built since 2001 (currently 2½ times non-performing loans; see Box 5).

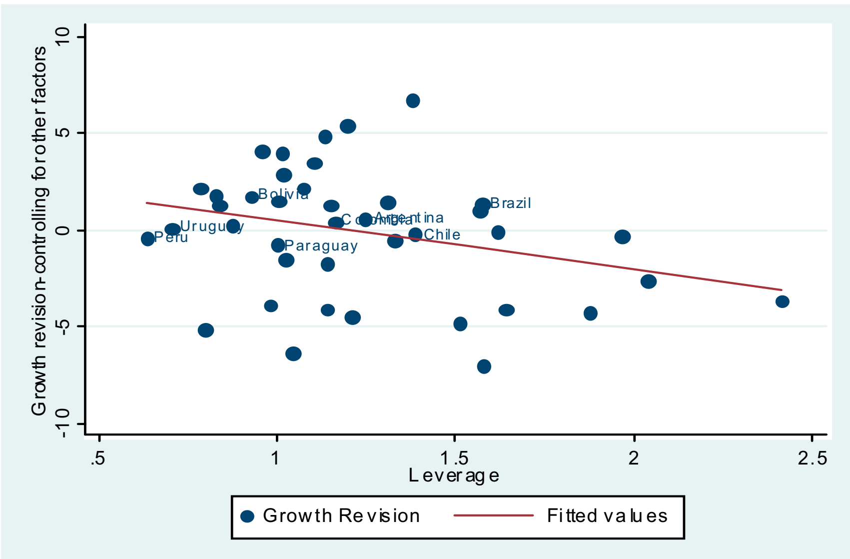
Box 1. Determinants of Cross-Country Differences in the Output Impact of the Global Crisis

A cross-country analysis on the factors explaining the extent to which mean Consensus growth projections were revised between August 2008 and August 2009 reveals that:

- Economies with higher credit growth and more leverage were hit more strongly.
- More flexible exchange-rate regimes allowed to absorb the shock more easily.
- For emerging markets, the financial channel trumps the trade impact.[1]

Among emerging markets, and also compared to the region, the growth impact of the crisis on Uruguay was relatively mild, with a growth revision of -3.8 percentage points, compared to a median revision among emerging markets of -6.4 percentage points. A low degree of leverage (credit over deposits) and a flexible exchange rate regime clearly dampened the impact of the shock. The simple model fits the Uruguayan case well, explaining 3.3 percentage points of the revision. Further factors that contributed to reducing the impact were the lack of developed capital markets and banks' low exposure to toxic assets.

Graph 1. Consensus Forecasts Growth Revisions and Leverage
(Residuals of forecast changes, after controlling for exchange rate flexibility, EU membership, and credit growth)

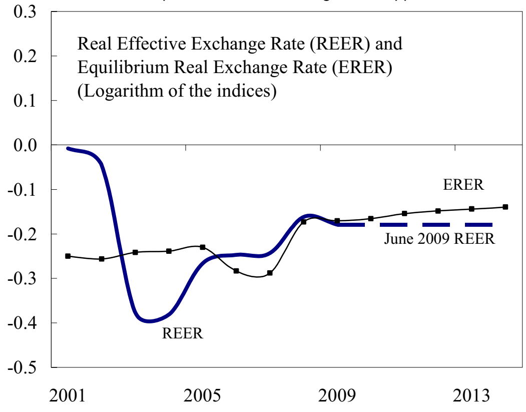


1/ Berkmen, P., G. Gelos, R. Rennhack, and J. Walsh (2009), "The Global Financial Crisis: Explaining Cross-Country Differences in the Output Impact," IMF Working Paper 09/280 (Washington: International Monetary Fund).

Box 2. Exchange Rate Assessment 1/

The assessment of the real effective exchange rate (REER) followed a broad-based approach. 2/ Four different methods were considered: (i) the purchasing power parity approach, which focuses on differences in relative productivity levels: (ii) the macroeconomic balance approach that calculates the exchange rate adjustment necessary to close the difference between the underlying current account balance (CAB) and an estimated equilibrium CAB; (iii) the external sustainability approach, which calculates the exchange rate adjustment that closes the difference between the underlying CAB and the balance that would stabilize the net foreign asset position at some benchmark level; and (iv) reduced-form models that directly estimate the equilibrium REER as a function of medium-term fundamentals. In this last approach both panel data estimation techniques and a country-specific vector error correction model were considered.

Equilibrium Real Exchange Rate Approach



Source: WEO and Fund staff estimates

The results suggest that the REER is broadly in line with its equilibrium value. All estimated deviations are smaller than ten percent. Four out of the five estimations indicate that the peso would need to appreciate slightly to reach its equilibrium value. For instance, the reduced-form approach estimates an undervaluation of about 4–5 percent.

Uruguay: Assessment of the Real Effective Exchange Rate

Real Exchange Rate Deviation from Equilibrium (in percent) overvaluation (+), undervaluation (-)				
I. PPP Approach	II. Macroeconomic Balance Approach	III. External Sustainability Approach	IV. Equilibrium Real Exchange Rate Approach	
			Panel	VECM
1.2	-3.1	-0.5	-4.8	-4.9

Source: Fund Staff estimates.

1/ See Zanna, F. "Exchange Rate and Competitiveness Assessment," accompanying SIP chapter.

2/ Uruguay is not currently covered by the Fund's estimates of the Consultative Group in Exchange Rate issues.

III. Economic Outlook and Risks

21. **The economy is well positioned to benefit from the global recovery**. For 2010 growth is expected to reach 3.5 percent, slightly below trend growth. However, with little room to provide further stimulus, developments in the near term will significantly depend on external developments. Given their strong influence on the Uruguayan economy, developments in the region will be of particular importance. Uruguay's linkages with Argentina have weakened in recent years, but the two business cycles remain highly correlated (see Box 3). Medium-term prospects are good, as considerable FDI in recent years has contributed to substantial productivity improvements in the tradable sectors.

22. **Lower international oil prices and domestic demand adjustment are reducing the current account deficit**. Despite the decline in export values, the current account deficit is expected to narrow from 4.6 percent of GDP to 1.6 percent this year and 2.5 percent in 2010, partly reflecting a terms-of-trade improvement (estimated at around 9 percent this year).

Uruguay: Macroeconomic Outlook

		Proj.	
	2008	2009	2010
	(In percent)		
Real GDP growth	8.9	0.6	3.5
Inflation (CPI, eop)	9.2	7.0	6.5
	(In percent of GDP, unless otherwise indicated)		
Overall fiscal balance	-1.4	-2.6	-2.1
Primary fiscal balance	1.4	0.4	0.8
Current account balance	-4.6	-1.6	-2.5
FDI	5.7	3.0	3.1
Gross International Reserves 1/	150.6	194.3	203.7

Sources: Uruguayan authorities; and Fund staff estimates.
1/ In percent of short term debt plus bank non-resident deposits

23. **Inflationary pressures are likely to persist**. With the level of output around potential, inflation expectations remain clearly in the upper half of the target range, and most core inflation measures are above it. Risks emanate from the resurgence of commodity prices, the ongoing recovery, a (moderate) positive fiscal impulse, and persistently high real wage growth, above productivity growth in the last few quarters (Figure 2).

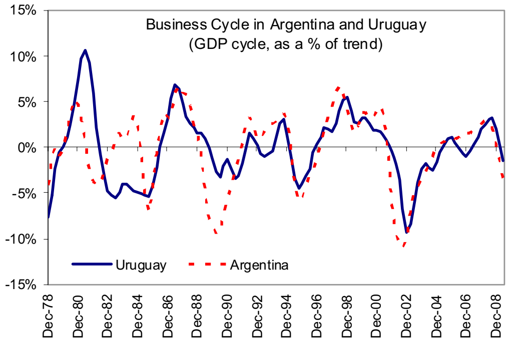
24. **The fiscal position could deteriorate further**. After declining in 2008, the primary fiscal surplus is worsening further in 2009, as revenue growth slows down in line with economic activity, public energy companies face higher drought-related costs (of about 1.6 percent of GDP) for the second consecutive year, and public spending continues to rise.[2] The overall deficit is projected to nearly double, from 1.4 percent of GDP last year to around 2.6 percent of GDP in 2009, the largest deficit since the 2002–03 crisis. To help cover this deficit, the authorities have secured credits of about 4 percent of GDP from multilateral organizations; more recently, they placed a US$500 million bond on the international market, which secures financing through 2010. The gross public debt ratio, which had fallen steadily since 2003 to 59.7 percent by end-December 2008, is projected to increase slightly this year.[3] Downside risks to the fiscal outlook stem mainly from uncertainty in the global growth outlook.

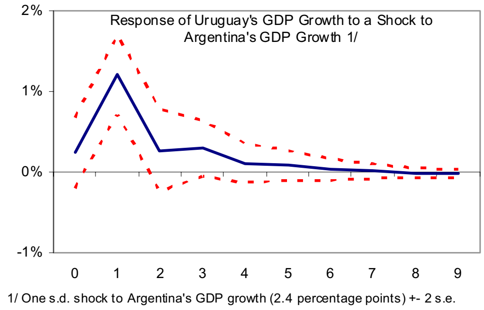
[2] The drought implied that hydroelectric generation had to be replaced by more expensive imports of electricity or oil-based generation. Last year, this cost had been compounded by very high oil prices.

[3] Net public debt (excluding central bank's net reserves) stands at around 50 percent of GDP.

Box 3. Uruguay: The Influence of Regional Factors 1/

The Uruguayan economy has historically been sensitive to changes in regional conditions. The Uruguayan business cycle has been highly correlated with that of Argentina—notably more so than with that of Brazil, despite the larger importance of Brazil as a destination for Uruguay's exports. Shocks stemming from Argentina have had large and rapid effects on Uruguay's GDP growth, with the largest response occurring one quarter after the shock.2/





This is mainly due to idiosyncratic linkages between Uruguay and Argentina (some of which are clearly weaker now than in the past), including:

- A large share of trade in regional goods—goods that are tradable only within the region;3/
- Argentine FDI flows —including in real estate and in the agriculture sector, and
- Significant Argentine deposits in Uruguay's banking system.

How vulnerable is Uruguay to disruptions in the region? While a crisis in the region would negatively affect Uruguay—mainly through real channels—it is not likely to trigger a financial crisis in Uruguay:

- Not every crisis in Argentina was followed by a crisis in Uruguay, as evidenced by the 1989–90 hyperinflation in Argentina;
- The regional concentration of exports (including tourism) has declined significantly in recent years, reducing Uruguay's vulnerability to the region—especially to Argentina;
- The exposure of the Uruguayan banking system to Argentina is considerably smaller;
- Brazilian crises—while affecting economic activity—have in the past not triggered financial crises in Uruguay;
- Uruguay has entered the current global crisis with stronger macroeconomic fundamentals; and
- Uruguay's banks are much healthier, and prudential regulation has been strengthened.

1/ Sosa, S.:" How Important are Regional Factors for Uruguay?", accompanying SIP chapter.

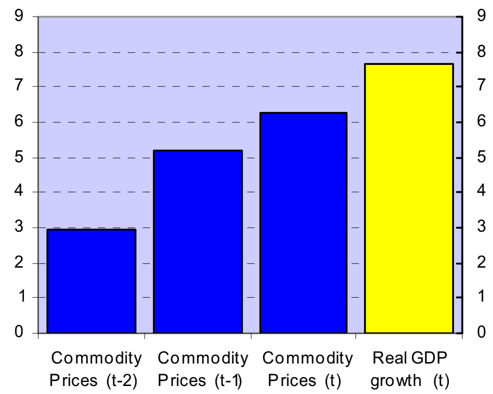
2/ Moreover, Argentine shocks explain about 20 percent of output fluctuations in Uruguay. These results are obtained from a VAR model estimated to quantify the extent of spillovers from different regions to Uruguay.

3/ While tourism and car parts represent the most important export items to Argentina, exports to Brazil consist mainly of agricultural commodities such as cereals and other grains.

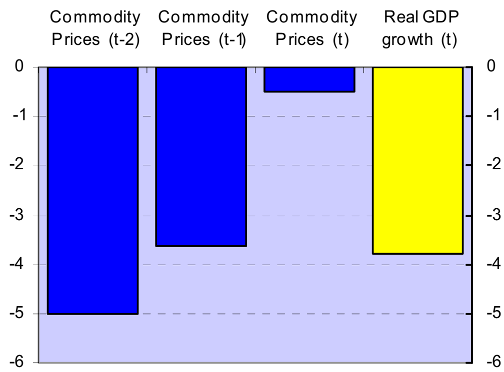
Box 4: Commodity Prices, Growth and the Fiscal Position[1/]

Booms and busts in Uruguay have historically coincided with corresponding commodity price movements. The correlation between growth and prices of Uruguay's commodity exports is positive. Periods of high growth have historically been preceded by periods of rising commodity prices. Similarly, periods of downturns have been preceded by a sharp declines in commodity prices.

Growth and Commodity Prices, 1970-2008
(percent)



Average real GDP growth in the years when growth was highest during the period 1970-2008, and the corresponding average growth in non-oil commodity prices (CP) at t=0, t-1 and t-2.



Average real GDP growth in the years when growth performance was lowest (i.e., negative) during 1970-2008, and the corresponding average growth in non-oil commodity prices (CP) at t=0, t-1 and t-2.

Since 2004, rising agricultural commodity prices have boosted economic activity and indirectly led to higher tax revenues, including through their positive impact on growth in neighboring countries. However, the concurrent oil price shock has led to a deterioration in Uruguay's terms of trade, and resulted in sizeable fiscal costs.

An analysis using VAR and Bayesian VAR techniques, controlling for the indirect impact through Argentina and Brazil (two large *net* commodity exporters with significant economic linkages to Uruguay), shows that:

a. An increase in commodity prices has a direct positive and significant effect on growth in Uruguay, lasting approximately one year.

b. Commodity price shocks also have a strong effect on Argentine growth, which in turn affects Uruguayan growth. There is no evidence of similar transmission channels through Brazil.

c. Commodity price shocks initially improve the primary balance (as spending falls more than revenues—which suffer as public enterprises take a hit from the oil shock), but the ensuing recovery of expenditures to previous levels (including on account of higher subsidy-related outlays) quickly deteriorates the primary balance. These effects are relatively short-lived, with a duration of 2–3 quarters.

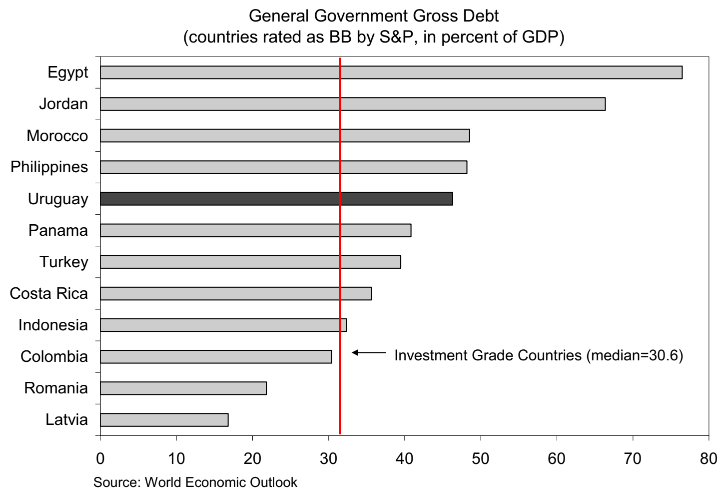
1/ Babihuga, R., "Commodity Prices, Growth and the Fiscal Position in Uruguay," accompanying SIP chapter.

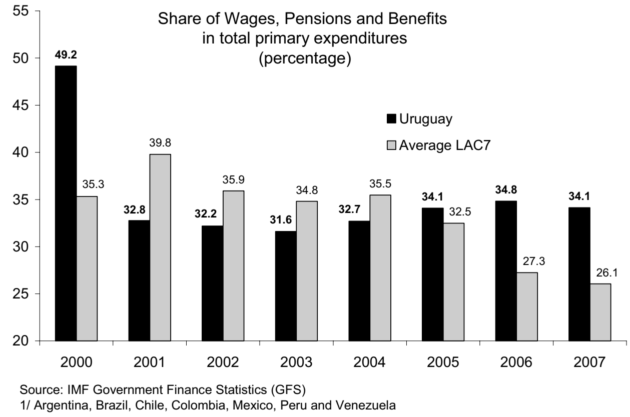
IV. Policy Discussions

Short term

25. **There is currently no clear-cut case for further stimulus.** With activity around potential, an ongoing recovery, and an expected growth rate of only slightly below potential next year, there is no obvious need for strengthening domestic demand further. Moreover, the risk of a W-shaped global recovery argues for retaining some scope for policy flexibility.

26. **Near term fiscal policy should be cautious.** Staff and the authorities agreed that despite a significant reduction in the debt-to-GDP ratio, public debt levels were still somewhat too high for comfort, particularly given the large share denominated in dollars (70 percent).[4] There was agreement that consequently, near term fiscal policy should strive to contain expenditure growth in non-priority areas. For this year, staff suggested to contain the budget deficit at no more than currently envisaged. For next year, staff advocated limiting the deficit to around 1 percent of GDP, roughly equivalent to a structural balance of -1.7 percent of GDP, which would keep fiscal policy broadly neutral. In staff's view, this could for example be achieved through a combination of expenditure and revenue measures in roughly equal proportions, totaling 1.1 percent of GDP compared to a passive scenario. The authorities believe that while this could be feasible, (partly because revenues could well exceed projections as a result of continued efficiency gains), substantially reducing expenditure growth without adversely affecting investment outlays would be difficult.





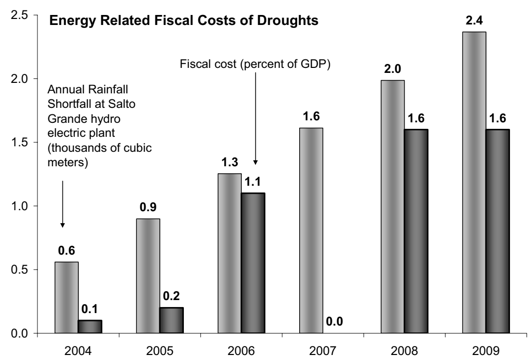
[4] The literature points to rising risks at relatively low levels of debt in emerging markets. Reinhart, Rogoff, and Savastano (2003) establish a minimum "safe" debt/GDP threshold of 35 percent for emerging markets, but argue that for some countries, this threshold could be as low as 15 to 20 percent.

27. **There is no room for further monetary policy easing at this point.** With real short-term-interest rates at around one percent, the current monetary stance is not particularly tight. In staff's view, a further normalization of real interest rates looking forward should be expected, but its pace depends partly on the degree to which the fiscal stance alleviated the burden on monetary policy. While the authorities highlighted the divergence in core inflation indicators, they agreed with staff that inflationary pressures persisted, and required vigilance on the part of the BCU. Currently, both staff and the authorities consider the real exchange rate to be broadly in equilibrium (see Box 2).

Medium-term

28. **A return to more ambitious fiscal targets would be important to reduce public debt to more comfortable levels and lower the risk of conducting procyclical policy.** Over the past years, buoyant revenues and the room provided by significantly-lower-than expected interest payments have been used to support additional expenditure, while the structural balances have been declining since 2006. Staff suggested that for the five-year budget plan to be adopted next year, the new authorities should seek to return to more ambitious targets. Specifically, staff proposed that the authorities target an overall deficit of at most 0.4 percent of GDP (equivalent to a primary surplus of around 2.3 percent of GDP) starting 2011 to bring down gross debt to below 40 percent of GDP by 2014. Barring revenue measures, this would imply some restraining of nominal expenditure growth; this should be feasible as the recent sharp wage (and associated pension) growth is unlikely to be sustained. The authorities agreed in principle that there could be some scope to contain expenditure growth looking forward but did not see the need to keep expenditure increases systematically below those of potential output in the medium term. Staff also argued that Uruguay's expenditure structure was relatively inflexible, and that a further buildup in budget rigidities should be avoided.[5] The authorities as well representatives from the opposition and private analysts agreed with the impetus for reducing debt further.

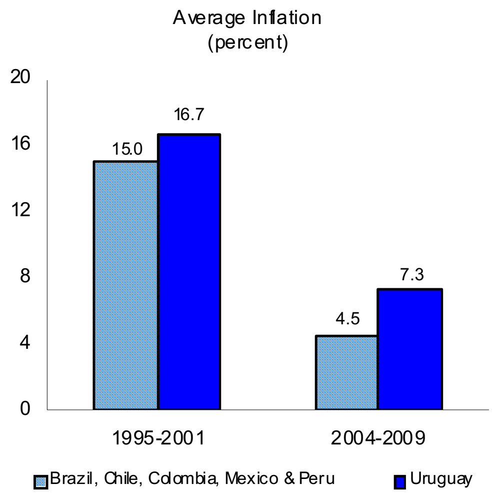
29. **The credibility of the fiscal policy framework would be enhanced by improved planning for contingencies.** Staff and the authorities agreed that fiscal policy should seek to minimize risks stemming from recurring droughts by better integrating related fiscal costs into budgeting. To this end, at least until the underlying structural energy problem is solved, staff suggested that the authorities consider creating an "energy fund" which could be drawn upon during drought years. The cost of such an

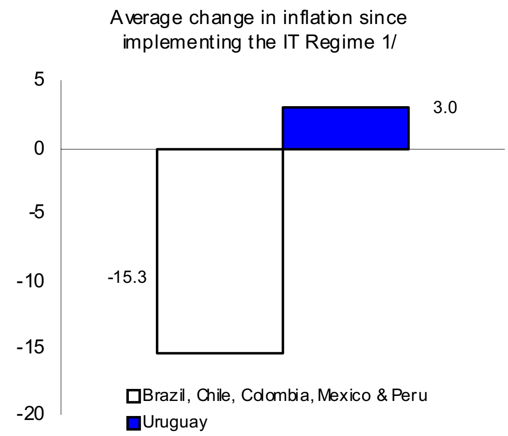


[5] Two long-pending structural measures in the fiscal area, the reforms of the pension funds for the police and the banking sector were implemented in 2008.

insurance mechanism would, in turn, need to be translated to tariffs. The authorities agreed with the need to tackle this issue and are also exploring possibilities of insuring against extreme weather shocks.

30. **Staff argued that in the medium term, Uruguay should aim for lower steady-state inflation levels, and aligned with the center of the target range.** Twelve-month inflation has averaged 7.5 percent since 2006, and the authorities have repeatedly needed to recur to ad-hoc measures to contain inflation from reaching two digits (which would have triggered more frequent pension and wage adjustments), while leaving the economy with little room for active monetary policy. A balanced policy mix—with a more neutral fiscal policy—would aid in reaching lower inflation levels. The authorities pointed out that ongoing structural changes with associated relative price changes made it difficult to assess the optimal inflation level for a developing country like Uruguay. Uruguay also needed a wide target range since, as a small, very open and dollarized economy, it was exposed to more shocks than most emerging markets, while the transmission mechanism of monetary policy was not particularly robust. Moreover, the authorities did not currently see a public demand for substantially lower inflation rates.

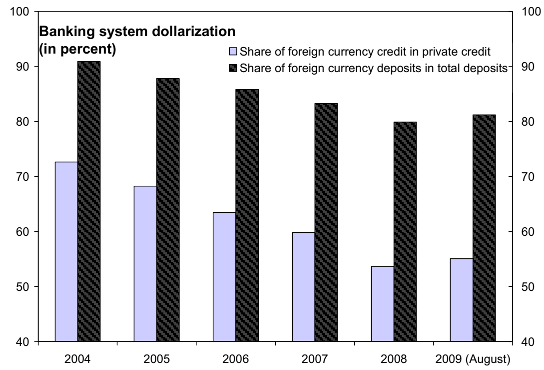




1/ Difference between current annual average inflation and average inflation in year *before* implementing IT regime (in the case of IT targeters), or adopting inflation target ranges (in the case of Uruguay).

31. **The monetary policy framework could benefit from improved transparency, communication, central bank autonomy, and accountability.** A stronger, more credible framework would not only help achieve lower inflation rates but also foster the de−dollarization process.

- **Transparency of foreign-exchange interventions.** Recurrent exchange rate intervention has occasionally contributed to a lack of clarity about the monetary framework and sometimes led to tensions with the inflation objective. Staff argued that intervention should be consistent with and clearly subordinated to the inflation target. The authorities stressed that reaching the inflation target was the main objective of monetary policy, that intervention was only aimed at limiting short-term volatility in a small market, and that intervention volumes had been reduced significantly. The private sector, however, has in the past tended to see policies as aiming for maximum peso weakness subject to inflation remaining in single digits.



- **Communication.** The authorities agreed that communication could be improved using a forward-looking framework; to this end the BCU was working on improving forecasting models and strengthening its communication so as to improve credibility.

- **Autonomy and accountability.** Enhancing the central bank's autonomy could be important to enhance credibility. Having a more formal accountability mechanism regarding the inflation objective may also be helpful toward that goal. The authorities did not see a need to change the BCU's formal status at this point.

32. **Staff emphasized, and the authorities agreed, on the need to achieve further de-dollarization.** While the use of the peso in lending to households has increased, corporate credit remains firmly dollarized. Moreover, during the recent period of financial turbulence, the private sector instinctively sought refuge in the US dollar, as historically has been the case in periods of volatility. In recent years, the authorities have taken several regulatory steps to promote de-dollarization, including the imposition of limits on net open foreign currency positions for banks; higher capital requirements for foreign currency loans; higher reserve and liquidity requirements on foreign currency deposits; and tighter loan classifications of consumer loans in foreign currency as well as of large corporate borrowers failing stress tests of a strong depreciation. Still, further measures are planned, including extending the yield curve in pesos and developing a local market for exchange rate hedges.

33. **While the banking system's vulnerability at this point is low, its profitability is declining substantially.** Stress tests as of May 2009 indicate that banks are generally resilient to sizeable macroeconomic shocks (the shocks are shown in Box 5). That said, banks' profitability remains depressed, with the return on average assets falling slightly to

0.9 percent in June 2009.[6] Factors behind the low profitability include low international interest rates (as a relatively large part of assets are placed abroad), high reserve requirements with low remuneration, fiercer competition for high-quality borrowers, as well as rising wage costs. In a recent move, the BCU reduced reserve requirements on peso deposits from 25 to 20 percent, and on dollar deposits from 35 to 30 percent, partially reversing the hikes from May 2008.

Uruguay: Selected Financial Soundness Indicators 1/

	2005	2006	2007	2008	2009 2/
Regulatory capital in percent of risk-weighted assets	24.5	22.8	21.7	17.9	19.8
Return on average assets	0.8	1	1.3	1	0.8 4/
Efficiency ratio (net operating costs in percent of net income)	67.9	71.7	69.8	69.3	76.6 4/
Liquidity ratio (maturities of up to 30 days)	80.7	69.5	53.9	66	64.4
Non-performing loans in percent of total loans 3/	5.3	3.6	1.1	0.9	1.0
Total loan loss reserves in percent of non-performing loans 3/	221	411	666	807	685
Dollarization of loans 3/	81.5	76.7	70.8	72.5	72.8

Source: Central Bank of Uruguay and IMF staff calculations.
1/ Excluding Banco Hipotecario; 2/ June data; 3/ Loans to the nonfinancial sector; 4/ Year-on-year basis.

34. **The regulatory framework is being refined further**. Since the 2002–03 banking crisis, Uruguay has persistently updated its prudential regulation, introducing, inter alia, explicit liquidity requirements, capital charges for market and operational risks, limits to risk exposures, as well as forward-looking loan classification and provisioning rules.[7] Earlier this year, the authorities published a set of regulations specifying the preconditions for selling investment instruments issued by third parties, and bolstering the rights of bank clients (particularly credit card holders). The authorities explained that they were moving towards consolidated supervision of financial groups, which they hoped to begin applying next year.

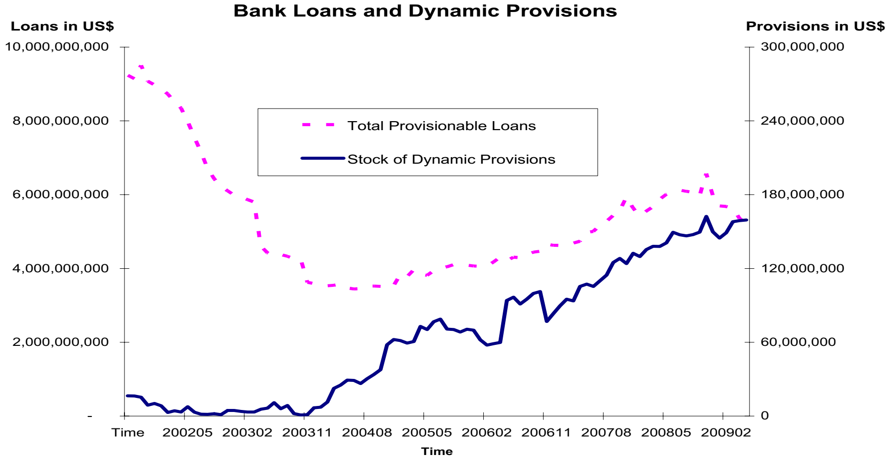
35. **Progress has also been achieved in other financial sector areas.** The financial sector reform law adopted last year includes a substantially improved bank resolution framework. The new deposit insurance agency foreseen in the law was formally established in September. A law on capital market reform aimed at improving the legal framework in the areas of securities registration and settlement, and providing for the supervision of brokerage houses was passed in the Lower House. The restructuring of state-owned housing bank BHU has progressed; with a much leaner structure, and its recapitalization about to be completed, the institution has cautiously begun to lend again.

[6] This figure is biased upward by the performance of the single state-owned bank (Banco República del Uruguay). When excluding this bank, the return on assets turns negative (-0.1 percent).

[7] For details see Adler, G., M. Mansilla, and T. Wezel (2009): “Modernizing Bank Regulation in Support of Financial Deepening: The Case of Uruguay,” IMF Working Paper No. 09/199.

Box 5. Dynamic Loan Loss Provisions in Uruguay 1/

Uruguay introduced dynamic (countercyclical) provisions in September 2001—as the first country after Spain. Banks are required to provision each year an average of one percent of their total loans to the non-financial private sector less specific loan losses incurred, until these provisions reach 3 percent of loans. This ensures that provisions for non-performing loans are less volatile than otherwise, thanks to the nature of the contribution rule that yields larger provisions when credit grows fast and loan delinquencies are low. Conversely, during downturns banks can cover rising loan losses by tapping into their funds of dynamic provisions.



To assess the buffer provided by dynamic provisions, loan losses predicted by the credit risk model of the BCU under certain macroeconomic shocks are set to equal the overall stock of dynamic provisions. Backward solving the system then yields the magnitude of the shocks required to deplete the stock of provisions. The results show that banks' dynamic provisions would fully cover the loan losses expected to be caused by a sizeable shock, while only cushioning part of the losses in a full-blown crisis. While overall, provisions appear sufficient, it seems too early to conclude that the system is overprovisioned given uncertainties about the magnitude of credit cycles looking forward.

Scenario/Shocks	Δ GDP	Δ Exchange Rate 2/	Bond Spread 3/	Dynamic Provisions 4/	Expected Loan Losses 4/	Coverage of Losses
BCU adverse scenario	-3.64%	13.02%	733	158.8	100	100.00%
BCU crisis scenario	-8.00%	31.70%	1000	158.8	383.6	41.40%
2002-03 Crisis	-11.00%	50.00%	2000	158.8	1,246.6	12.70%

2/ Increase = depreciation of the local currency; 3/ Uruguayan Bond Index; 4/ milllions of US dollars

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1/ Wezel, T., "Dynamic Loan Loss Provisions In Uruguay," accompanying SIP chapter.

36. **The authorities recognize that improvements in the energy sector are crucial to avoid bottlenecks and enhance the growth potential**. They highlighted the planned and ongoing projects in this area, including generation capacity expansions through traditional and alternative energy sources, improvements in the connection with the Brazilian electricity network, and exploring possible gas and mineral deposits. Staff argued that private investment could be promoted through public-private partnerships (with adequate risk sharing), and the development of a competitive spot market for electricity.

37. **Reforming the public sector remains a key element of the agenda towards enhancing the investment climate.** Staff highlighted the need to streamline regulations and reduce the administrative burden on the private sector and stressed the importance of strengthening corporate governance in public enterprises. [8] The authorities agreed that there was scope for a thorough review of these issues. They explained efforts at reducing administrative procedures for private companies, including a plan to drastically simplify the opening and closing of businesses. Staff also inquired about the effects of labor market regulations passed in recent years, including the implementation of tripartite negotiations; the authorities argued that so far there was no evidence of any adverse impact, citing the fact that unemployment had barely risen with the downturn.

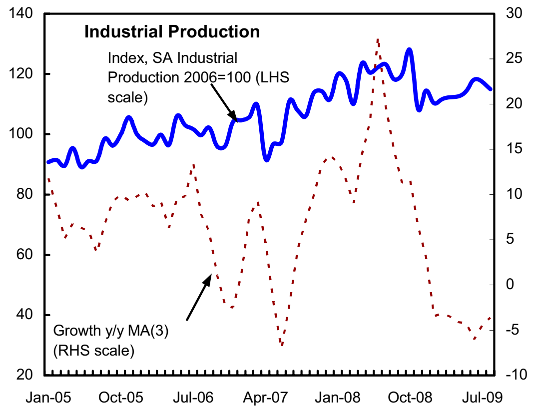
38. **Improving social inclusion will be important for sustainable growth.** A significant share of public resources has been directed to social ends, with the share of central government social expenditures (comprising mainly outlays in health, housing, and education as well as social security benefits and transfers) in total rising from 57 percent in 2003 to 75 percent in 2008, and the authorities highlighted that poverty levels had fallen from around 32 percent in the aftermath of the 2002 crisis to currently 20 percent. There was broad agreement that continuing to improve carefully targeted social programs through budget re-prioritization remained an important policy objective.

[8] Uruguay continues to rank unfavorably in some international comparisons of red tape (such as starting a business, registering property, or dealing with construction permits).

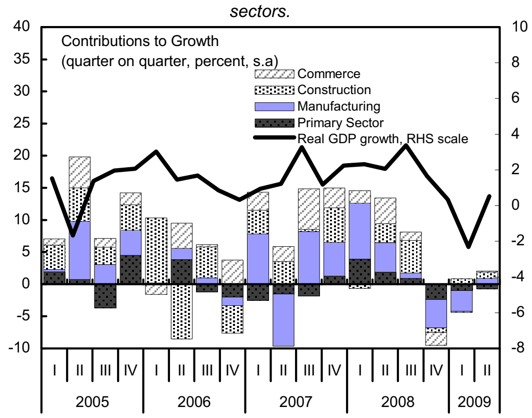
Figure 1. Uruguay: Economic Activity

Economic activity declined sharply with the global crisis, but has rebounded in the second quarter.

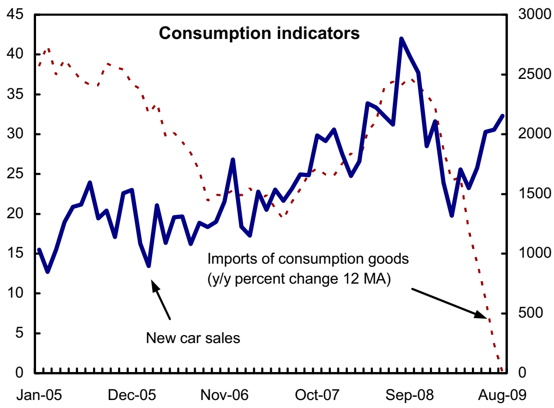
After decelerating sharply to its lowest growth rate since 2004, activity "has begun" rising…



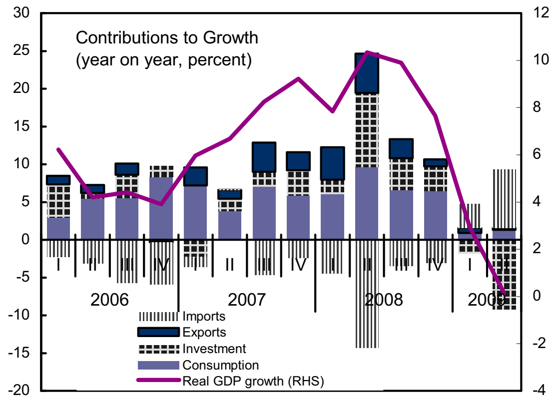
…led by the manufacturing, construction and commerce sectors.



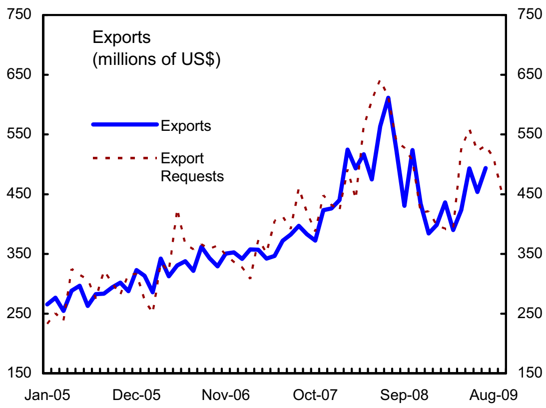
After falling off sharply, there are some signs of a recovery in domestic demand.



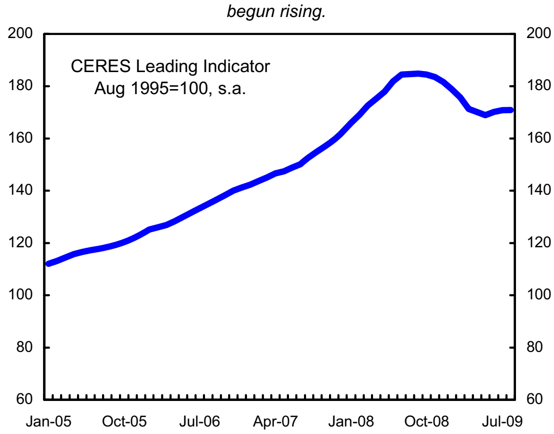
…led by domestic consumption.



Exports were initially hit the hardest, but have recently rebounded...



…while a key leading indicator of economic activity has begun rising.

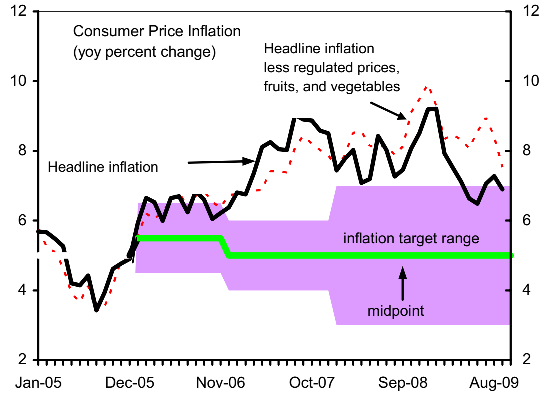


Source: Central Bank of Uruguay

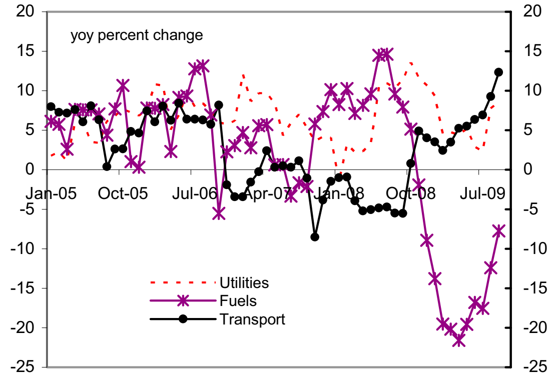
Figure 2. Uruguay: Inflation

Inflationary pressures persist, in a context of administrative price increases, rising wages and a still positive output gap.

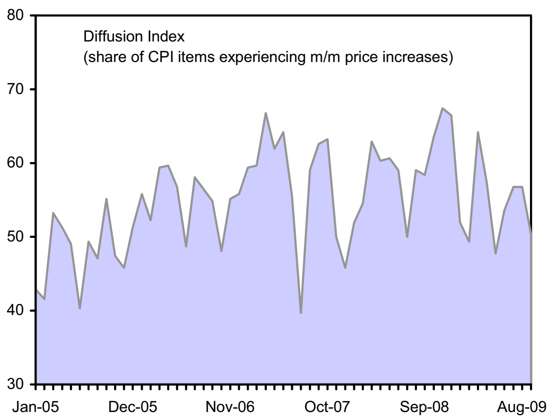
Headline and core inflation remain close to the upper end or above the central bank's target range...



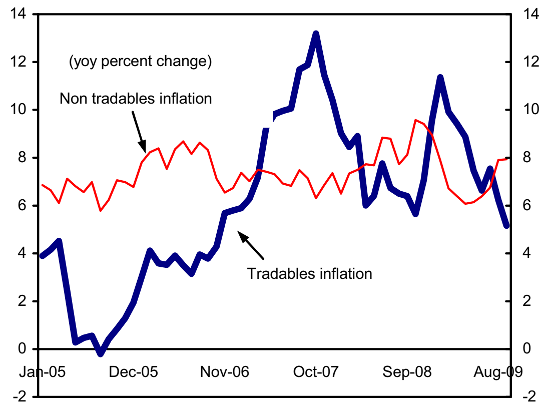
...with non core inflation driven by recent increases in administered prices.



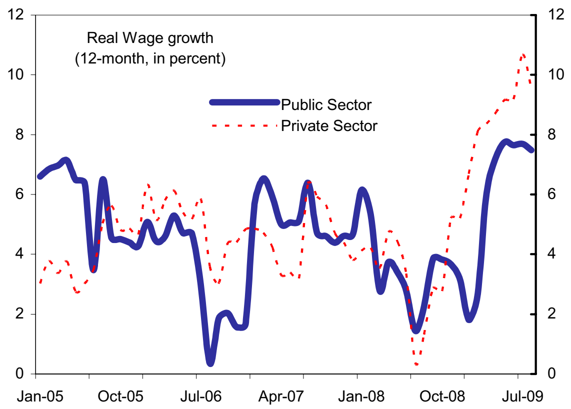
Inflation remains widespread...



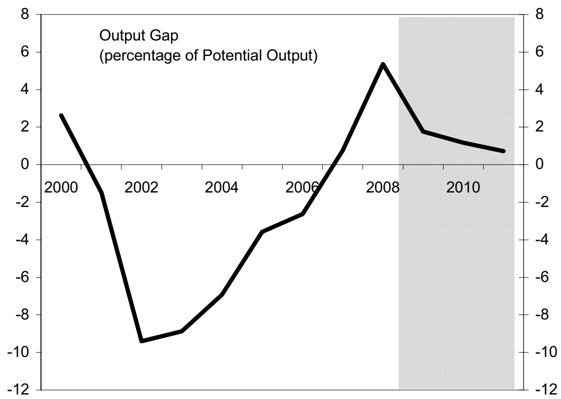
...with non tradable inflation recently rising.



Real wages have grown steadily...



..and the output gap is slowly closing but the economy has yet to develop significant slack.

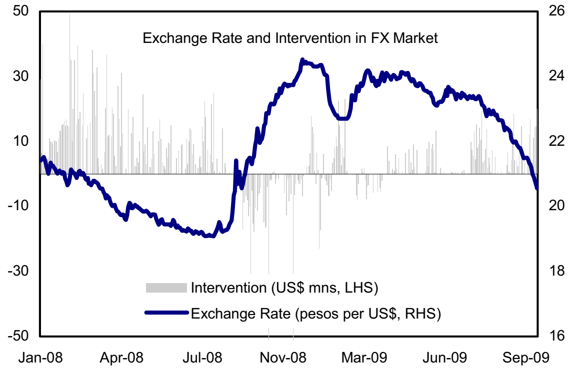


Source: Uruguay National Bureau of Statistics and Central Bank of Uruguay.

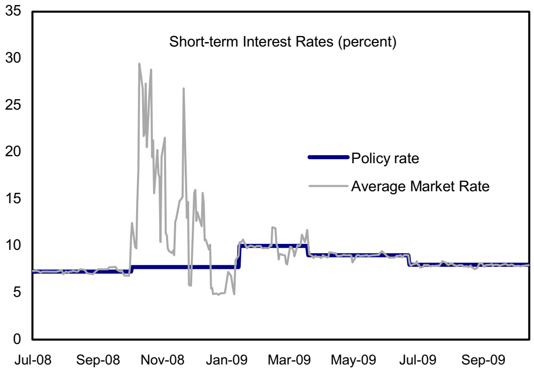
Figure 3. Uruguay: Policy Responses to the Global Crisis

While allowing the exchange rate to adjust amid intervention, monetary policy has been guided mainly by inflation concerns. Although there has been no explicit fiscal stimulus package, the fiscal position is projected to deteriorate in light of still strong expenditure growth and lower revenues.

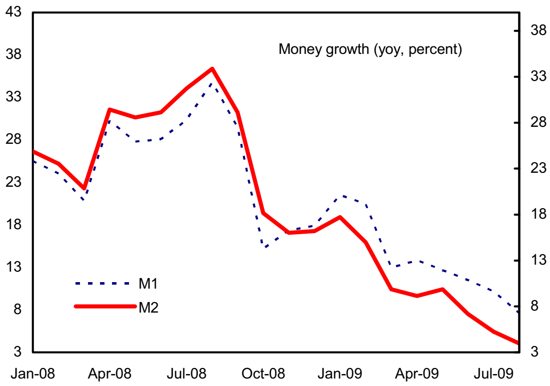
The exchange rate adjusted to the external shock, with the central bank intervening to smooth volatility.



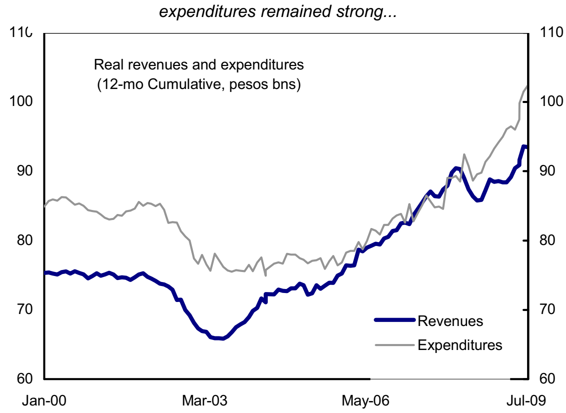
After tightening policy amid inflation concerns, the central bank has recently cut rates as inflation has declined.



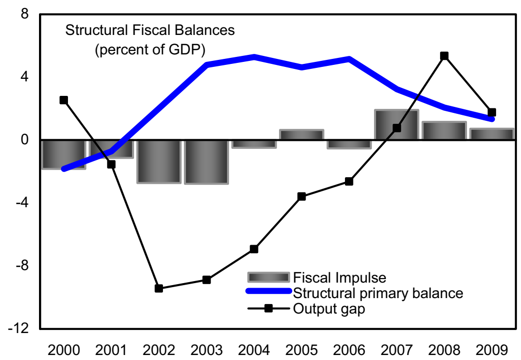
Money growth has slowed significantly.



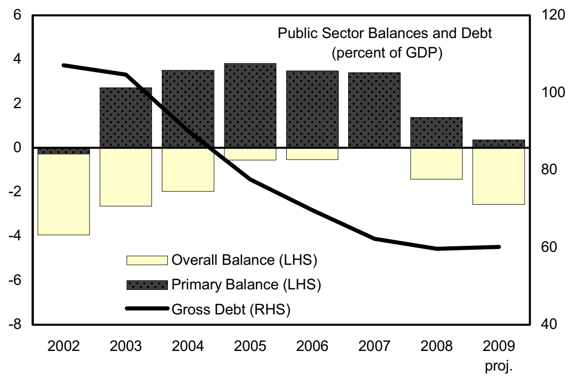
Revenues levelled off with the slowdown in activity, while expenditures remained strong...



...which will deteriorate the fiscal position...



...and interrupt the downward trend in public debt.

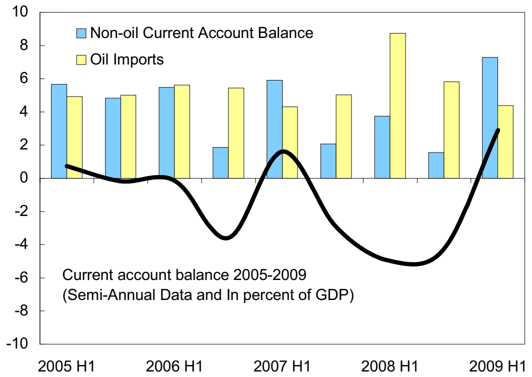


Source: Central Bank of Uruguay, Ministry of Finance and staff calculations.

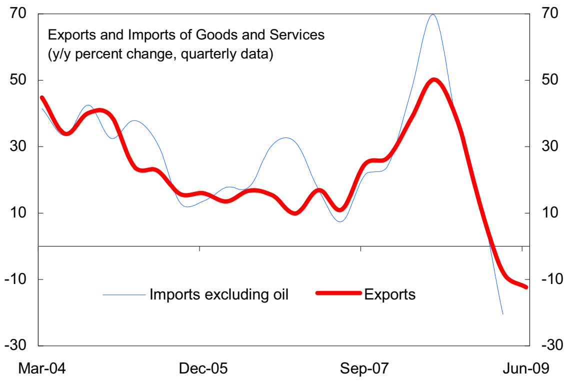
Figure 4. Uruguay: External Developments

Although the global crisis has negatively affected trade and capital inflows, particularly FDI, sovereign spreads have normalized and gross international reserves continue to increase.

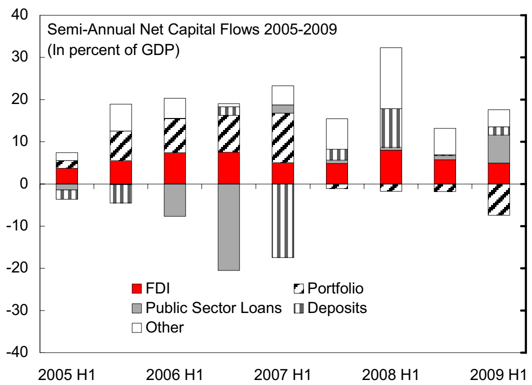
The current account balance has improved on the back of a declining oil import bill...



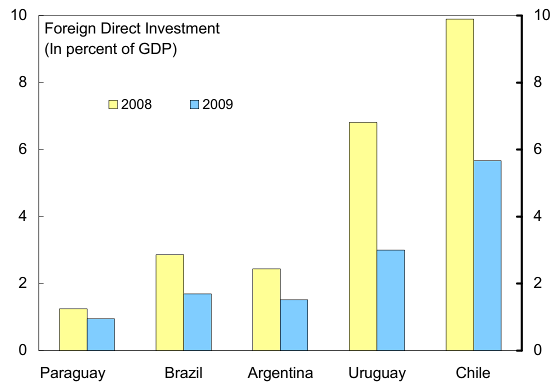
...and a less pronounced deterioration of exports than that of non-oil imports.



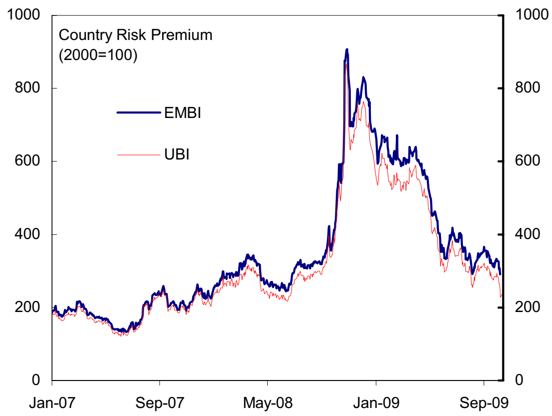
Loans to the public sector and FDI have become important sources of external financing...



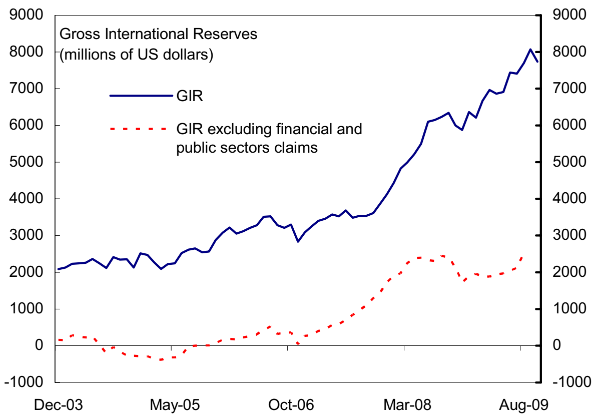
...and although FDI is expected to decline, it is still significant even by regional standards



Other private capital flows have decreased, but the country risk premium has diminished...



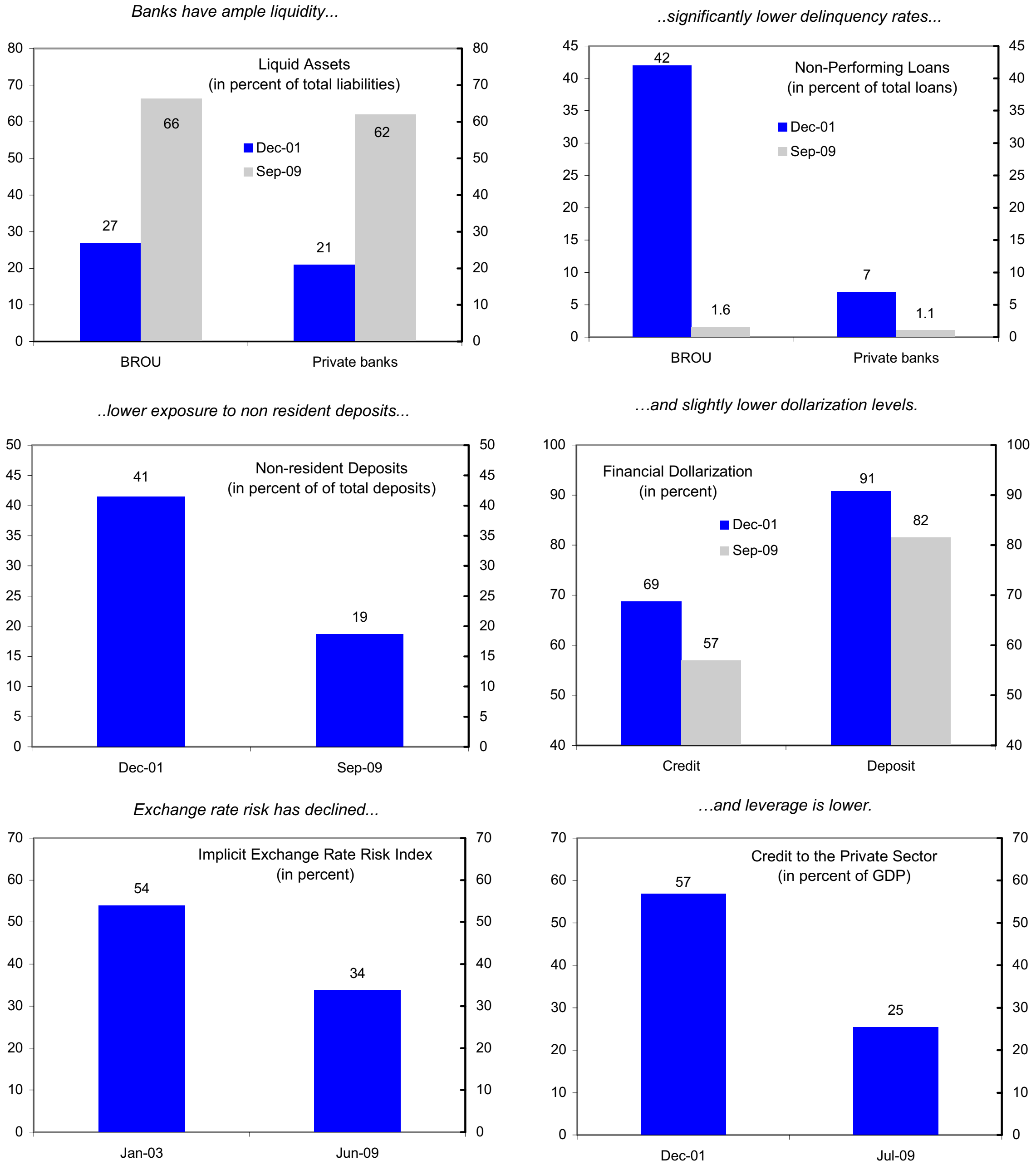
...and gross international reserves continue to increase.



Sources: Central Bank of Uruguay; IMF World Economic Outlook; and IMF staff calculations.

Figure 5. Uruguay. Banking System Indicators

The banking system is stronger than it was ahead of the 2002-03 Uruguayan financial crisis.



1/ Foreign currency credit to the non-tradable sector as a percentage of total credit

Table 1. Uruguay: Selected Economic and Social Indicators

Latest information available			
Population (estimate)	3.5	Physicians per 1,000	3.7
		Hospital beds per 1,000	4.4
Life expectancy at birth (years)	75.7		
Crude birth rate (per thousand)	14.9	Access to safe water	
Infant mortality rate (per thousand live births)	12.0	(percent of population)	98.0
Income share held by highest 10 percent of households	n.a.	Adult literacy rate	98.0
Income share held by lowest 20 percent of households	n.a.	Gross enrollment rate	
Gini coefficient	n.a.	Primary education	113.1
Unemployment rate	6.8	Secondary education	106.9
Poverty rate	25.3	Tertiary education	42.0
GDP per capita in 2008 (in US$)	9,654		
Human Development Index Rank	43 (out of 177)		

	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
									Projections			
(Percent change, unless otherwise specified)												
I. Output, prices, and employment												
Real GDP	2.3	4.6	6.8	4.6	7.6	8.9	0.6	3.5	3.6	3.8	3.9	3.9
Real consumption	-3.1	2.9	5.2	7.1	7.3	8.8	3.9	2.9	2.2	4.3	4.2	4.3
Real investment	14.4	15.8	4.2	13.3	6.3	25.0	-0.6	2.4	1.5	3.0	1.5	1.5
GDP (Ur$ billions)	339.8	392.8	425.0	482.0	569.3	674.3	736.3	815.8	900.2	989	1,083	1,173
GDP (US$ billions)	12.0	13.7	17.4	20.0	24.3	32.2	31.6	35.5	39.1	43.5	48.1	52.1
GDP deflator	14.8	10.5	1.3	8.4	9.8	8.8	8.5	7.0	6.5	5.8	5.4	4.3
CPI inflation (average)	20.0	9.2	4.7	6.4	8.1	7.9	7.3	7.0	6.0	5.2	5.0	4.6
CPI inflation (eop)	10.2	7.6	4.9	6.4	8.5	9.2	7.0	6.5	5.5	5.0	5.0	4.3
Exchange rate change (Ur$/US$)(average)	32.7	1.8	-14.7	-1.7	-2.5	-10.7	11.2	...	...	...	...	...
Exchange rate change (Ur$/US$) (eop)	7.5	-9.1	-11.1	3.4	-11.3	12.3	-5.6	...	...	...	...	...
Unemployment (in percent)	15.4	12.1	12.1	9.1	7.7	6.8	...	...	...	...	...	...
II. Monetary indicators												
Base Money (eop)	20.0	10.6	55.4	12.5	16.4	29.3	9.2	...	...	...	...	...
M-1	33.2	14.3	33.5	23.6	29.4	18.6	12.5	...	...	...	...	...
M-2	28.1	13.2	26.7	25.7	30.6	17.1	7.9	...	...	...	...	...
M-3	15.2	-3.0	0.0	14.8	3.8	28.6	8.1	...	...	...	...	...
Credit to the private sector (constant exch. rate)	-31.8	-31.4	6.3	11.0	22.1	28.0	0.6	...	...	...	...	...
(Percent of GDP, unless otherwise specified)												
III. Public sector operations												
Revenue 1/	27.9	28.0	28.0	27.7	27.6	25.4	26.3	27.3	27.9	27.9	28.0	27.9
Non-interest expenditure 1/	24.6	24.2	24.3	24.3	24.4	24.3	26.2	26.8	26.1	25.8	25.7	25.7
Primary balance 2/	2.7	3.5	3.8	3.5	3.4	1.4	0.4	0.8	2.0	2.4	2.5	2.5
Interest 2/	5.4	5.5	4.4	4.0	3.4	2.8	2.9	2.9	2.8	2.9	2.9	2.8
Overall balance 2/	-2.6	-2.0	-0.6	-0.5	0.0	-1.4	-2.6	-2.1	-0.7	-0.5	-0.4	-0.3
Gross public sector debt	104.6	90.1	77.6	69.6	62.2	59.7	60.1	56.3	51.8	47.6	43.9	40.8
Net public sector debt 3/	98.6	86.7	72.6	65.0	55.1	50.2	47.4	…	…	…	…	…
IV. Savings and investment												
Gross domestic investment	15.2	17.5	17.7	20.3	21.0	23.0	21.8	22.0	21.2	21.3	20.8	20.5
Gross national savings	14.7	17.8	17.7	18.0	20.6	18.4	20.2	19.6	19.6	20.4	20.3	20.3
Foreign savings	0.5	-0.3	0.0	2.3	0.3	4.6	1.6	2.5	1.6	0.9	0.5	0.2
V. External indicators												
Merchandise exports, fob (US$ millions)	2,281	3,145	3,758	4,389	5,043	7,083	6,301	6,942	7,773	8,544	9,291	9,984
Merchandise imports, fob (US$ millions)	2,098	2,992	3,730	4,863	5,598	8,799	7,261	8,385	9,157	9,834	10,494	11,123
Merchandise terms of trade (percentage change)	2.9	-3.1	-9.7	-1.8	1.4	-1.2	7.6	-4.9	0.5	1.2	0.9	0.5
Current account balance	-0.5	0.3	0.0	-2.3	-0.3	-4.6	-1.6	-2.5	-1.6	-0.9	-0.5	-0.2
Of which: excluding pulp mills projects	-0.5	0.3	0.0	-2.3	-0.3	-4.6	-1.6	-2.5	-1.6	-0.9	-0.5	-0.2
Foreign direct investment	3.3	2.3	4.1	6.9	4.7	5.7	3.0	3.1	2.9	2.7	2.5	2.3
Overall balance of payments (US$ millions)	1,380	454	951	-337	1,005	2,232	1,883	600	406	493	492	543
External debt 4/	91.4	84.7	65.8	52.7	50.4	37.4	41.1	38.1	35.3	32.4	29.9	28.6
Of which: external public debt	79.3	74.6	58.6	46.5	45.6	33.4	37.1	34.1	31.3	28.4	25.9	24.6
External debt service (percent of exports of goods and services)	52.3	44.8	53.1	92.5	26.1	29.8	21.0	15.1	14.0	12.8	11.5	10.6
Gross official reserves (US$ millions) 5/	2,087	2,512	3,438	3,091	4,096	6,328	8,211	8,811	9,218	9,710	10,203	10,745
In months of imports of goods and services	6.6	6.5	7.1	5.5	4.9	8.9	10.0	9.8	9.6	9.4	9.3	9.3
In percent of short-term debt	131.3	112.4	153.8	492.6	469.9	786.5	994.4	951.2	906.4	864.5	824.7	798.9
In percent of short-term debt plus bank non-resident deposits	51.2	55.4	75.8	101.6	116.7	150.6	194.3	203.7	208.7	214.7	220.0	226.4
In percent of short-term debt plus FX deposits	20.0	27.7	41.3	43.2	52.1	69.6	80.7	89.5	88.7	82.5	76.6	...
REER (percentage depreciation -, e.o.p.)	-13.1	9.5	9.4	-6.2	8.0	6.0	0.5	...	...	...	...	...

Sources: Data provided by the Uruguayan authorities; and Fund staff estimates.

1/ Non-financial public sector excluding local governments.
2/ Total public sector.
3/ Public sector debt, net of free reserves of the central bank of Uruguay.
4/ Excludes nonresident deposits.
5/ Includes reserve buildup through reserve requirements of resident financial institutions.

Table 2. Uruguay: Consolidated Public Sector Operations
(in percent of GDP)

	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
						Projections					
Revenues (Non financial public sector) 1/	**28.0**	**28.0**	**27.7**	**27.6**	**25.4**	**26.3**	**27.3**	**27.9**	**27.9**	**28.0**	**27.9**
Central Government	20.9	20.9	21.2	20.3	19.4	19.8	19.8	20.1	20.2	20.3	20.2
Tax revenue	19.1	18.9	19.3	18.5	17.9	18.1	18.2	18.6	18.9	19.2	19.2
DGI	15.3	15.9	16.4	15.9	16.1	16.6	16.6	17.0	17.3	17.6	17.6
IRP	1.3	0.8	0.9	0.6	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Public enterprises	1.2	1.0	0.7	0.7	0.7	0.7	0.7	0.7	0.7	0.7	0.7
Foreign trade	1.3	1.2	1.2	1.2	1.1	0.9	0.9	0.9	0.9	0.9	0.9
Non tax revenue	1.8	1.9	1.9	1.8	1.5	1.6	1.6	1.5	1.3	1.1	1.1
BPS	4.4	5.0	5.2	5.0	5.2	5.7	5.7	5.8	5.7	5.6	5.6
Current surplus of public enterprises	2.7	2.1	1.4	2.3	0.8	0.8	1.8	2.0	2.1	2.1	2.1
Expenditure (Non financial public sector) 1/	**24.2**	**24.3**	**24.3**	**24.4**	**24.3**	**26.2**	**26.8**	**26.1**	**25.8**	**25.7**	**25.7**
Current Expenditure	21.7	22.0	21.8	21.6	21.1	22.6	23.4	22.6	22.6	22.5	22.5
Wages	4.5	4.6	4.5	4.4	4.3	4.8	5.0	4.8	4.8	4.8	4.8
Goods and services	3.8	4.0	4.2	4.0	3.6	3.6	3.6	3.4	3.4	3.4	3.4
Social security benefits	9.3	9.2	8.8	8.2	7.8	8.4	8.7	8.4	8.4	8.3	8.3
Other transfers	4.1	4.2	4.3	4.9	5.4	5.9	6.1	6.0	6.0	6.0	6.0
Capital Expenditure	2.5	2.3	2.5	2.8	3.1	3.6	3.4	3.5	3.2	3.2	3.2
Primary Balance (Local Government)	0.1	0.2	0.4	0.2	0.2	0.1	0.1	0.1	0.1	0.1	0.1
Primary Balance (BSE)	-0.2	0.1	-0.1	0.2	0.3	0.3	0.3	0.3	0.3	0.3	0.3
Primary Balance (Non financial public sector)	3.7	4.0	3.6	3.5	1.5	0.5	1.0	2.1	2.5	2.7	2.6
Primary Balance (BCU)	-0.2	-0.2	-0.2	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1
Primary Balance (Total Public Sector)	**3.5**	**3.8**	**3.5**	**3.4**	**1.4**	**0.4**	**0.8**	**2.0**	**2.4**	**2.5**	**2.5**
Interest	5.5	4.4	4.0	3.4	2.8	2.9	2.9	2.8	2.9	2.9	2.8
Overall Balance (Total Public Sector)	**-2.0**	**-0.6**	**-0.5**	**0.0**	**-1.4**	**-2.6**	**-2.1**	**-0.7**	**-0.5**	**-0.4**	**-0.3**

1/ Excluding local governments
Sources: Data provided by the Uruguayan authorities; and Fund staff estimates and projections.

Table 3. Uruguay: Consolidated Public Sector Operations
(in millions of pesos)

	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
						Projections					
Revenues (Non financial public sector) 1/	109,830	118,924	133,714	157,132	170,943	193,489	222,818	250,724	276,251	302,755	327,855
Central Government	81,989	88,734	101,982	115,289	130,751	145,603	161,227	180,945	199,575	219,630	237,107
Tax revenue	74,957	80,487	92,955	105,054	120,560	133,514	148,541	167,749	186,869	207,368	224,740
DGI	60,206	67,585	79,103	90,564	108,731	122,027	135,608	153,446	171,208	190,299	206,289
IRP	4,947	3,285	4,401	3,519	0	-	-	-	-	-	-
Public enterprises	4,848	4,423	3,455	3,894	4,727	5,161	5,719	6,310	6,929	7,589	8,226
Foreign trade	4,956	5,195	5,995	7,077	7,103	6,326	7,214	7,993	8,732	9,480	10,225
Non tax revenue	7,032	8,247	9,028	10,234	10,190	12,089	12,686	13,196	12,705	12,262	12,367
BPS	17,370	21,425	25,155	28,473	34,778	42,156	46,906	51,775	55,917	60,391	66,106
Current surplus of public enterprises	10,471	8,766	6,577	13,370	5,414	5,730	14,685	18,003	20,759	22,734	24,642
Expenditure (Non financial public sector) 1/	95,040	103,093	117,229	138,973	163,578	192,786	218,240	234,941	255,036	278,224	301,573
Current Expenditure	85,232	93,313	105,009	122,855	142,457	166,625	190,501	203,436	223,403	243,581	264,023
Wages	17,608	19,415	21,790	25,291	29,220	35,310	40,792	43,208	47,449	51,964	56,325
Goods and services	14,999	16,955	20,182	22,870	24,404	26,358	29,371	30,605	33,609	36,808	39,897
Social security benefits	36,526	39,018	42,446	46,598	52,502	61,540	70,571	75,613	83,035	89,854	97,395
Other transfers	16,099	17,926	20,591	28,095	36,330	43,416	49,767	54,010	59,311	64,955	70,406
Capital Expenditure	9,808.6	9,780.1	12,219.6	16,118.6	21,121.2	26,161	27,739	31,506	31,632	34,643	37,550
Primary Balance (Local Government)	275.1	750.1	1,725.7	1,053.1	1,014.6	1,011	1,120	1,236	1,357	1,486	1,611
Primary Balance (BSE)	-621	392	-668	869	1,737	1,865	2,066	2,280	2,503	2,742	2,972
Primary Balance (Non financial public sector)	14,444	16,973	17,544	20,080	10,116	3,578	7,765	19,297	25,075	28,758	30,865
Primary Balance (BCU)	-665	-712	-743	-723	-863	-915	-1,014	-1,119	-1,228	-1,345	-1,458
Primary Balance (Total Public Sector)	13,779	16,261	16,801	19,357	9,253	2,663	6,751	18,179	23,847	27,413	29,406
Interest	21,502	18,608	19,356	19,317	18,810	21,513	23,676	24,852	28,667	31,395	33,001
Overall Balance (Total Public Sector)	-7,723	-2,347	-2,555	40	-9,557	-18,849	-16,925	-6,673	-4,820	-3,982	-3,595

1/ Excluding local governments

Sources: Data provided by the Uruguayan authorities; and Fund staff estimates and projections.

Table 4. Uruguay: Summary Accounts of the Banking System
(In millions of U.S. dollars)

	2004	2005	2006	2007	2008	2009 Proj.
			1. Banco Central del Uruguay			
Net foreign assets	-22	1,341	3,357	5,287	7,107	8,570
Net international reserves 1/	-173	774	3,085	4,121	6,356	8,239
Gross international reserves	2,511	3,078	3,085	4,121	6,356	8,239
Reserve liabilities 1/	2,684	2,304	0	0	0	0
Other net foreign assets	151	572	273	1,165	751	331
Net domestic assets	802	5	-1,844	-3,342	-4,931	-6,194
Net credit to the public sector	2,806	2,164	931	-55	1,512	1,509
Net credit to the financial system	-1,747	-1,636	-1,735	-1,799	-3,314	-3,269
Credit to the private sector	15	15	15	15	14	16
Securities issued by the BCU	-741	-960	-1,443	-2,564	-2,545	-3,200
Other	468	423	389	1,061	-599	-1,250
Peso monetary liabilities	780	1,346	1,513	1,945	2,176	2,376
			2. Public and Private Banks 2/			
Net foreign assets	1,832	1,969	2,162	2,345	1,722	2,545
Net domestic assets	5,511	5,924	6,522	7,706	9,856	10,392
Net credit to the public sector	673	347	317	142	-1	866
Net credit to the financial system	2,172	2,681	2,907	3,352	4,858	4,651
Credit to the private sector	3,592	3,949	4,612	5,968	7,260	7,300
Other	-926	-1,052	-1,313	-1,756	-2,261	-2,425
Liabilities to the private sector (residents)	7,343	7,893	8,684	10,051	11,578	12,937
Public banks	3,986	4,244	4,643	5,367	5,978	6,598
Local currency	650	873	1,140	1,618	1,751	1,797
Foreign currency	3,336	3,371	3,503	3,749	4,227	4,801
Private banks	3,357	3,649	4,041	4,684	5,599	6,339
Local currency	430	607	702	1,122	1,226	1,217
Foreign currency	2,927	3,042	3,338	3,562	4,373	5,123
			3. Banking System			
Net foreign assets	1,810	3,310	5,519	7,631	8,829	11,114
Net domestic assets	5,493	4,676	3,287	2,743	2,428	1,050
Credit to the public sector	3,479	2,511	1,248	87	1,511	2,376
Credit to the rest of financial system	-396	-208	-220	-67	-953	-1,766
Credit to the private sector	3,607	3,964	4,626	5,983	7,274	7,316
Other	-1,198	-1,590	-2,368	-3,259	-5,404	-6,875
Broad money (M3)	7,302	7,986	8,806	10,375	11,257	12,165
Memorandum items (in pesos):			(Percentage change, otherwise indicated)			
Base money (end-of-period)	10.6	55.4	12.5	16.4	29.3	9.2
Currency issued	15.7	22.0	27.6	11.6	13.1	9.1
M-1	14.3	33.5	23.6	29.4	18.6	12.5
M-2	13.2	26.7	25.7	30.6	17.1	7.9
M-3	-3.0	0.0	14.8	3.8	28.6	8.1
Credit to private sector (constant exchange rate)	-31.4	6.3	11.0	22.1	28.0	0.6
"Free" international reserves (in millions of US$) 3/	513	898	899	1,847	2,615	4,230

Sources: Central Bank of Uruguay; and Fund staff estimates and projections.

1/ Includes all outstanding liabilities to the IMF, but excludes liabilities to resident financial institutions.
2/ The Banco de la Republica Oriental de Uruguay (BROU), Banco Hipotecario de Uruguay (BHU; mortgage institution), private banks, *casas financieras* and cooperatives.
3/ Net of liabilities to resident financial institutions.

Table 5. Uruguay: Balance of Payments

(In millions of US$, unless otherwise stated)

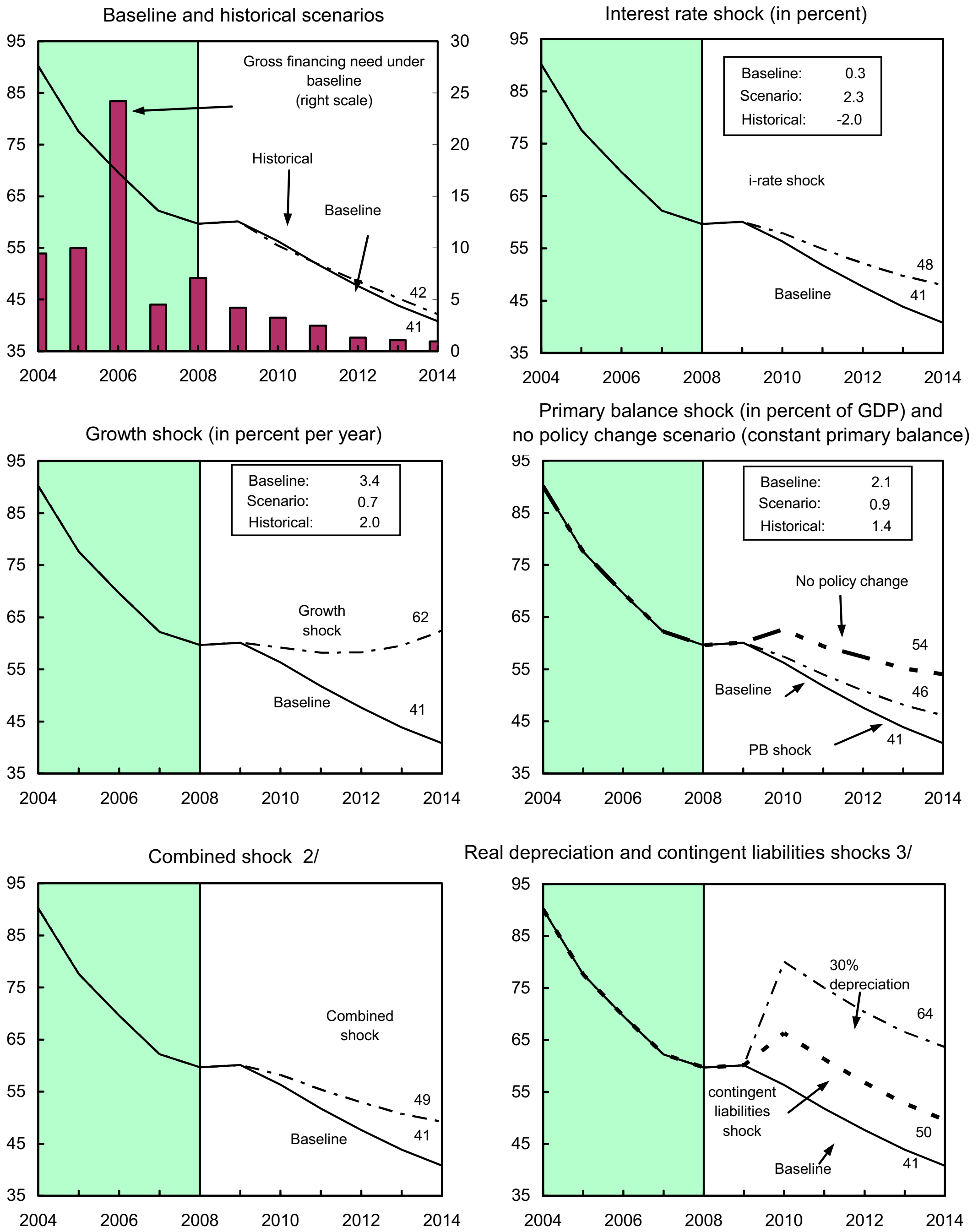
	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
										Projections			
					1. Balance of Payments								
Current account	**382**	**-56**	**43**	**2**	**-457**	**-80**	**-1,484**	**-507**	**-874**	**-632**	**-389**	**-223**	**-121**
Trade balance	48	183	153	28	-474	-555	-1,716	-960	-1,442	-1,384	-1,290	-1,203	-1,139
Exports, f.o.b.	1,922	2,281	3,145	3,758	4,389	5,043	7,083	6,301	6,942	7,773	8,544	9,291	9,984
Imports, f.o.b.	1,874	2,098	2,992	3,730	4,863	5,598	8,799	7,261	8,385	9,157	9,834	10,494	11,123
Services	153	167	365	409	361	683	808	1,003	1,117	1,282	1,432	1,563	1,668
Exports, f.o.b.	771	803	1,151	1,335	1,284	1,807	2,222	2,312	2,561	2,863	3,156	3,429	3,677
Imports, f.o.b.	618	636	786	926	923	1,124	1,413	1,309	1,444	1,581	1,724	1,866	2,009
Income (net)	109	-489	-588	-585	-470	-345	-727	-670	-709	-651	-611	-642	-701
Transfers (net)	72	83	113	149	126	136	150	120	160	120	80	60	50
Financial and capital account	**-2,234**	**1,039**	**67**	**1,016**	**202**	**1,685**	**2,820**	**2,390**	**1,475**	**1,038**	**881**	**715**	**664**
Foreign direct investment	180	401	315	715	1,377	1,139	1,840	950	1,100	1,122	1,144	1,167	1,191
Portfolio investment	415	-541	-422	766	1,810	1,113	-571	-101	-10	91	126	147	171
Government securities	171	-5	240	566	1,830	935	-504	-21	-101	5	39	66	90
Issues	710	613	504	1,094	2,391	1,325	211	600	250	300	300	300	300
Amortization	539	618	263	528	562	390	714	621	351	295	261	234	210
Banks and Other	244	-537	-663	200	-20	179	-68	-80	91	86	86	81	81
Other capital flows (net)	-2,828	1,179	174	-466	-2,985	-568	1,551	1,541	384	-175	-389	-600	-698
Loans	1,290	375	-133	-198	-2,922	275	310	1,116	389	25	-89	-120	-138
Of which: WB, IDB, commercial (net)	633	237	-37	80	-450	344	302	1,016	443	98	-16	-32	-65
Disbursements	792	472	479	689	437	703	1,335	1,236	670	338	202	174	130
Amortization	159	235	517	609	887	358	1,033	220	227	240	217	206	195
Deposits, net	-1,693	267	180	-428	3	-187	626	230	150	-100	-150	-200	-280
Other flows, net	-2,426	537	128	161	-66	-660	614	195	-155	-100	-150	-280	-280
Unidentified Financing	0	0	0	0	0	0	0	0	0	0	0	0	0
Errors and omissions	-476	397	345	-66	-83	-599	897	0	0	0	0	0	0
Overall balance	-2,328	1,380	454	951	-337	1,005	2,232	1,883	600	406	493	492	543
Reserve assets (- increase)	**2,328**	**-1,380**	**-454**	**-951**	**337**	**-1,005**	**-2,232**	**-1,883**	**-600**	**-406**	**-493**	**-492**	**-543**
					2. Reserve Adequacy and External Indicators								
Gross official reserves (stock)	**772**	**2,087**	**2,512**	**3,438**	**3,091**	**4,096**	**6,328**	**8,211**	**8,811**	**9,218**	**9,710**	**10,203**	**10,745**
In months of next year's imports of goods and services	3.4	6.6	6.5	7.1	5.5	4.8	8.9	10.0	9.8	9.6	9.4	9.3	9.3
In percent of short-term debt	32.3	131.3	112.4	153.8	492.6	469.9	786.5	994.4	951.2	906.4	864.5	824.7	798.9
In percent of short-term debt and nonres. deposits	16.7	51.2	55.4	75.8	101.6	116.7	150.6	194.3	203.7	208.7	214.7	220.0	226.4
Net international reserves (stock)	**-1,088**	**-763**	**-2,218**	**-1,166**	**3,085**	**4,121**	**6,356**	**7,116**	**8,071**	**8,718**	**9,412**	**10,286**	**11,241**
					(As percent of GDP)								
Exports	14.1	18.9	23.0	21.6	21.9	20.8	22.0	19.9	19.6	20.0	19.9	19.6	19.4
Imports	13.8	17.4	21.9	21.5	24.3	23.1	27.3	23.0	23.6	23.5	22.9	22.2	21.6
Current account	2.8	-0.5	0.3	0.0	-2.3	-0.3	-4.6	-1.6	-2.5	-1.6	-0.9	-0.5	-0.2
Underlying current account 1/	2.8	-0.5	0.3	0.0	-2.3	0.4	-4.6	-1.6	-2.5	-1.6	-0.9	-0.5	-0.2
Financial and capital account	-16.4	8.6	0.5	5.9	1.0	6.9	8.8	7.6	4.2	2.7	2.1	1.5	1.3
Of which: foreign direct investment (net)	1.3	3.3	2.3	4.1	6.9	4.7	5.7	3.0	3.1	2.9	2.7	2.5	2.3
Of which: government securities (net)	1.3	0.0	1.8	3.3	9.1	3.9	-1.6	-0.1	-0.3	0.0	0.1	0.1	0.2
Of which: IMF (net)	6.5	3.5	1.1	-1.0	-11.9	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Overall balance	-17.1	11.5	3.3	5.5	-1.7	4.1	6.9	6.0	1.7	1.0	1.1	1.0	1.1
Changes in GIR	17.1	-11.5	-3.3	-5.5	1.7	-4.1	-6.9	-6.0	-1.7	-1.0	-1.1	-1.0	-1.1
External debt	77.8	91.4	84.7	65.8	52.7	50.4	37.4	41.1	38.1	35.3	32.4	29.9	28.6
Short-term debt (residual maturity)	22.7	19.9	11.6	12.9	3.1	3.6	2.5	2.6	2.6	2.6	2.6	2.6	2.6
External public debt	61.2	79.3	74.6	58.6	46.5	45.6	33.4	37.1	34.1	31.3	28.4	25.9	24.6
External debt + NR deposits	94.9	109.9	102.9	79.0	64.8	61.3	47.9	51.9	47.7	44.0	40.3	37.0	35.2
					(As percent of annual exports of goods and services)								
Total external debt	392.8	357.1	269.9	224.2	186.1	178.4	129.3	150.9	142.0	129.1	119.0	111.1	107.8
Total external debt (including nonresidential deposits)	479.2	429.3	327.8	269.3	228.8	217.0	165.8	190.5	177.8	161.1	148.1	137.9	132.7
Debt service	55.0	52.3	44.8	53.1	92.5	26.1	29.8	21.0	15.1	14.0	12.8	11.5	10.6
Of which: interest payments	24.5	19.2	16.7	16.6	15.8	12.5	8.8	8.8	6.9	6.9	6.5	5.9	5.4
					(Annual percent changes)								
Exports of goods	-10.2	18.7	37.9	19.5	16.8	14.9	40.5	-11.0	10.2	12.0	9.9	8.7	7.5
Imports of goods	-35.7	12.0	42.6	24.7	30.4	15.1	57.2	-17.5	15.5	9.2	7.4	6.7	6.0
Export prices in US$ (year-on-year percent change) 1/	-7.7	7.4	6.4	5.1	6.5	8.5	17.1	-8.7	2.6	3.1	2.8	2.7	2.1
Import prices in US$ (year-on-year percent change) 1/	-10.8	5.1	9.1	12.2	8.2	7.9	18.4	-16.3	7.0	2.7	1.7	1.8	1.7
Terms of trade 1/	3.5	2.2	-2.4	-6.3	-1.6	0.5	-1.1	9.2	-4.1	0.4	1.1	0.9	0.5
Export volume 1/	-2.1	9.4	28.7	16.2	9.2	4.7	11.5	2.0	7.5	8.5	7.0	6.0	5.5
Import volume 1/	-26.9	6.2	29.1	9.4	13.6	20.0	31.0	1.6	7.1	6.3	5.8	5.0	4.5

Sources: Central Bank of Uruguay; and Fund staff estimates and projections.

1/ Excluding imports related to the construction of pulp mill projects (Botnia and ENCE).

ANNEX I. DEBT SUSTAINABILITY

Figure 1. Uruguay: Public Debt Sustainability: Bound Tests 1/
(Public debt in percent of GDP)



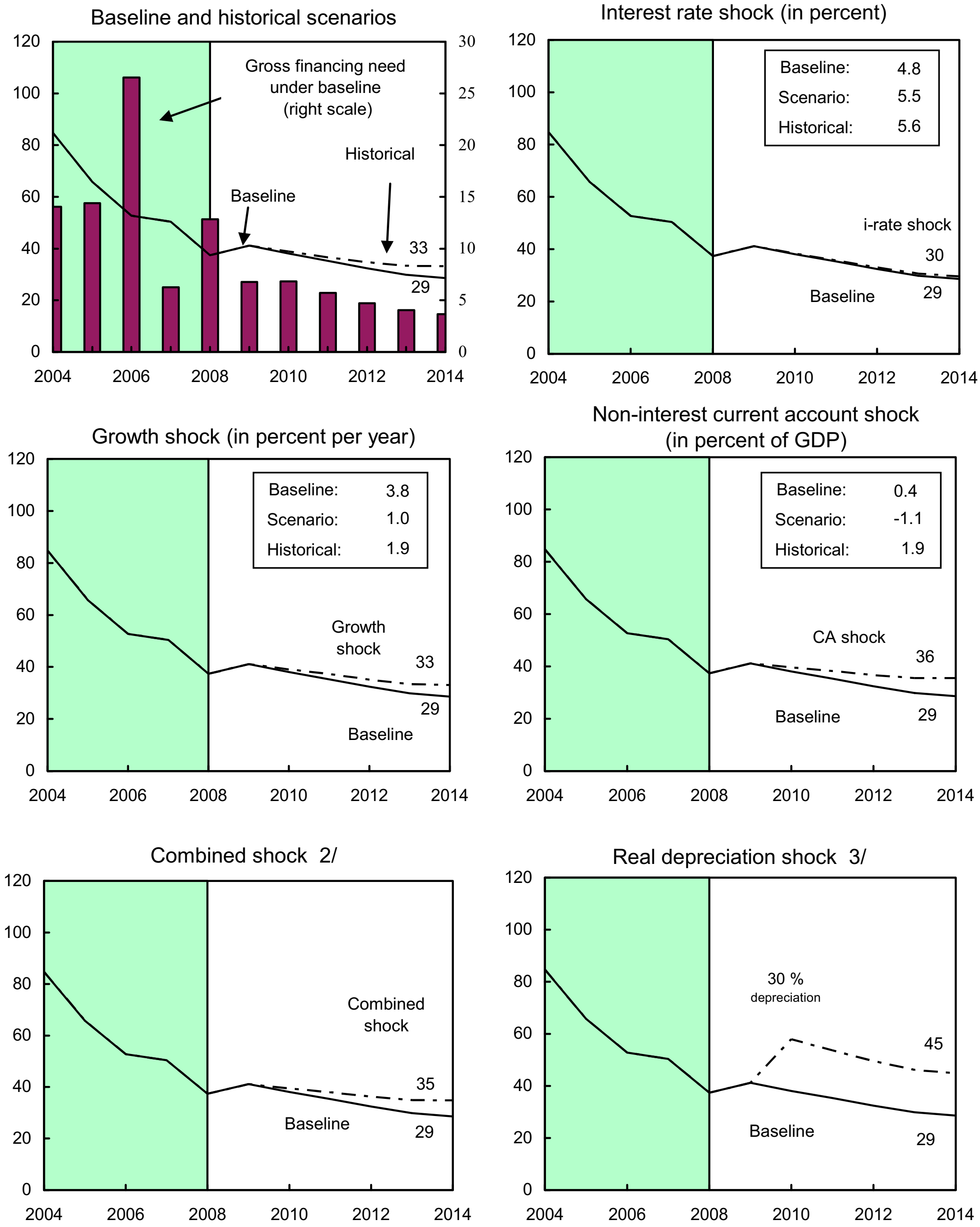
Sources: International Monetary Fund, country desk data, and staff estimates.

1/ Shaded areas represent actual data. Individual shocks are permanent one-half standard deviation shocks. Figures in the boxes represent average projections for the respective variables in the baseline and scenario being presented. Ten-year historical average for the variable is also shown.

2/ Permanent 1/4 standard deviation shocks applied to real interest rate, growth rate, and primary balance.

3/ One-time real depreciation of 30 percent and 10 percent of GDP shock to contingent liabilities occur in 2009, with real depreciation defined as nominal depreciation (measured by percentage fall in dollar value of local currency) minus domestic inflation (based on GDP deflator).

Figure 2. Uruguay: External Debt Sustainability: Bound Tests 1/
(External debt in percent of GDP)



Sources: International Monetary Fund, Country desk data, and staff estimates.

1/ Shaded areas represent actual data. Individual shocks are permanent one-half standard deviation shocks. Figures in the boxes represent average projections for the respective variables in the baseline and scenario being presented. Ten-year historical average for the variable is also shown.

2/ Permanent 1/4 standard deviation shocks applied to real interest rate, growth rate, and current account balance.

3/ One-time real depreciation of 30 percent occurs in 2009.

Table 1. Country: Public Sector Debt Sustainability Framework, 2004-2014
(In percent of GDP, unless otherwise indicated)

	Actual					Projections						
	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	Debt-stabilizing primary balance 9/
Baseline: Public sector debt 1/	90.1	77.6	69.6	62.2	59.7	**60.1**	**56.3**	**51.8**	**47.6**	**43.9**	**40.8**	**-0.5**
o/w foreign-currency denominated	81.3	67.7	56.7	43.1	40.9	41.2	37.8	34.2	30.0	25.9	23.7	
Change in public sector debt	-14.5	-12.5	-8.0	-7.4	-2.5	0.4	-3.8	-4.5	-4.1	-3.8	-3.1	
Identified debt-creating flows (4+7+12)	-20.4	-15.0	-6.5	-16.4	-3.5	-2.5	-2.8	-4.5	-4.1	-3.8	-3.1	
Primary deficit	-3.7	-3.8	-3.5	-3.4	-1.3	-0.4	-0.8	-2.0	-2.4	-2.5	-2.5	
Revenue and grants	30.0	30.8	30.7	30.4	28.0	28.8	29.9	30.6	30.7	30.7	30.7	
Primary (noninterest) expenditure	26.3	26.9	27.2	27.0	26.7	28.5	29.1	28.6	28.3	28.2	28.2	
Automatic debt dynamics 2/	-16.7	-11.1	-3.0	-13.0	-2.2	-2.1	-2.0	-2.5	-1.7	-1.2	-0.6	
Contribution from interest rate/growth differential 3/	-8.7	-2.4	-5.2	-7.3	-6.9	-2.1	-2.0	-2.5	-1.7	-1.2	-0.6	
Of which contribution from real interest rate	-4.5	3.2	-2.0	-2.8	-2.2	-1.8	-1.0	-0.7	0.1	0.5	1.0	
Of which contribution from real GDP growth	-4.2	-5.7	-3.2	-4.5	-4.7	-0.4	-1.0	-1.8	-1.8	-1.7	-1.6	
Contribution from exchange rate depreciation 4/	-8.0	-8.7	2.2	-5.7	4.7	...	...	...	...	...	...	
Other identified debt-creating flows	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Privatization receipts (negative)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Recognition of implicit or contingent liabilities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Other (specify, e.g. bank recapitalization)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Residual, including asset changes (2-3) 5/	5.9	2.4	-1.5	9.0	1.0	2.9	-1.0	0.0	0.0	0.0	0.0	
Public sector debt-to-revenue ratio 1/	300.4	252.3	226.7	204.8	212.9	208.5	188.2	169.3	155.3	142.9	132.8	
Gross financing need 6/	9.5	10.0	24.2	4.5	7.1	4.2	3.2	2.5	1.3	1.1	0.9	
in billions of U.S. dollars	1.3	1.7	4.8	1.1	2.3	1.3	1.2	1.0	0.6	0.5	0.5	
Scenario with key variables at their historical averages 7/						**60.1**	**55.4**	**51.9**	**48.5**	**45.2**	**42.1**	**-1.6**
Scenario with no policy change (constant primary balance) in 2009-2014						**60.1**	**62.6**	**59.4**	**57.3**	**55.1**	**54.0**	**-0.7**
Key Macroeconomic and Fiscal Assumptions Underlying Baseline												
Real GDP growth (in percent)	4.6	6.8	4.6	7.6	8.9	0.6	1.7	3.5	3.8	3.9	3.9	
Average nominal interest rate on public debt (in percent) 8/	6.0	5.3	5.9	5.8	5.3	5.3	5.4	5.4	6.2	6.7	6.9	
Average real interest rate (nominal rate minus change in GDP deflator, in percent)	-4.4	4.0	-2.5	-4.0	-3.5	-3.2	-1.7	-1.1	0.4	1.3	2.6	
Nominal appreciation (increase in US dollar value of local currency, in percent)	10.0	12.4	-3.3	12.7	-10.8	...	...	...	...	...	...	
Inflation rate (GDP deflator, in percent)	10.5	1.3	8.4	9.8	8.8	8.5	7.0	6.5	5.8	5.4	4.3	
Growth of real primary spending (deflated by GDP deflator, in percent)	-0.3	9.1	5.8	6.6	7.8	7.3	5.9	1.7	2.7	3.5	4.0	
Primary deficit	-3.7	-3.8	-3.5	-3.4	-1.3	-0.4	-0.8	-2.0	-2.4	-2.5	-2.5	

1/ Indicate coverage of public sector, e.g., general government or nonfinancial public sector. Also whether net or gross debt is used.
2/ Derived as $[(r - \pi(1+g) - g + \alpha\varepsilon(1+r)]/(1+g+\pi+g\pi))$ times previous period debt ratio, with r = interest rate; π = growth rate of GDP deflator; g = real GDP growth rate; α = share of foreign-currency denominated debt; and ε = nominal exchange rate depreciation (measured by increase in local currency value of U.S. dollar).
3/ The real interest rate contribution is derived from the denominator in footnote 2/ as $r - \pi$ (1+g) and the real growth contribution as -g.
4/ The exchange rate contribution is derived from the numerator in footnote 2/ as $\alpha\varepsilon(1+r)$.
5/ For projections, this line includes exchange rate changes.
6/ Defined as public sector deficit, plus amortization of medium and long-term public sector debt, plus short-term debt at end of previous period.
7/ The key variables include real GDP growth; real interest rate; and primary balance in percent of GDP.
8/ Derived as nominal interest expenditure divided by previous period debt stock.
9/ Assumes that key variables (real GDP growth, real interest rate, and other identified debt-creating flows) remain at the level of the last projection year.

Table 2. Uruguay: External Debt Sustainability Framework, 2004-2014
(In percent of GDP, unless otherwise indicated)

	Actual					Projections						
	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	**Debt-stabilizing non-interest current account 6/**
Baseline: External debt	84.7	65.8	52.7	50.4	37.4	**41.1**	**38.1**	**35.3**	**32.4**	**29.9**	**28.6**	**-3.4**
Change in external debt	-6.7	-19.0	-13.0	-2.4	-13.0	3.8	-3.1	-2.8	-2.9	-2.5	-1.2	
Identified external debt-creating flows (4+8+9)	-13.6	-21.6	-13.3	-13.5	-12.8	-1.6	-1.9	-2.5	-3.0	-3.1	-3.2	
Current account deficit, excluding interest payments	-5.2	-4.5	-1.7	-2.8	2.5	-0.7	0.7	-0.1	-0.7	-0.9	-1.0	
Deficit in balance of goods and services	-59.0	-56.2	-57.2	-56.0	-60.6	-54.4	-54.5	-54.9	-54.1	-53.0	-52.1	
Exports	31.4	29.3	28.3	28.2	28.9	27.3	26.8	27.3	27.2	26.9	26.5	
Imports	-27.6	-26.8	-28.9	-27.7	-31.7	-27.1	-27.7	-27.6	-26.9	-26.1	-25.5	
Net non-debt creating capital inflows (negative)	-2.3	-4.1	-6.9	-4.7	-5.7	-3.0	-3.1	-2.9	-2.7	-2.5	-2.3	
Automatic debt dynamics 1/	-6.1	-13.0	-4.7	-6.0	-9.6	2.1	0.5	0.5	0.4	0.2	0.2	
Contribution from nominal interest rate	4.9	4.5	4.0	3.1	2.1	2.3	1.8	1.7	1.6	1.4	1.3	
Contribution from real GDP growth	-3.7	-4.5	-2.7	-3.3	-3.4	-0.2	-1.3	-1.2	-1.2	-1.1	-1.1	
Contribution from price and exchange rate changes 2/	-7.2	-12.9	-6.0	-5.8	-8.3	...	...	...	...	...	...	
Residual, incl. change in gross foreign assets (2-3) 3/	6.9	2.6	0.3	11.1	-0.2	5.4	-1.1	-0.3	0.1	0.6	1.9	
External debt-to-exports ratio (in percent)	269.9	224.2	186.1	178.4	129.3	150.9	142.0	129.1	119.0	111.1	107.8	
Gross external financing need (in billions of US dollars) 4/	1.9	2.5	5.3	1.5	4.1	2.1	2.4	2.2	2.0	1.9	1.9	
in percent of GDP	14.0	14.4	26.5	6.3	12.8	6.8	6.8	5.7	4.7	4.1	3.7	
Scenario with key variables at their historical averages 5/						**41.1**	**38.9**	**36.6**	**34.7**	**33.3**	**33.1**	**-2.6**
Key Macroeconomic Assumptions Underlying Baseline												
Real GDP growth (in percent)	4.6	6.8	4.6	7.6	8.9	0.6	3.5	3.6	3.8	3.9	3.9	
GDP deflator in US dollars (change in percent)	8.6	18.8	10.2	12.6	21.9	-2.4	8.3	6.0	6.4	6.0	4.6	
Nominal external interest rate (in percent)	6.1	6.7	7.0	7.2	5.6	6.1	4.9	4.9	4.9	4.7	4.6	
Growth of exports (US dollar terms, in percent)	39.3	18.6	11.4	20.7	35.8	-7.4	10.3	11.9	10.0	8.7	7.4	
Growth of imports (US dollar terms, in percent)	38.2	23.2	24.3	16.2	51.9	-16.1	14.7	9.3	7.6	6.9	6.2	
Current account balance, excluding interest payments	5.2	4.5	1.7	2.8	-2.5	0.7	-0.7	0.1	0.7	0.9	1.0	
Net non-debt creating capital inflows	2.3	4.1	6.9	4.7	5.7	3.0	3.1	2.9	2.7	2.5	2.3	

1/ Derived as $[r - g - \rho(1+g) + \varepsilon\alpha(1+r)]/(1+g+\rho+g\rho)$ times previous period debt stock, with r = nominal effective interest rate on external debt; ρ = change in domestic GDP deflator in US dollar terms, g = real GDP growth rate, ε = nominal appreciation (increase in dollar value of domestic currency), and α = share of domestic-currency denominated debt in total external debt.

2/ The contribution from price and exchange rate changes is defined as $[-\rho(1+g) + \varepsilon\alpha(1+r)]/(1+g+\rho+g\rho)$ times previous period debt stock. ρ increases with an appreciating domestic currency ($\varepsilon > 0$) and rising inflation (based on GDP deflator).

3/ For projection, line includes the impact of price and exchange rate changes.

4/ Defined as current account deficit, plus amortization on medium- and long-term debt, plus short-term debt at end of previous period.

5/ The key variables include real GDP growth; nominal interest rate; dollar deflator growth; and both non-interest current account and non-debt inflows in percent of GDP.

6/ Long-run, constant balance that stabilizes the debt ratio assuming that key variables (real GDP growth, nominal interest rate, dollar deflator growth, and non-debt inflows in percent of GDP) remain at their levels of the last projection year.

INTERNATIONAL MONETARY FUND

URUGUAY

Staff Report for the 2009 Article IV Consultation—Informational Annex

Prepared by the Staff Representatives for the 2009 Article IV Consultation with Uruguay

Approved by Rodrigo Valdés and Dhaneshwar Ghura

October 21, 2009

Contents Page

ANNEX 1. FUND RELATIONS
(As of August 31, 2009)

I. Membership Status: Joined: March 11, 1946; Article VIII

II. General Resources Account:	**SDR Million**	**% Quota**
Quota	306.50	100.00
Fund holdings of currency	306.51	100.00
Reserve Position	0.00	0.00
Holdings Exchange Rate		

III. SDR Department:	**SDR Million**	**% Allocation**
Net cumulative allocation	277.19	100.00
Holdings	229.63	82.84

IV. Outstanding Purchases and Loans: None

V. Latest Financial Arrangements:

Type	Date of Arrangement	Expiration Date	Amount Approved (SDR Million)	Amount Drawn (SDR Million)
Stand-By	Jun 08, 2005	Dec 27, 2006	766.25	263.59
Stand-By	Apr 01, 2002	Mar 31, 2005	1,988.50	1,988.50
of which SRF	Jun 25, 2002	Aug 08, 2002	128.70	128.70
Stand-By	May 31, 2000	Mar 31, 2002	150.00	150.00

VI. Projected Payments to Fund [1/]
(SDR Million; based on existing use of resources and present holdings of SDRs):

	Forthcoming				
	2009	2010	2011	2012	2012
Principal					
Charges/Interest	0.03	0.15	0.15	0.15	0.15
Total	0.03	0.15	0.15	0.15	0.15

[1/] When a member has overdue financial obligations outstanding for more than three months, the amount of such arrears will be shown in this section.

VII. ***Safeguards Assessment***. The authorities are in the process of addressing all safeguards concerns raised in the safeguards assessment completed in September 2005, and have already implemented many of the recommendations proposed by staff. Uruguay's total obligations to the Fund are now included in the BCU's financial statements and the criteria for the selection and appointment of the BCU's external audit firm have been amended in line with the safeguards recommendation.

VIII. ***Exchange Rate Arrangement***. The currency is the Uruguayan peso (Ur$). Uruguay has followed an independently floating exchange rate regime since July 29, 2002. In 2008, Uruguay’s de facto exchange rate regime was reclassified from a managed float with no predetermined path for the exchange rate to a floating exchange rate regime. On October 5, 2009, the exchange rate in the official market was Ur$ 21.173 per US dollar. Uruguay's exchange system is free of restrictions on payments and transfers for current international transactions.

IX. ***Article IV Consultation***. The 2008 Article IV consultation was concluded by the Executive Board on October 24, 2008 (Country Report No. 09/104). Uruguay is on the standard consultation cycle governed by the provisions approved by the Executive Board on July 15, 2002.

X. ***Ex Post Assessment***. The last Ex Post Assessment of Longer-Term Program Engagement was considered by the Executive Board on August 29, 2007 (Country Report No. 08/47).

XI. ***FSAP participation and ROSCs***. The Financial Sector Stability Assessment (FSSA) was considered by the Executive Board on June 28, 2006 (Country Report No. 06/187). The ROSC-module on fiscal transparency was published on March 5, 2001. A ROSC-module on data dissemination practices was published on October 18, 2001. The ROSC on Anti-Money Laundering and Combating the Financing of Terrorism (AML/CFT) was published on December 2006 (Country Report No. 06/435)

XII. ***Technical Assistance***

DPT	Purpose	Date of Delivery
FAD	Tax, customs, and social security administration	2008; February 2007; March 2006; June 2005 and July 2006
	Tax policy	October 2005 and May 2003
	Public financial management	March 2005 and July 2006
	Resident advisor on social security administration, 1 year	July 2006 to June 2007
LEG	TA to develop a framework to elaborate and implement a national AML/CFT strategy consistent with the recommendations of the Fund's 2005 AML/CFT assessment report	February 2007
	TA to conduct a money laundering/terrorist financing country risk assessment consistent with the objectives of the national AML/CFT strategy	January. April, and July 2009
MCM	Substantial and continuous technical assistance in the resolution of intervened banks, the restructuring of the public bank BROU, and recently on BHU	Since 2002
	Debt Management (jointly with ICM)	July 2005
	Strengthening the formulation and conduct of monetary and exchange rate policies	July 2006; May 2007
STA	TA to develop adequate recording of loans funded by the FSBS	April 2003
	Monetary and financial statistics	November 2007
	Government Finance Statistics, to assist in improving the quality of public debt data	February 2008

XIII. ***Resident Representative***. Mr. Gaston Gelos. The Resident Representative covers Uruguay from the Buenos Aires' office.

ANNEX 2. RELATIONS WITH THE WORLD BANK GROUP
(As of September 7, 2009)

The last Country Assistance Strategy (CAS) for Uruguay was approved on June 9, 2005. The CAS envisaged a base case scenario of up to US$800 million in new lending over the period FY05–10, and proposed to rebuild the investment portfolio with new operations supporting investments in infrastructure, social programs and innovation.

The Bank's strategy was anchored around a series of programmatic development loans (DPLs) supporting the Government in key policy areas. The first DPL (SPDPL) for US$75 million was approved by the Board of Directors together with the CAS on June 9, 2005. It supported reforms in social policies as well as important measures taken by the Government with respect to health, education and social protection. A subsequent DPL, the First Programmatic Reform Implementation Development Policy Loan (PRIDPL 1) in the amount of US$100 million, was approved by the Board of Directors on May 30, 2007. This operation supported the Government's reform program in taxation, business climate and capital markets development, and aimed at improving the social protection system. The US$100 million PRIDPL1 was disbursed in local currency in May 2008, as the World Bank became the first foreign issuer to launch a public bond in (inflation indexed) Uruguayan pesos. This was the first that the World Bank has issued a local currency bond for the purpose of a back-to-back disbursement of a specific loan.

A CAS Progress Report (PR) to assess progress in implementing the program outlined in the 2005 CAS and lay out a program for the remainder of the CAS period (FY08-FY10) was approved on April 1, 2008. The CAS PR confirmed the validity of the overall thrust and long-term goals of the 2005 CAS and recognized the important economic developments that have taken place since the 2005 CAS was approved, most notably Uruguay's full recovery from the 2002 crisis.

The current investment portfolio comprises eight investment projects totaling US$261.9 million in commitments, with an undisbursed amount of US$123.9 million as of September 7, 2009. Seven of these investment operations have been approved since the beginning of the new CAS period. These include two investment operations for Integrated Natural Resources and Transport Infrastructure and Rural Access, in the amount of US$30 million and US$70 million respectively, approved by the Board on June 9, 2005 together with the CAS**.** In addition, in December 2006, the Board approved a Supplemental Financing for the Foot and Mouth Disease Project in the amount of US$6.5 million. On May 30, 2007 an Institution Building Technical Assistance Project in the amount of US$15 million was also approved (together with the First PRIDPL).

In addition, the second phase of an Adaptable Program Loan (APL) for OSE Modernization and Rehabilitation Systems (US$50 million) was approved on July 28, 2007. Another investment loan in support of the Promoting Innovation to Enhance Competitiveness Project was approved on May 1, 2007 in the amount of US$26 million, and a Non Communicable Disease Prevention Project in the amount of US$25.30 million was approved on August 28, 2008.

In addition to investment lending, a second PRIDPL in the amount of $400 million was approved on 3 February 2009 and has been fully disbursed. This operation continues the support provided under PRIDPL1 for the implementation of key reforms in taxation, business climate and capital markets, as well as the social protections system, where the loan builds on the achievements of the SPDPL.

The Bank has also engaged with the authorities in an active AAA program. In FY08, the program has included completion of a Programmatic DPR in Infrastructure, a PSIA on Tax Reform, an Investment Climate Assessment and a Non-Lending Technical Assistance (NLTA) on Strengthening Participatory Monitoring and Evaluation in Social Policies. A second phase of the NLTA on Strengthening Participatory Monitoring and Evaluation in Social Policies and a Study on the Payments System was completed in FY09, and a Railways Sector Study, a Country Economic Memorandum (CEM) focusing on trade, a Study on Family Farm Development and one on Opportunity and Informality are under preparation for FY10 delivery. The Policy Notes which will inform the next Country Partnership Strategy (CPS) are also under preparation and will be finalized in the third quarter of FY10, while the new CPS is expected to be presented to the Board of Executive Directors in the fourth quarter of FY10.

FINANCIAL RELATIONS WITH THE WORLD BANK GROUP
(In millions of U.S. dollars)

I. IBRD Operations (as of September 7, 2009)

	Commitments (Net of Cancellations)	Disbursed	Undisbursed
Foot & Mouth Disease (AF)	6.5	4.7	1.8
Basic Education III	42.0	40.6	1.4
Transport Infrastr. Maint. & Rural Access	70.0	48.1	21.9
Integrated Nat. Resources & Biodiv. Mgnt.	30.0	16.8	13.2
Innovation to Enhance Competitiveness	26.0	1.1	24.9
Institutions Building TAL	12.1	2.0	10.1
OSE Modernization & Systems Rehab.APL2	50.0	24.4	25.6
Non Communicable Diseases Prevention	25.3	0.4	24.9
Total	**261.9**	**138.0**	**123.9**

II. IFC Operations (as of August, 2009)

	Loans	Equity	Quasi	Guarantees	Participation
Committed	108.6	0.0	5.0	14.7	87.5
Outstanding	98.6	0.0	5.0	14.2	87.5

III. IBRD Loan Transactions (calendar year)

	2002	2003	2004	2005	2006	2007	2008	2009*
Disbursements	234	97	144	134	42	74	147	430
Repayments	75	78	80	104	205	85	86	47
Net Disbursements	158	19	64	30	-163	-11	62	382
Debt service payments	104	107	102	138	246	116	117	67
Net Transfers	129	-9	41	-4	-204	-42	30	363

* As of September 7, 2009

ANNEX 3. RELATIONS WITH THE INTER-AMERICAN DEVELOPMENT BANK

(As of September 15, 2009)

The Inter-American Development Board of Executive Directors approved a new Country Strategy for Uruguay on March 15, 2006. The Bank's Country Strategy supports the Government's policy, which seeks to consolidate growth and improve the population's social welfare. In support of this longer-term goal, the Strategy focuses on the following priority areas: (i) improving public sector management, to increase its efficiency and efficacy, while supporting fiscal and debt sustainability; (ii) enhancing regional and international competitiveness of domestic output and encouraging private investment in order to promote sustainable growth; and (iii) reducing poverty and increasing social inclusion.

The Bank's strategy proposed a lending scenario of about US$1.2 million for the five-year period 2005–09, which was thought to be consistent with Uruguay's five year budget plan, annual amendments approved by Congress, and the maintenance of a relatively neutral net flow of Bank resources (during this period of concentrated external-IFI maturities). At present we estimate that total approvals will add to US$920.5 million for the period, a total of 77% of planned resources.

This program included lending to support the Government in the key policy areas of competitiveness, the social sectors and poverty reduction, and public sector management. To this end, within the area of competitiveness, a loan for a program to support the productivity and development of new livestock products, for US$15.8 million, was approved in July 2005; an investment project to improve cluster competitiveness for US$9 million was approved in July 2006; and a two-year programmatic loan to improve competitiveness for a total of US$150 million—for US$75 million each—is under preparation, with the first loan approved in January 2007 and expected approval of the second loan in March 2009; and a loan to strengthen the institutional capacity for international insertion, for US$5.4 million was approved in April 2008. In the social sector area, a sector loan, for US$250 million, was approved in August 2005, to support the development and implementation of Government's social policy aimed at reducing poverty, improving the human resource base among the poor, and strengthening the sector's institutional framework; and a loan for sanitation, for US$118.6 million, was approved in January 2006, to improve the standard of living of the population in Montevideo by increasing the coverage of sanitation service and reducing pollution in the bay; a sanitation program for Ciudad de la Costa for US$43 million; also in Montevideo, a program to support the modernization of the harbor ($40 million), and two loans to improve transportation (US$80 million and US$100 million) and a neighborhood improvement program for US$70 million was approved in October, 2008.

Within the public sector management area, a loan to support the public debt management unit for US$2.45 million was approved in November 2005; and a three year programmatic loan to support improvements in tax administration and public sector management is being prepared.

The first loan for US$50 million was approved in October 2006; a second loan for US$285 million was approved in early-2009 while the amount for the third loan is still to be determined; a program related to e-government management for US$5 million was approved in March 2008; a program to support the social security system for US$3.2 millions was approved in December, 2008; a program to support the entities in charge of public oversight for US$2.2 million was also approved in December 2008.

As of September 15, 2009 the Bank's current portfolio in Uruguay includes loans for the financing of 35 projects; two of which are to the private sector without sovereign guarantee. The lending portfolio, largely aligned to the administration's priorities and consistent with the Bank's Country Strategy, amounts to US$1,379.9 million, of which US$510.4 million are pending disbursement. Portfolio performance related to investment loans in 2009 is relatively normal and disbursements will totalUS$495 million in 2009. PBL disbursements, focusing in Tax Administration, at US$285 million aimed to support government in the middle of the international financial crisis, compensating for the lack of market financing, related to the crisis. The Bank's Operational Program for 2009 has 4 additional investment loans with sovereign guarantee in the agricultural, financial, education and infrastructure sectors and two operations without sovereign guarantee with the private sector supporting trade.

FINANCIAL RELATIONS WITH THE INTER-AMERICAN DEVELOPMENT BANK [1]

(In millions of U.S. dollars)

Total outstanding loans: US$1,828.01

Loan transactions:

	2001	**2002**	**2003**	**2004**	**2005**	**2006**	**2007**	**2008**	**2009[2]**
Disbursements	214.2	558.6	367.2	53.1	242.3	114.8	112.9	337.2	495.0
Amortization	60.7	73.1	103.7	113.3	220.0	519.6	133.8	138.7	166.2
Net Loan Flows	**153.5**	**485.5**	**263.6**	**-60.2**	**22.3**	**-404.8**	**-20.9**	**198.5**	**328.8**

Source: Inter-American Development Bank.

[1] As of September 15, 2009.

[2] IDB staff projection.

ANNEX 4—STATISTICAL ISSUES

As of October 14, 2009

I. Assessment of Data Adequacy for Surveillance
General: Data provision has some shortcomings, but broadly adequate for surveillance. Most affected area is national accounts.
National Accounts: In 2009, the Uruguayan authorities completed a revision of national accounts statistics, in which they updated the benchmark year (from 1983 to 1997 and 2005) and adopted the *System of National Accounts 1993 (SNA93)*. However, national accounts statistics still have a number of shortcomings, limited coverage of the enterprise survey, long publication lags, inadequate information on the informal economy, and incomplete quarterly accounts. The central bank (BCU) compiles and disseminates annual GDP estimates in current and at previous year prices by the production and expenditure approaches, as well as quarterly constant price GDP estimates by the production and expenditure approaches. Gross national income, gross disposable income and gross savings are also available annually.
Consumer prices: Both the consumer and wholesale price indices are reported on a regular and timely basis for publication in the *IFS*. The consumer price index has a base period of March 1997 = 100, and the base of the wholesale price index has been updated to 2001. Coverage of the CPI is limited to the capital city. The authorities do not provide trade price and volume indices for publication in the *International Financial Statistics (IFS)*.
Government finance statistics: Official data on the central administration, the state enterprises and the social security system are complete and current, but there are problems with the timeliness of the data on local governments. There are also problems with the timeliness of financing and debt data reported for inclusion in the Fund's statistical publications. Information on a monthly and quarterly basis for financing and debt data respectively, are disseminated on the BCU website from 1999 onwards for the central government and total public sector. The information reported for publication in the *Government Finance Statistics Yearbook* covers transactions on revenue and expense for the consolidated central government, and the general government's operations on financial assets and liabilities, both in terms of flows (financing) and stocks (debt). However, data on revenue and expense for local governments have not been reported since 1994.
Monetary and financial statistics: Monetary and financial statistics are prepared in accordance with the IMF's *Monetary and Financial Statistics Manual (2000).* Authorities have yet to report monetary data using the standardized reporting forms (SRF). In April 2003, a STA mission visited Montevideo to assist the authorities in the adequate recording of the loans funded from the Fund for the Stabilization of the Banking System in the Central Bank's balance sheet. The mission's recommendations have been implemented and were reflected in the *IFS* June 2003 issue.

External sector statistics: Balance of payments statements are compiled and published on a quarterly basis. Data are compiled following the recommendations of the fifth edition of the *Balance of Payments Manual*. Uruguay compiles and reports to STA quarterly data on balance of payments and annual data on the international investment position (IIP) for publication in the *IFS* and the *Balance of Payments Statistics Yearbook*. The new surveys would also allow for improved coverage of the private sector in the IIP. Uruguay started disseminating the international reserves and foreign currency liquidity data template on the Fund's external website in 2005. The BCU also disseminates quarterly external debt statistics on its website, although not in the format envisaged by the SDDS.	
II. Data Standards and Quality	
Uruguay subscribed to the SDDS in February 2004 and is in observance.	Data ROSC published on October 1, 2001.
III. Reporting to STA (Optional)	
No data are currently reported to STA for publication in the *Government Finance Statistics* or in the *International Financial Statistics*.	

Statement by the IMF Staff Representative on Uruguay
November 9, 2009

1. This statement provides additional information that has become available since the circulation of the staff report. It does not alter the thrust of the staff appraisal.

2. In the presidential elections on October 25th, José Mujica from the governing Frente Amplio received 48.0 percent of all votes, compared to 29.1 percent for Luis Alberto Lacalle from the National (Blanco) Party and 17.0 percent for Pedro Bordaberry from the Colorado Party. Consequently, there will be a run-off presidential election on November 29th; Mr. Bordaberry has announced his support for Mr. Lacalle. The Frente Amplio obtained the majority of seats in both chambers of Congress.

3. To dampen the effects of exchange-rate volatility and potentially limit appreciation pressures, the central bank recently announced various measures. They include: (i) fostering the creation of a market for foreign-exchange forwards, with market participation of the central bank; (ii) reducing reserve requirements on US dollar deposits by 5 percentage points (to 25 percent) over the next 5 months; (iii) refunding deposits for export prefinancing operations at the central bank in pesos instead of US dollars; and (iv) signing a letter of intent with the Brazilian central bank to implement a bilateral payment system, enabling to conduct trade transactions in local currency. In the past two weeks, appreciation pressures have lessened somewhat, and intervention levels in the foreign-exchange market have been substantially lower.

INTERNATIONAL MONETARY FUND
Public Information Notice
EXTERNAL RELATIONS DEPARTMENT

Public Information Notice (PIN) No. 09/127
FOR IMMEDIATE RELEASE
November 11, 2009

International Monetary Fund
700 19th Street, NW
Washington, D. C. 20431 USA

IMF Executive Board Concludes the 2009 Article IV Consultation with Uruguay

On November 9, 2009, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with Uruguay.[1]

Background

The Uruguayan economy has held up considerably well in the face of the global recession. In recent years, Uruguay had taken advantage of favorable global economic conditions to consolidate macroeconomic stability while building up significant buffers. Improved fundamentals included a more robust and well-regulated banking system, substantial international reserves, a more flexible exchange rate regime, external current account deficits more than financed by Foreign Direct Investment (FDI), as well as reduced debt vulnerabilities. Together with low private sector leverage levels, these factors have helped to dampen the impact of the global recession.

The impact of the crisis appears to have been relatively short-lived. Real GDP contracted by 2.3 percent (quarter-over-quarter, seasonally adjusted) during the first quarter of 2009, as the decline in external demand leaned on key export-oriented sectors, and a severe drought affected activity in the agriculture, livestock and energy sectors. Private consumption and investment decelerated while the unemployment rate rose only little, and temporarily. In the second quarter, real GDP expanded again, by 0.5 percent (quarter-over-quarter, seasonally

[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. An explanation of any qualifiers used in summings up can be found here: http://www.imf.org/external/np/sec/misc/qualifiers.htm.

adjusted), led by a recovery in manufacturing and commerce. Overall, the economy is now expected to grow by at least 0.6 percent in 2009.

The policy response to the crisis has sought to balance different risks. Concerns about an overshooting of the exchange rate during the period of financial turbulence led to forceful but temporary intervention. Persistent inflationary pressures resulted in a more restrictive monetary stance than in other emerging markets. After coming under pressure late last year, the peso has been appreciating again in recent months and capital inflows have resumed, while yields and country risk have stabilized near pre-crisis levels. Core inflation remains in the upper half of the target range in an economy that is still operating around potential.

Fiscal policy has been maintained at keeping nominal expenditure growth as planned. The authorities have not implemented any discretionary stimulus plans, besides specific, limited measures to support particularly affected sectors. However, with strong expenditure growth, lower-than-expected revenues and drought-related costs (of 1.6 percent of GDP), the overall fiscal deficit is projected to deteriorate further in 2009 to 2.6 percent of GDP.

In 2010, the recovery is expected to strengthen, with growth projected to reach 3.5 percent. Medium term-prospects are good, as considerable FDI in recent years has contributed to substantial productivity improvements in the tradable sectors.

Executive Board Assessment

Executive Directors commended the authorities' achievements in reducing Uruguay's vulnerabilities, which have enabled the economy to withstand well the global recession. Directors praised in particular Uruguay's sound macroeconomic policies and skilful public debt management; its robust and well-regulated banking system; its solid external position—underpinned by a flexible exchange rate regime; and its advances in poverty alleviation. Low private sector leverage and minimal bank exposure to foreign toxic assets have also helped to limit the transmission of the global crisis to Uruguay. Directors noted the quick turnaround in the Uruguayan economy, welcoming the resumption of growth in the second quarter of 2009.

Directors commended the authorities' policy response to the global recession. The monetary policy stance was appropriately tighter than in other emerging markets in light of inflation concerns, while fiscal policy was geared to broadly maintaining the significant increase in nominal expenditure as planned, allowing automatic stabilizers to work. Directors agreed that there is no clear case for strengthening domestic demand further, given that the Uruguayan economy is still operating around potential. Looking forward, the recent sizable inflows of foreign investment and associated productivity improvements should enable Uruguay to benefit from the recovery of global demand for its exports.

Directors agreed that fiscal policy should continue to aim at debt reduction. While recognizing that the recent increase in the fiscal deficit reflected largely temporary factors, they considered that the still high levels of public debt call for a cautious approach going forward. Directors therefore welcomed the authorities' intention to contain growth in non-priority areas in the near term, while preserving room for much-needed infrastructure and social outlays, and encouraged the authorities to seek to return to more ambitious fiscal targets over the medium term.

Directors welcomed the achievement of single-digit inflation over the last several years, while noting that inflation remains relatively high. Against this backdrop, they did not see room for monetary easing in the near term, and encouraged the authorities to aim for lower inflation rates over the medium term. This would allow Uruguay to reap associated growth benefits, protect the poor, promote de-dollarization, and avoid the need to resort to costly measures should inflation threaten to reach the 10 percent threshold. Directors noted the staff assessment that the real effective exchange rate is broadly in line with fundamentals.

Directors considered that, building on recent improvements, Uruguay’s monetary policy framework could be strengthened further. This could be achieved through an even stronger commitment to the inflation target range, while ensuring that exchange-rate intervention remains limited to addressing volatility and consistent with the inflation objective. Consideration could also be given to strengthening the central bank’s autonomy, enhancing accountability, and improving communication. Strengthening credibility would be key to de-dollarize the economy further.

Directors welcomed Uruguay’s achievement in bringing prudential regulation and supervision of the banking sector up to international best practices, drawing on Financial Sector Assessment Program recommendations. They supported the authorities’ intention to move towards consolidated supervision of financial groups starting next year, and encouraged them to continue strengthening the framework as needed.

Directors supported the authorities’ commitment to improve productivity and the business climate. They welcomed the efforts to promote public sector efficiency, reduce red tape, and improve the governance of public enterprises. It will be important to further strengthen efforts to promote private investment in the electricity sector. Directors agreed that planning for energy-related contingencies could be improved to avoid bottlenecks and enhance the growth potential.

Directors commended the authorities’ achievements in reducing poverty. They highlighted the need for further fostering social inclusion and improving targeted social programs through budget re-prioritization.

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.

Uruguay: Selected Economic Indicators

	2004	2005	2006	2007	2008	Projections 2009	2010
(Percent change, unless otherwise specified)							
Real GDP	4.6	6.8	4.6	7.6	8.9	0.6	3.5
Real consumption	2.9	5.2	7.1	7.3	8.8	3.9	2.9
Real investment	15.8	4.2	13.3	6.3	25.0	-0.6	2.4
Prices							
CPI inflation (average)	9.2	4.7	6.4	8.1	7.9	7.3	7.0
CPI inflation (eop)	7.6	4.9	6.4	8.5	9.2	7.0	6.5
Money and Credit							
Base Money (eop)	10.6	55.4	12.5	16.4	29.3	9.2	...
M-1	14.3	33.5	23.6	29.4	18.6	12.5	...
M-2	13.2	26.7	25.7	30.6	17.1	7.9	...
M-3	-3.0	0.0	14.8	3.8	28.6	8.1	...
Credit to the private sector (constant exch. rate)	-31.4	6.3	11.0	22.1	28.0	0.6	...
Gross official reserves (US$ millions) 1/	2,512	3,438	3,091	4,096	6,328	8,211	8,811
In percent of short-term debt	112.4	153.8	492.6	469.9	786.5	994.4	951.2
In percent of short-term debt plus FX deposits	27.7	41.3	43.2	52.1	69.6	80.7	89.5
(Percent of GDP, unless otherwise specified)							
Public sector finances							
Revenue 2/	28.0	28.0	27.7	27.6	25.4	26.3	27.3
Non-interest expenditure 2/	24.2	24.3	24.3	24.4	24.3	26.2	26.8
Primary balance 3/	3.5	3.8	3.5	3.4	1.4	0.4	0.8
Interest 3/	5.5	4.4	4.0	3.4	2.8	2.9	2.9
Overall balance 3/	-2.0	-0.6	-0.5	0.0	-1.4	-2.6	-2.1
Gross public sector debt	90.1	77.6	69.6	62.2	59.7	60.1	56.3
Net public sector debt 4/	86.7	72.6	65.0	55.1	50.2	47.4	…
External debt 5/	84.7	65.8	52.7	50.4	37.4	41.1	38.1
Of which: external public debt	74.6	58.6	46.5	45.6	33.4	37.1	34.1
Balance of payments							
Current account balance	0.3	0.0	-2.3	-0.3	-4.6	-1.6	-2.5
Merchandise exports, f.o.b.	23.0	21.6	21.9	20.8	22.0	19.9	19.6
Merchandise imports, f.o.b.	21.9	21.5	24.3	23.1	27.3	23.0	23.6
Services, income, and transfers (net)	-0.8	-0.2	0.1	2.0	0.7	1.4	1.6
Capital and financial account	0.5	5.9	1.0	6.9	8.8	7.6	4.2
Foreign direct investment	2.3	4.1	6.9	4.7	5.7	3.0	3.1
Overall balance of payments (US$ millions)	454	951	-337	1,005	2,232	1,883	600
External debt service (percent of exports of goods and services)	44.8	53.1	92.5	26.1	29.8	21.0	15.1

Sources: Data provided by the Uruguayan authorities; and IMF staff estimates.
1/ Includes reserve buildup through reserve requirements of resident financial institutions.
2/ Non-financial public sector excluding local governments.
3/ Total public sector.
4/ Public sector debt, net of free reserves of the central bank of Uruguay.
5/ Excludes nonresident deposits.

Statement by Mr. David Vogel Alternate Executive Director for Uruguay
November 9, 2009

From Uruguay's Worst Crisis ...

1. Seven years ago, Uruguay suffered the deepest economic, financial, and social crisis in its history. In about six months, the country's financial system lost almost half of its deposits; after the abandonment of the crawling band, the exchange rate followed an overshooting process and depreciated more than 80 percent (at the end of 2002 relative to the end of 2001); unemployment rates steadily climbed to almost 20 percent; the gross public sector debt–to-GDP ratio increased to above 100 percent and the rollover of the public debt highlighted a critical issue which was exacerbated when some analysts confused liquidity with solvency aspects, and temporary with permanent effects. The crisis drove a large number of the population to poverty, while many others decided to emigrate.

... to a Promising Future

2. The current situation is completely different. After exhibiting an average economic growth of approximately 7 percent over the last five years, Uruguay's GDP will end this year with a positive variation, as economic activity has already increased in the second quarter of 2009; unemployment rate is just above 7 percent; the country is continuing to attract a significant amount of direct investment; inflation is fully under control; the financial sector is showing a remarkable, sound performance; public debt indicators have improved substantially; and poverty rates have significantly declined together with migration flows.

What Happened in the Meantime?

3. **During bad times, and when daunting challenges had to be faced, Uruguay relied on its solid traditions and democratic institutions.** The country ratified its strong tradition of honoring its debts and commitments in general; and, once again, Uruguay's political system demonstrated a noteworthy responsibility to deal with sensitive issues. Following the rule of law, Uruguay was able to overcome the crisis and contain social tensions.

4. **Uruguay enjoys a high level of political stability which is critical.** For instance, with regard to some last episodes, it is worth highlighting that in October 2009 the President invited three former Presidents from two opposition parties to inaugurate a significant investment from a foreign company aimed to further increase Montevideo's seaport infrastructure, allowing the country to enhance its position as a key hub in the region. Something similar occurred in early October when the President invited his predecessor—from an opposition party— to the inauguration of a new airport under whose government this private investment was decided to be implemented. Beyond the critical importance of the

above-referred investments, these facts once again reveal Uruguay's political stability. Meanwhile, recent national elections were held in a sound democratic environment, as usual.

5. **Alleviating the conditions of the most vulnerable sectors of society has been a high priority.** Needless to say, an economic and financial crisis such as Uruguay endured mostly affects these sectors, and improving their conditions largely exceeded the recovery of economic growth. Beyond the role of the automatic stabilizers in this regard, the situation required decisive plans (particularly the Plan de Emergencia Social) which were implemented in a transparent manner, having been of vital importance to meet imperious social needs. It is important to note that, as envisaged, the Plan de Emergencia Social was temporary, and after its completion new social plans have been implemented, which are more focused on removing the roots of poverty, and giving the most vulnerable people the necessary instruments and conditions to reemerge economically and socially. In 2008, poverty rates continued decreasing from 26 percent in 2007 to 20.5 percent, while extreme poverty (indigence) declined from 2 percent to 1.5 percent.

6. **Policies have aimed at attaining economic and social sustainability.** Meeting these objectives together is not only possible but essential to enter a virtuous cycle. Therefore, with a pragmatic approach, the government implemented fiscal policies fully consistent with the objective of ensuring fiscal sustainability, while implementing the above-referred social plans. Fiscal policies have been gradually set up, considering the imperious need to attain fiscal consolidation and give strict priority to social policies, for which there has been a critical reorganization of expenditures.

7. **Public debt indicators have shown tremendous progress.** Gross public sector debt-to-GDP ratio is currently below 60 percent (and net public debt-to-GDP-ratio has exhibited a dramatic decline, considering also the increase of international reserves). Furthermore, and beyond this specific case, when comparing debt dynamics across countries, it is necessary—among other things that could allow us to compare more consistently among indicators—to take into account the burden of future pensions on public debt indicators. In this regard, Uruguay's debt indicators fully include the effects of a major pension system reform implemented more than a decade ago. Indeed, nearly US$ 4 billion (about 13 percent of GDP) of public debt are held by the Pension Fund Administrators (AFAPs).

8. **The skillful and professional work of the Debt Management Unit (created in 2005) has also allowed the country to strengthen its fiscal position while creating more space for social expenditures.** Thus, Uruguay has been able to lengthen public debt maturities (from 7.4 years in 2004 to 12.8 years in 2009), take firm steps in its de-dollarization (89 percent of the debt was denominated in foreign currency five years ago while 71 percent is currently), and reduce its interest costs. The country's financing needs are well covered for the coming years, with most of the debt being at fixed rates; and Uruguay has been able to obtain some contingent lines, all of which have driven the country to substantially minimize vulnerabilities and risks in this regard.

9. **Monetary policies have aimed at keeping inflation in check, which is essential not only to further improve the investment environment, but also as a critical way to protect the most vulnerable sectors of society.** During a period where the rise in international commodities prices exerted significant pressures on domestic prices, the Central Bank implemented the needed measures to address the situation. When many countries, including Uruguay, exhibited a temporary deviation of inflation rates from their targets, the authorities were especially eager to prevent inflation rising above 10 percent, which would have fed inflationary pressures through second-round effects due to the introduction of indexation mechanisms, making it even more difficult to reach the target range (from 3 percent to 7 percent). Therefore, the government, demonstrating again its commitment to maintaining low and stable inflation rates, and incurring a fiscal cost, collaborated, under exceptional circumstances, with the monetary policy to avoid the possibility of the above-referred second-round effects. Currently, twelve-month inflation (6.5 percent in October) and inflationary expectations (6.15 percent in October 2009-September 2010) are well within the Central Bank's target range.

10. **Maintaining a flexible exchange rate system and without pushing against the wind, the Central Bank has simply intervened in the exchange rate market to smooth volatility.** Interventions have led to an increase in international reserves, allowing Uruguay to build up a considerable financial buffer in this regard. The authorities fully agree with the staff's conclusion that "there is no evidence of competitiveness problems and a potential misalignment of the real exchange rate".

11. **Labor market developments provide another sample of the efforts towards reinforcing economic and social stability.** After a substantial decrease in real wages during the crisis (about 20 percent in 2002 and 4 percent in 2003), a considerable rise has been observed in recent years, which should be seen in the context of a recovery from the deep decline. This process was also accompanied by a significant increase in productivity. Unemployment figures (showing historic low levels) along with those associated with economic activity, inflation and investment clearly demonstrate that income policies and labor reforms have been meticulously carried out, considering the need to be consistent with the authorities' broad concept of stability.

12. **Regulation and supervision of the financial system has been substantially strengthened.** The Financial Sector Assessment Program (FSAP) undertaken by the IMF and World Bank staff has provided an important input in this regard, and its suggestions were carefully considered by the authorities when the reforms were analyzed and implemented. Among other things, it is interesting to note a recent IMF Working Paper on Uruguay[1], which concludes "the gradual but persistent reforms have brought financial regulation and supervision generally up to international best practices, while also embracing innovative elements such as dynamic provisions and explicit liquidity requirements". Furthermore, after

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[1] "Modernizing Bank Regulation in Support of Financial Deepening: The Case of Uruguay", IMF Working Paper 09/199.

having successfully faced arduous challenges, public banks (BROU and BHU) are exhibiting noticeable transformations, where functioning and incentives have changed dramatically.

13. **Market and product diversification allows Uruguay to be substantially less dependent on regional events.** We also note a substantial decrease in non-resident deposits, which, of course, further weaken regional economic and financial linkages. Chapter III of the Selected Issues is very eloquent in showing Uruguay's current situation and outlook as less exposed from occurrences in the surrounding region. Of course, regional developments do not pass inadvertently in Uruguay, but diversification and structural changes have significantly minimized risks of contagion.

14. **Support from the international community has been key, although it does not necessarily ensure success, as it critically depends on the authorities' ownership.** We recall once again that just after the Stand-By Arrangement was approved in June 2005, Uruguay's Minister of Finance at the time publicly underlined "this is the economic program of Uruguay and not of the Fund" establishing a powerful proof of political leadership. In the Buff statement issued on June 6, 2005, the authorities' strong commitment to make Uruguay "a successful case for the benefit of the Uruguayan people and also for the Fund" and "their firm willingness to establish a well articulated exit strategy from the Fund's financial support" was underscored.

15. **Effectively, the exit strategy was well-articulated, and after Uruguay repaid its outstanding debt to the Fund—based on economic and financial arguments— the authorities' ownership of the program was demonstrated once again.** They have continued to be extremely successful in approving the envisaged reforms established in Uruguay's agenda. Among many others, these reforms included those on the tax system and revenue administration, autonomy to the Central Bank, the approval of the bankruptcy law, and the above reforms on the financial system and BHU.

16. **Until 2008, Uruguay and the rest of the world enjoyed a favorable external environment; as noted in other occasions, positive cycles can be capitalized to establish pillars for higher and sustainable growth or may sometimes lead to dilapidation. Clearly, Uruguay chose the first option.** At the same time, it is important to underscore that the favorable external environment was less benign in Uruguay than in many other countries, to the extent that Uruguay is an oil importer (as noted by the staff "the concurrent oil price shock has led to a deterioration in Uruguay's terms of trade) and, combined with years of severe drought (oil products were necessary to substitute the lack of hydroelectric power), substantial fiscal costs were incurred. Admittedly, the international situation until 2008 generated an abundance of liquidity, and Uruguay, based on its sound policies, reforms and traditions, has been able to benefit from the situation to successfully attract direct investment, although it seems to be well beyond the international environment, to the extent that it has continued to benefit even after the crisis erupted.

Facing the International Crisis

17. A year ago, during the last Article IV Consultation on Uruguay, precisely when the international crisis started to demonstrate its powerful virulence, the Uruguayan authorities' confidence in the country's position to face the crisis was emphasized. Evidently, the authorities' confidence was well based. Of course, as a small and open economy, Uruguay has been affected by the crisis, exhibiting a slowdown from the high growth rates of past years. However, the effects have been very moderate and the country only showed a decline in GDP in the first quarter of 2009, having continued to grow thereafter. It is worth underlining that the above-referred growth performance during the crisis has been attained in the context of extremely moderate countercyclical fiscal policies, which allows Uruguay to present a sound fiscal outlook, to the extent that its solid basis are maintained, and the situation was temporarily affected especially by the drought. Meanwhile, revenues (relative to GDP, which has continue rising) will increase in 2009 in comparison with 2008. In this regard, it is important to give an appropriate interpretation of the situation and outlook without confusing temporary with permanent factors. Moreover, financial indicators show a remarkable resilience. Therefore, Uruguay's economic outlook is seen as promissory, which have driven to the continuation of a positive process in terms of investment –especially FDI which, meanwhile, entails positive effects on the labor market (it exhibits records in terms of employment and unemployment) all of which more than offsets the negative effects of the international crisis.

Looking at the World and the Future

18. The authorities are fully aware of the need to continue implementing structural reforms and basically share many of the staff's views in this regard. Clearly, further progress in the energy and public sectors is warranted to continue enhancing Uruguay's business environment and boost potential growth; as usual in every country, macroeconomic policies need to be refined consistently with new circumstances and future challenges (for example, to the extent possible, the authorities are eager to continue progressing towards a more formal framework of countercyclical fiscal policies); and, of course, although many important advances have been made so far, much remains to be done with respect to social issues.

19. At the same time, the authorities are very satisfied with the efforts made and outputs obtained so far. Policies and reforms have been guided by their firm conviction of the need to increase opportunities for all, encouraging not only access to knowledge but also generating it by boosting research, while further inserting the country into the global economy. Although there have been many structural reforms in recent years in different areas—for instance, the substantial transformation of the provision of public health services—perhaps the most emblematic has been the Plan Ceibal, whereby one laptop with Internet connection has been provided to every child in public schools. This may be the reform which best reflects the authorities' objectives to achieve higher and sustainable growth, enhance the level and quality of employment, improve social conditions, and increase social equity.