



IMF Executive Board Concludes the 2009 Article IV Consultation with Uruguay

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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 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.

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
<i>Of which:</i> 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.

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>.

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