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IMF Mission Concludes Article IV Consultation with Uruguay

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An International Monetary Fund (IMF) mission headed by Ulric Erickson von Allmen visited Uruguay Oct 24-Nov 4 to conduct the country's annual Article IV consultation[1]. At the end of discussions, Mr. Von Allmen, division chief in the IMF's Western Hemisphere Department, issued the following statement in Montevideo today:

"Uruguay's economic growth in the last several years has produced significant welfare gains. Per capita income in purchasing power terms has doubled from a decade ago, unemployment has fallen to record lows, and social indicators have improved further. Key factors supporting this excellent performance include significant policy reforms, prudent macroeconomic policies, strong social policies, and a generally supportive external environment.

"Although the baseline scenario is for continued robust growth, Uruguay's near-term prospects will be shaped by global outlook developments. Uruguay's real Gross Domestic Product (GDP) growth is projected to slow to 6 percent in 2011 and to 4 percent over the medium term. Private consumption will remain the main engine of growth, but will cool further as household income growth moderates. Large Foreign Direct Investment (FDI) inflows will underpin growth in 2012-13. Exports, while better diversified into emerging markets than in the past, will not be as dynamic as in recent years due to a slowdown in Uruguay's key trading partners.

"The most immediate downside risk is that the global economy enters into a spiral of increased uncertainty and risk aversion with falling demand. Uruguay does not have major macroeconomic imbalances, the external position is robust, the exchange rate is not overvalued and remains flexible, and households are not heavily leveraged. Also, Uruguay's reliance on FDI rather on portfolio flows should prevent large direct effects of international financial volatility. The authorities also have built important buffers. Nonetheless, a shock involving sharply lower export earnings (terms of trade and volume) and FDI inflows for a protracted period could cause dislocations.

"In this uncertain global context, the main challenge will be continuing the implementation of prudent economic policies with appropriately tailored action were downside risks to materialize. The mission welcomes the monetary policy tightening in the first half of the year, and supports policy tightening in the first half of the year, and supports keeping monetary policy unchanged until the outlook becomes clearer. In the event of a negative external shock, staff would recommend a monetary policy easing so long as prospects for disinflation increase and inflation expectations converge toward the target. A reduction in reserve requirements to alleviate liquidity conditions and support credit growth could also be considered.

"The mission welcomes the broadly neutral fiscal stance in 2011, and that the fiscal plans for 2012 imply a similar stance. These plans are consistent with achieving the debt targets over the medium term. In the event of a negative shock, automatic stabilizers (allowing a higher deficit due to automatic rises in specific programs, such as unemployment benefits, and lower tax receipts due to weaker economic activity) could be allowed to operate, although if the downturn is long lasting, the fiscal space would be limited by the need to maintain prudent debt dynamics, which are sensitive to growth and the exchange rate.

"The active debt management—an area where Uruguay can be a model for other countries—has helped reduce public debt vulnerabilities significantly through lower dollarization, longer maturities, and better terms more generally. The mission welcomes the building of buffers through the large deposits at the Central Bank of Uruguay and the contingent credit lines arranged with several international financial institutions.

"Maintaining exchange rate flexibility is crucial for dealing with external shocks, supporting the de-dollarization process by ensuring foreign exchange risk awareness in the private sector, as well as for monetary policy traction.

"The financial sector remains sound and robust, and its deepening would support long-term investment and growth. Banks are liquid, well capitalized, with few non-performing loans and largely funded on local deposits. The mission welcomes the recently announced reforms for 2012 that will strengthen banks' regulations further. The Bancarization and Financial Literacy Reform should help improve access to financial services.

"A long-term policy challenge is to sustain strong and balanced growth with less volatility than in the past. Uruguay's growth prospects are generally bright, and bringing them to fruition will require boosting productivity and continued careful resource management. Private-Public Partnerships will play a key role in tackling the infrastructure gaps; the mission welcomes the important progress on the legal framework. It will also be important to ensure a labor market that allows for sufficient flexibility to support a dynamic economy and lower the cost of adjustment to shocks, while fostering equity. Finally, the mission applauds the government's prudent and inclusive approach for considering the management of the newfound iron resources."

[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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