INTERNATIONAL MONETARY FUND

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URUGUAY

January 2018

2017 ARTICLE IV CONSULTATION—PRESS RELEASE; STAFF REPORT; 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 2017 Article IV consultation with Uruguay, the following documents have been released and are included in this package:

- A **Press Release** summarizing the views of the Executive Board as expressed during its January 22, 2018 consideration of the staff report that concluded the Article IV consultation with Uruguay.
- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on January 22, 2018, following discussions that ended on December 7, 2017, 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 December 20, 2017.
- An **Informational Annex** prepared by the IMF staff.
- A **Statement by the Executive Director** for Uruguay.

The documents listed below have been or will be separately released.

Selected Issues

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IMF Executive Board Concludes 2017 Article IV Consultation with Uruguay

On January 22, 2018, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation[1] with Uruguay.

Recent Developments and Outlook

Uruguay has had a good year in 2017, with growth estimated at above 3 percent and the rise in unemployment forecast to have come to a halt. A relatively tight monetary policy stance and an appreciating exchange rate have contributed to a notable decline in inflation—estimated at 6½ percent by year end—bringing it within the central bank's target range for the first time in seven years.

The fiscal adjustment is on track. Fiscal policy has been countercyclical in 2017, with higher income tax receipts partly offset by rising pension and health care costs. The overall deficit is estimated to decline to 3.3 percent of GDP, and the government continues to be able to access international financial markets on favorable terms, including through global nominal-peso bonds.

Financial flows have remained volatile, and local and nonresident investor interest in the peso has been strong overall. The central bank intervened to accommodate these portfolio shifts, adding US$3 billion to its stock of net reserves in the first three quarters of 2017.

The current account balance has been improving and is now in surplus, estimated to approach 2 percent of GDP in 2017. The increased competitiveness against Argentina has supported a rapid and strong increase in tourism inflows, while the real appreciation relative to the rest of the world has weakened export competitiveness for many agricultural and manufacturing products (even if output remained strong, in part owing to good harvests).

Risks to the outlook nonetheless remain. On the upside, a possible foreign investment in Uruguay's third paper pulp-processing plant could be the largest FDI project in the country ever,

[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.

boosting confidence and growth beyond the current projections. Downside risks include a prolonged loss of competitiveness or dampened investor interest in emerging markets. A reversal of the recoveries in Argentina and Brazil, or a significant slowdown in China could undermine investment and growth as well. Uruguay's large buffers—gross reserves of the central bank, liquid financial assets, and contingent credit lines at international financial institutions—together with the flexible exchange rate regime would allow the country to weather potential short-term shocks relatively unscathed.

Financial stability risks are limited. Uruguay's banking sector is small relative to the size of the economy, and even though non-performing loans have increased in the last few years, they remain moderate, at less than 4 percent, and are covered by provisions and excess capital.

Executive Board Assessment[2]

Executive Directors commended the authorities on their prudent policies, which allowed the country to capitalize on favorable external conditions to achieve good macroeconomic outcomes in 2017. Directors noted that fiscal adjustment is proceeding broadly as planned and that inflation has successfully been brought within the central bank's target range. They encouraged the authorities to take advantage of the country's strong position to continue to strengthen economic resilience and address structural constraints to inclusive growth over the medium term.

Directors noted that keeping inflation on a downward path over the medium term would greatly enhance the credibility of the central bank. Toward this end, maintaining a tight monetary stance would be appropriate as demand pressures materialize. Keeping nominal wage growth on a declining path would help anchor inflation and set the stage for broader efforts toward de dollarization, which in turn would help enhance monetary transmission.

Directors welcomed the authorities' commitment to exchange rate flexibility as an important stabilizer in the face of shocks. They stressed that interventions should be limited to countering disorderly market conditions, and highlighted the importance of clear communications to ensure that interventions do not undermine the credibility of the central bank's commitment to reducing inflation.

Directors agreed that Uruguay's main fiscal challenges are of a medium term nature. In the short term, Directors generally agreed that revenue windfalls should be saved if possible. While a few Directors noted that revenue windfalls could also be directed toward public investment, a number of other Directors recommended taking the opportunity to achieve the 2.5 percent of GDP fiscal deficit target already in 2018. In the medium term, an enhanced fiscal rule could be helpful to keep net debt on a sustainable and declining path, and reforms to ensure the viability of the pension system will be needed. To address Uruguay's infrastructure gap, reallocating public

[2] 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.

spending toward investment will be important, while carefully assessing the costs and benefits of public and public private projects and the adequacy of incentives to attract private investment. Strong governance of state owned enterprises will also be important for limiting fiscal risks.

Directors emphasized that to provide the conditions for sustained robust and inclusive growth, ongoing fiscal and monetary prudence should be combined with a greater focus on structural reforms. They noted that Uruguay’s strong institutions and hard won economic stability are widely recognized. Nonetheless, there is scope to address weakness in transportation infrastructure, education and skills formation, labor market flexibility, and access to foreign markets. Reforms to improve the business climate to support a vibrant and diverse manufacturing and agricultural base will be important for enhancing competitiveness, especially in case of further appreciation pressures. Increasing firms’ access to credit and hedging instruments would also be important to strengthen their resilience.

Uruguay: Selected Economic Indicators

						Projections					
	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Output, prices, and employment											
Real GDP (percent change)	3.5	4.6	3.2	0.4	1.5	3.1	3.4	3.1	3.0	2.9	3.0
GDP (US$ billions)	51.3	57.5	57.2	53.3	52.4	58.6	63.6	67.2	71.0	74.7	78.8
Unemployment (in percent, eop)	6.3	6.5	6.6	7.5	7.9	7.4	7.1	7.1	7.1	7.2	7.2
Output gap (percent of potential output)	2.9	3.3	2.7	0.4	-0.8	-0.4	0.1	0.2	0.1	0.0	0.0
CPI inflation (in percent, average)	8.1	8.6	8.9	8.7	9.6	6.2	6.4	6.7	6.6	6.5	6.1
CPI inflation (in percent, end of period))	7.5	8.5	8.3	9.4	8.1	6.4	6.7	6.5	6.4	6.3	6.2
Exchange rate (UY$/US$, average)	20.3	20.5	23.2	27.3	30.2	...	...	...	...	...	...
Real effective exchange rate (percent change, eop)	4.4	7.7	-2.9	1.9	-1.2	...	...	...	...	...	...
				(Percent change, unless otherwise specified)							
Monetary and banking indicators 1/											
Base money	26.7	12.9	1.4	7.2	9.7	...	...	...	...	...	...
Broader M1 (M1 plus savings deposits)	11.2	15.0	3.7	5.6	8.4	...	...	...	...	...	...
M2	10.3	13.7	6.4	9.0	14.4	...	...	...	...	...	...
Growth of credit to households (in real UY$)	7.3	9.9	4.7	6.3	-0.5	...	...	...	...	...	...
Growth of credit to firms (in US$)	17.5	16.2	6.8	2.8	1.5	...	...	...	...	...	...
Bank assets (in percent of GDP)	57.1	60.8	63.6	72.5	65.9	...	...	...	...	...	...
Private credit (in percent of GDP) 2/	23.5	26.0	27.1	30.2	28.2	...	...	...	...	...	...
				(Percent of GDP, unless otherwise specified)							
Public sector indicators											
Revenue 3/	27.7	29.5	29.1	29.0	29.4	29.6	29.8	30.0	30.1	30.2	30.3
Non-interest expenditure 3/	28.0	29.1	29.5	28.8	30.0	29.7	29.6	29.5	29.5	29.5	29.5
Wage bill	5.0	4.9	5.0	5.0	5.2	5.1	5.1	5.0	5.0	4.9	5.0
Primary balance 4/	-0.2	0.4	-0.6	0.0	-0.7	-0.1	0.2	0.5	0.5	0.7	0.8
Structural primary balance 4/	0.0	-0.9	-1.4	-0.6	-0.5	0.0	0.1	0.4	0.5	0.7	0.8
Interest 4/	2.5	2.7	2.8	3.6	3.3	3.2	2.9	3.0	3.1	3.2	3.3
Overall balance 4/	-2.7	-2.3	-3.5	-3.6	-4.0	-3.3	-2.7	-2.5	-2.5	-2.5	-2.5
Gross public sector debt	58.0	60.2	61.4	64.6	61.9	64.9	65.0	63.8	63.7	63.9	63.8
Public sector debt net of liquid financial assets 5/	34.0	34.4	35.9	39.7	42.7	44.1	44.3	44.6	44.7	44.9	44.8
Net public sector debt 4/	25.9	24.2	22.9	25.8	30.1	32.1	33.3	33.2	33.6	34.0	34.0
External indicators											
Merchandise exports, fob (US$ millions)	13,093	13,289	13,772	11,145	10,766	11,574	12,317	12,912	13,542	14,215	14,901
Merchandise imports, fob (US$ millions)	12,744	12,165	11,755	9,801	8,427	9,196	10,061	10,699	11,371	12,161	12,924
Terms of trade (percent change)	5.8	0.2	2.6	1.9	2.3	-0.9	0.6	0.9	0.7	0.4	0.6
Current account balance	-4.0	-3.3	-2.8	-0.7	1.7	1.9	1.3	0.6	0.3	-0.1	-0.7
Foreign direct investment	4.3	4.9	4.1	1.6	-1.5	1.4	1.3	1.2	1.2	1.1	1.0
Overall balance of payments (US$ millions)	3,239	2,778	1,357	-1,867	-2,190	2,000	340	340	630	935	950
Total external debt + non-resident deposits	67.7	69.0	74.9	89.5	74.8	68.5	70.1	70.4	70.6	71.1	71.3
Of which: External public debt	30.3	31.9	33.7	37.1	31.8	30.6	32.3	32.6	32.9	33.5	33.7
External debt service (in percent of exports of g&s)		6.5	5.8	6.0	9.1	7.1	9.3	9.5	10.0	10.7	12.3
Gross official reserves (US$ millions)	13,604	16,279	17,574	15,637	13,473	15,473	15,813	16,153	16,783	17,718	18,668
In months of imports of goods and services	9.8	11.3	12.6	13.5	13.8	14.5	13.5	12.8	12.5	12.3	12.1
In percent of:											
Short-term external (STE) debt	154.5	173.2	167.8	166.3	169.4	201.2	207.8	202.3	194.8	176.4	202.0
STE debt plus banks' non-resident deposits	108.5	120.5	119.8	113.9	120.2	144.3	146.4	142.5	138.2	128.9	142.2

Sources: Banco Central del Uruguay, Ministerio de Economia y Finanzas, Instituto Nacional de Estadistica, and Fund staff calculations.
1/ Percent change of end-of-year data on one year ago.
2/ Includes bank and non-bank credit.
3/ Non-financial public sector excluding local governments.
4/ Total public sector. Includes the non-financial public sector, local governments, Banco Central del Uruguay, and Banco de Seguros del Estado.
5/ Gross debt of the public sector minus liquid financial assets of the public sector. Liquid financial assets are given by deducting from total public sector assets the part of central bank reserves held as a counterpart to required reserves on foreign currency deposits.

URUGUAY

STAFF REPORT FOR THE 2017 ARTICLE IV CONSULTATION

December 20, 2017

KEY ISSUES

Context. 2017 has been a good year for Uruguay. GDP growth picked up and the unemployment rate stabilized. A relatively tight monetary policy stance and an appreciating exchange rate contributed to a notable decline in inflation since mid-2017, bringing it within the central bank's target range for the first time in seven years. The current account has been improving and is now in surplus, while the government has reduced its fiscal deficit and continued to be able to access international markets on favorable terms.

Main Policy Recommendations

- As expected demand pressures materialize, some monetary tightening would be appropriate in order to lower inflation toward the middle of the central bank's target range.
- Improving monetary policy transmission will require (i) fostering de-dollarization; (ii) taking steps to strengthen the policy signal; (iii) moderating nominal wage increases going forward.
- Exchange rate flexibility should remain an important means of stabilization in the face of shocks.
- Improved macroeconomic performance and steadfast implementation of the spending allocations should allow the authorities to reach their 2.5-percent of GDP fiscal deficit objective already in 2018. Spending should be reoriented toward investments in infrastructure.
- To address medium-term growth bottlenecks, structural reforms should focus on encouraging investment, improving labor market flexibility, enhancing education, and facilitating economic integration with countries in the region and elsewhere.

Past advice. The authorities and staff have remained in broad agreement on the macroeconomic policy objectives, including implementation of the fiscal consolidation package, steadfast pursuit of disinflation (through tight monetary stance and lower wage indexation), and the necessity of structural reforms. Both monetary policy and the overall fiscal stance have been in line with staff advice. Structural reforms and a reorientation of the budget to support capital spending, however, have not progressed as recommended by staff.

Approved By	
Patricia Alonso-Gamo (WHD) and Vikram Haksar (SPR)	Discussions took place in Montevideo during November 27–December 7, 2017. The staff team comprised Jan Kees Martijn (head), Yehenew Endegnanew, Dmitry Gershenson, and Galen Sher (all WHD). Diva Singh and Frederik Toscani (both WHD) contributed to the preparatory work, and Jose Luis Saboin (WHD) provided research assistance. Staff met with Minister Astori, Minister Murro, Central Bank President Bergara, other senior government officials, as well as representatives of public enterprises, the private sector, unions, and civil society.

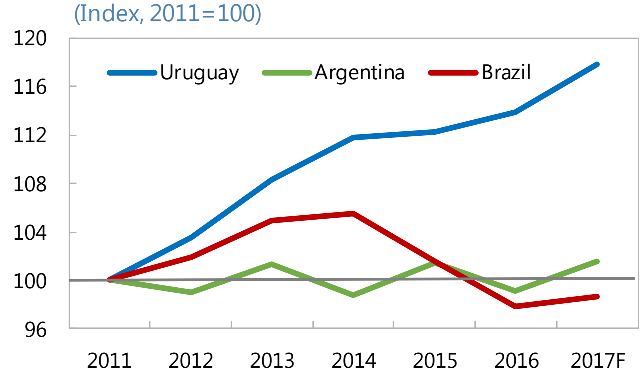
CONTENTS

ANNEXES

CONTEXT

1. **2017 has been a good year for Uruguay.** With stronger GDP growth (in a volatile region), the increase in unemployment since 2014 has come to a halt. A relatively tight monetary policy stance and an appreciating exchange rate have contributed to a notable decline in inflation, bringing it within the central bank's target range (3 to 7 percent) for the first time in seven years. The current account balance has been improving and is now in surplus, while the government has reduced its fiscal deficit and continues to be able to access international markets on favorable terms. In particular, since mid-2017 it has successfully, and for the first time, issued two bonds in international markets denominated in domestic currency. In addition, the country has maintained its strong record in promoting social inclusion, including gender equality. With the benign global environment expected to last for the time being, and building on Uruguay's strong institutions and social cohesion, it is a good time to focus on medium-term priorities, in particular, reinforcing the sources of growth, strengthening policy anchors, and promoting de-dollarization.

Real Gross Domestic Product
(Index, 2011=100)



Source: IMF, World Economic Outlook.

RECENT DEVELOPMENTS

2. **Since the Spring of 2016, appreciation pressures have reinforced the immediate benefits from the authorities' prudent policies.** Strong investor interest in emerging markets combined with a positive assessment of Uruguay's risk profile, record tourism inflows, and also currency switching by domestic agents, contributed to the pressures on the currency. From April through October 2016, these forces resulted in a nominal appreciation of the peso (by 12 percent vis-à-vis the U.S. dollar), which reduced tradable goods inflation, and boosted real wages and (wage-linked) pensions and consumption (see Box 1). Subsequently, the inflows fueled a significant accumulation of international reserves as the authorities intervened in the exchange market through 2017 to limit further appreciation.

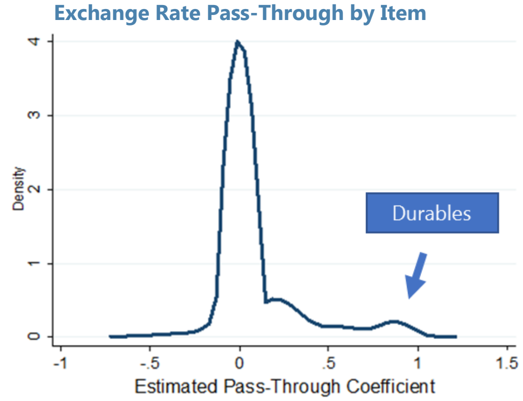
Box 1. Uruguay: The Impact of Exchange Rate Movements on Consumption 1/

Exchange rate depreciations quickly reduce private consumption in Uruguay. Results from a vector autoregression (VAR) model and a vector error correction model (VECM) are that, on average, a 10 percent depreciation is accompanied by approximately a 1 percentage point fall in private consumption growth in the short run. Our estimations indicate that this demand effect also leads to a contractionary effect on GDP. This finding deviates from the standard view that depreciations are typically expansionary (through higher net exports).

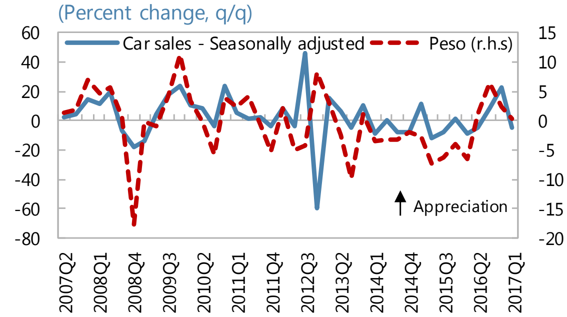
We find two main explanations for the impact of exchange rate movements on private consumption:

- The first is a negative impact of depreciations on real incomes. Nominal wages are fixed in the short-run and with an immediate exchange rate pass-through of around 15 percent, real wages temporarily fall. A high share of Uruguayan households is liquidity constrained leading them to adjust consumption in response to temporary income shocks.
- Second, we find that exchange rate pass-through across goods is heterogenous, and close to 100 percent for durables. Depreciations thus imply a price hike for durable goods, and durable consumption reacts very strongly in the short run to exchange rate movements, possibly indicating inter-temporal substitution by households.
- By contrast, we see little evidence of changes in consumption through wealth effects or changes in expected permanent income.

Exchange Rate Pass-Through by Item



Car Sales and Exchange Rate Movements
(Percent change, q/q)



Sources: Asociación de Comercio Automotor del Uruguay, BCU and IMF staff calculations.

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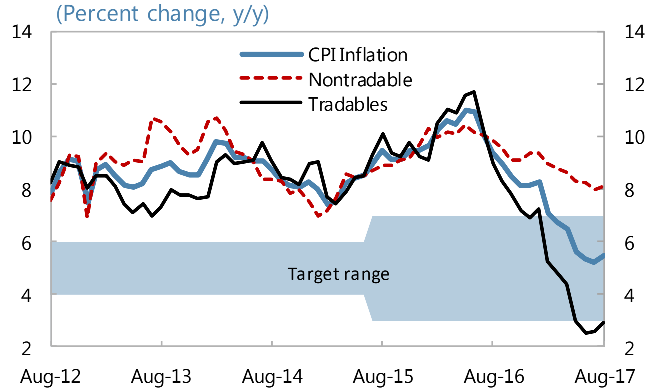
1/ Based on Toscani, F., "The Impact of Exchange Rate Movements on Consumption in Uruguay," Selected Issues Paper, *forthcoming*.

3. As a result, inflation has declined to 6¼ percent, while growth is projected to rise to more than 3 percent in 2017. With a sharp fall in tradables inflation, and nontradables inflation on a tentative downward path, inflation fell to 5½ percent in July before edging up as the appreciation effect waned. Monetary policy effectively tightened between mid-2016 through the first quarter of 2017, as nominal interest rates remained fairly stable while inflation came down. Since then, interest rates have fallen, with short-term real rates moderating to 2–3 percent, which is in line with a calibrated Taylor rule. Real GDP growth is projected to increase, from 1.5 percent in 2016 to 3.1 percent in 2017, driven largely by private consumption, net exports (with an exceptionally strong tourist season, mostly from Argentina) and, on the production side, a good harvest. On the other hand, a prolonged closure of the oil refinery due to maintenance and a labor dispute dampened growth by more than ½ of a percentage point.

Inflation, Target Range, and Expectations
(Percent change, y/y)

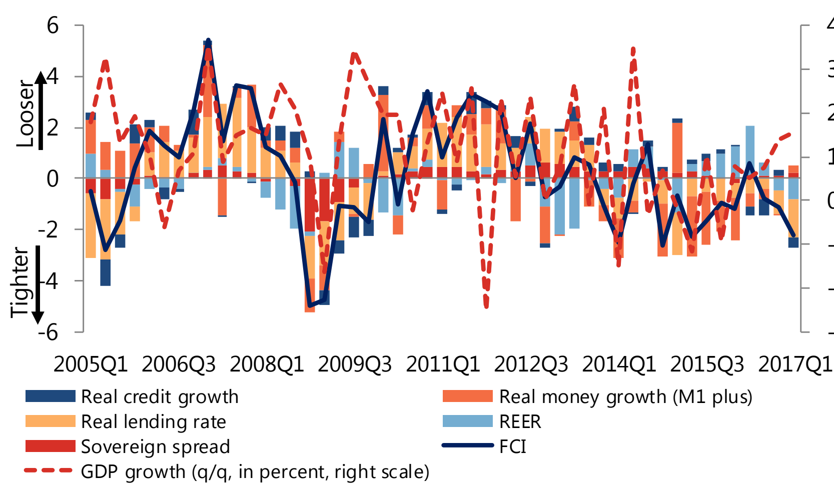


Sources: Instituto Nacional de Estadistica, and Fund staff estimates and calculations.

4. Fiscal adjustment is proceeding. The 2016 fiscal deficit—at 4.0 percent of GDP—was 0.3 percent of GDP smaller than budgeted, largely due to a lower interest bill. Fiscal policy has been countercyclical in 2017, with higher income taxes partly offset by rising pension and health care costs, and staff projects the overall deficit to decline to 3.3 percent of GDP.

5. Credit remains weak, and has not served as a source of growth. Bank credit to firms (in U.S. dollars, the typical denomination) declined by about 4¾ percent (y/y) by October, mostly reflecting weak demand, while credit to households edged up by more than 2 percent (y/y) in real terms. Indeed, the ongoing uptick in growth seems unrelated to financial conditions, which have tightened since 2015. More generally, bank credit remains relatively low in Uruguay (below 30 percent of GDP), and domestic

Financial Conditions Index



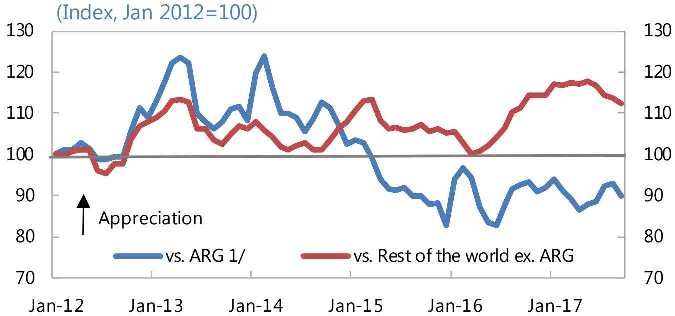
Note: The financial condition index provides a summary measure of the effect of financial variables on economic activity. The computation follows IMF Country Report 13/220.

bond markets do not provide significant private sector financing. Non-performing loans have increased since 2014 but remain moderate, at less than 4 percent, and are covered by provisions and excess capital.[1]

6. While the exchange rate has appreciated, the current account has turned positive in 2016 and 2017.[2]

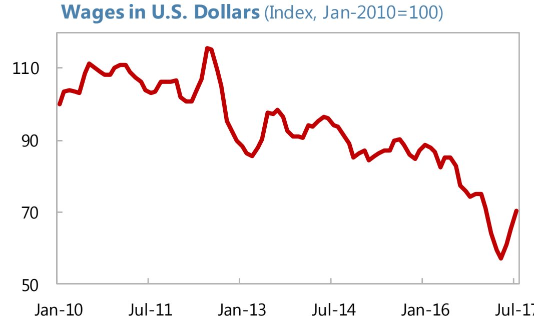
- *Strong investor interest has spurred nominal appreciation pressures vis-à-vis the U.S. dollar since early 2016.* The multilateral real exchange rate appreciated by 9 percent between April 2016–September 2017, while the bilateral real exchange rates versus Argentina and Brazil, both key trading partners, depreciated over this period.

Uruguay: Real Exchange Rates
(Index, Jan 2012=100)



Sources: Banco Central de Uruguay (BCU), World Economic Outlook, Instituto Nacional de Estadistica data, Haver Analytics, and Fund staff calculations.
1/ The real exchange rate against Argentina is calculated using the unofficial CPI for Argentina until April 2016 and the official onwards; and the average of the unofficial and official exchange rates for the Argentine peso until November 2015 and the official exchange rate onwards.

Uruguay: Ratio of Export Prices to Nominal Wages in U.S. Dollars (Index, Jan-2010=100)



Sources: BCU, Haver Analytics and IMF staff calculations.

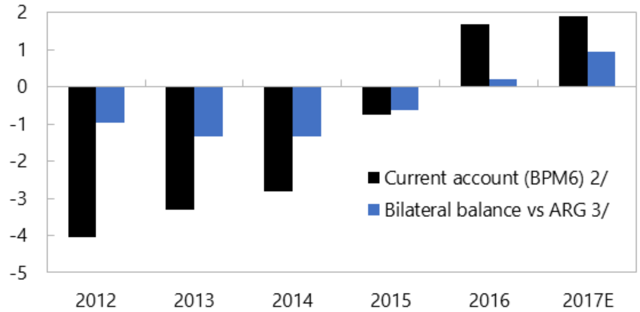
- *The diverging real exchange rate trends vis-a-vis Argentina versus the rest of the world are mirrored in diverging pressures on the current account.* The increased competitiveness against Argentina has supported a rapid and strong increase in tourism inflows (despite an Argentinean recession) and a decline in consumer purchases by Uruguayans across the border. The real appreciation relative to the rest of the world combined with weak or declining world market prices of key export goods (including beef, rice and soy), has weakened export competitiveness for most manufacturing and agricultural products (even if actual export performance has shown a mixed picture, in particular owing to strong harvests in 2017). Manufacturing export growth has stagnated over the past 5 years for many products (countered by sharp growth of the second paper pulp plant), and overall (y/y) production growth by manufacturing exporters turned negative by mid-2017. After Uruguay managed to diversify its export products and destinations over the past decade and a half—

[1] Non-performing loans refer to obligations that are overdue by at least 60 days (rather than 90 days).

[2] The current account balance has been revised upward relative to the last staff report due to a move to Balance of Payments Manual 6 and an appreciable widening of the sample of firms surveyed, in particular, merchanting companies ("compraventas"). The newly included firms are also expected to make the behavior of FDI more volatile, and to add to gross external debt (See Annex IV).

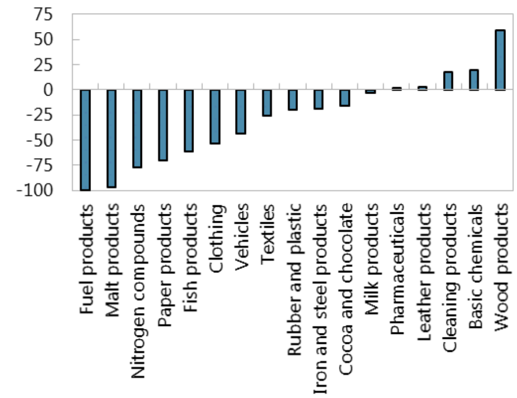
which has greatly diminished its vulnerability to recurrent shocks in neighboring countries—a prolonged loss of competitiveness would put these gains at risk.

Current Account 1/
(Percent of GDP)



Sources: Banco Central de Uruguay (BCU) and Fund staff calculations.
1/ 2017E denotes an estimate.
2/ The current account balance for 2017 reflects data until June 2017 under the recently published BPM6 method.
3/ The bilateral balance against Argentina reflects merchandise trade and tourism only.

Manufacturing Export Volumes
(Percentage change, 5-year)



Sources: Banco Central de Uruguay and IMF staff calculations

- *The current account is expected to maintain a surplus of more than 1.5 percent of GDP in 2017.* The current account improvement has mostly reflected the surging net tourism and merchandise trade inflows from Argentina, while a contraction in merchandise exports would play out more slowly. The current account surplus has also been supported by the decline in oil import prices in 2015 and 2016 and by a sharp decline in inward FDI (with a high import component.

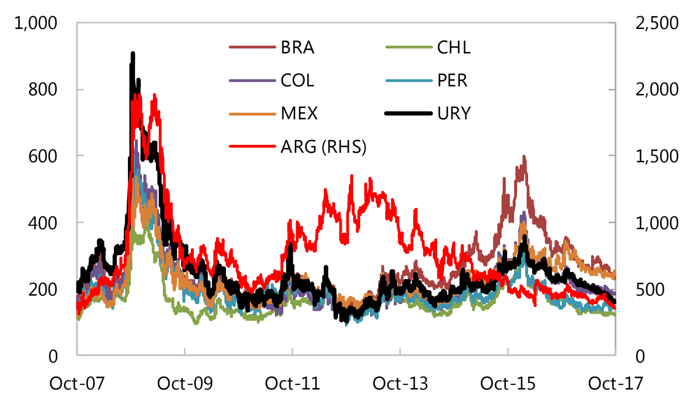
7. Staff's assessment is that the external position is stronger than consistent with fundamentals and desirable policy settings, reflecting the unusually strong current account (see Annex I). Staff estimates a current account gap of 2–3 percent of GDP after adjusting for the impact of the overvaluation of the Argentinean peso. Given the typically greater reliability of the current account model, this would suggest that the external position is on the strong side. At the same time, the external sustainability approach—based on the projected rather than the present current account balance—suggests that the real exchange rate is broadly in line with fundamentals. The EBA 'lite' real effective exchange rate model—which does not depend on an assessment of the current account position—points to a 11 percent overvaluation, which broadly corresponds with the above-mentioned recent real appreciation. Additional uncertainties arise from the challenge of correcting for merchanting activities.[3] Overall, the sizeable challenges for assessing the external position here add to the urgency of structural reform measures to boost productivity and competitiveness.

[3] An assessment of the impact of the newly measured merchanting activities on the Uruguayan economy is not yet available (see Annex I and Annex IV).

8. Financial flows have remained volatile. In late 2016 through early 2017, a large drop in nonresident holdings of government and central bank paper (more than $1 billion) due to a one-off portfolio adjustment by a single investor could have resulted in depreciation pressures on the peso, if not for an offsetting portfolio shift by Uruguay's pension funds from U.S. dollars to local currency, which continued through the third quarter of this year. More generally, however, local and nonresident investor interest has been strong, with significant portfolio inflows in 2017 Q2 and Q3. The central bank intervened to accommodate these large portfolio shifts, adding US$3 billion to its stock of net reserves in the first three quarters of 2017. In other capital flows, since August 2016, a tax amnesty in Argentina has led to the orderly withdrawal of about US$1.3 billion in nonresident foreign-currency bank deposits, with Uruguayan banks reducing their foreign assets accordingly. Finally, revised foreign direct investment data shows that inflows slowed significantly in 2015, and turned to net outflows in 2016, partly as foreign-owned Uruguayan "merchanting" firms redeemed debt obligations owed to their parent companies. Excluding these merchanting firms, the slowdown in net FDI inflows amounted to 2.1 percent of GDP in 2015, and 2.6 percent of GDP in 2016.

9. To reduce public debt vulnerabilities, the authorities have successfully capitalized on financial markets' benign view of the country and have diversified the investor base. In mid-2017, following the notable decline in inflation and buoyed by strong investor appetite, Uruguay issued nominal-peso bonds in the global market.[4] The government raised over US$ 2billion at yields of 10 percent or below for five- and ten-year paper.[5] The share of the public debt denominated in foreign currency is expected to remain at about 50 percent by end 2017. The resulting longer local-currency yield curve can assist in the pricing of long-term peso-denominated financial contracts, such as life insurance and pensions.

LA7: Emerging Market Bond Indices



Source: J.P. Morgan.

OUTLOOK AND RISKS

10. Staff expects the recovery to continue. Growth is projected to remain somewhat above its 3-percent potential rate in 2018 and 2019, supported by planned investment in rail infrastructure, and the output gap is projected to turn slightly positive in these years. Over the medium term, the current account balance is expected to worsen gradually to a deficit of

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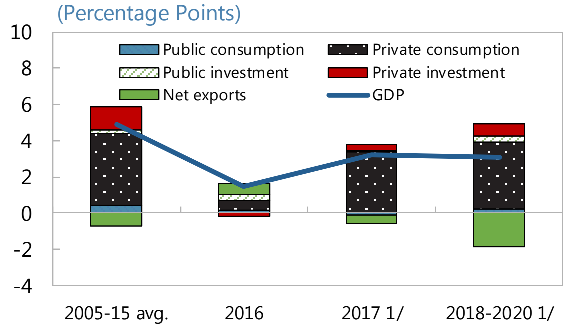
[4] Previously, the country had issued only dollar-denominated and inflation-indexed bonds in the global market.

[5] Furthermore, both bonds benefitted from being included in the JP Morgan GBI-EM index.

¾ percent of GDP as investment and import volumes increase. Net FDI outflows are expected to turn to inflows again in 2017 and beyond, in line with historical savings patterns and expectations for domestic growth. Inflation is projected to pick up to 6½ percent by end-2017—as the effects of the 2015 spike in food prices and of the peso appreciation dissipate—and is subsequently expected to edge down to about 6 percent. Real domestic credit is projected to rebound modestly to a growth rate of 2–3 percent as investment picks up, nevertheless remaining subdued given structural impediments (see below).

Uruguay: Contributions to Real GDP Growth
(Percentage Points)



Sources: BCU and IMF staff calculations.
1/ Staff projections.

11. This largely benign outlook is subject to nontrivial upside and downside risks (see the Risk Assessment Matrix). On the upside, the authorities have reached agreement, in principle, with the Finnish company UPM on a possible foreign investment in Uruguay's third paper pulp-processing plant—which, at about US$3 billion (5 percent of GDP) would be the largest FDI project in the country ever and could boost confidence and growth further, especially during the construction phase. On the downside, there is risk of dampened investor interest in emerging markets. A reversal of the recoveries in Argentina and Brazil, or a significant slowdown in China—with these three countries accounting for half of Uruguay's merchandise exports, and Argentina alone for more than two-thirds of tourism receipts—would undermine investment and growth. These forces could also trigger a correction of the external imbalances in Argentina which, in turn, could result in depreciation pressures in Uruguay that would negatively impact consumption and inflation and reinvigorate dollarization. Furthermore, hedging options are limited, raising the cost of exchange rate volatility.

12. The country has the ability to weather conceivable short-term shocks. Uruguay's large buffers—gross reserves of the central bank well above the upper bound of the IMF reserve adequacy metric range (see Annex I), liquid financial assets sufficient to cover debt service for 12 months, and contingent credit lines at international financial institutions of 4 percent of GDP—would allow the country to weather potential short-term shocks relatively unscathed. Against this background, and given the fiscal costs of sterilizing reserves, the authorities plan to reverse more than half of the net reserve increase of 2017 over the next three years, by selling foreign exchange to public companies (with large import needs) on a fixed schedule. Allowing the exchange rate to adjust in response to shifts in economic fundamentals offers another important shock absorber.

Risk Assessment Matrix

Sources of Risk	Likelihood	Impact if Realized	Policy Response
Structurally weak growth in neighboring economies.	**Medium**	**Medium (↓)** • A reversal of the recoveries in Argentina and Brazil would adversely affect exports, tourism and FDI.	• Maintain flexible exchange rate. • Adjust fiscal and monetary policies to stabilize aggregate demand, where space allows.
Significant slowdown in China.	**Medium**	**Low/Medium (↓)** • As the country receiving the largest share of Uruguay's goods exports, a slowdown in China could materially affect export volumes. • Global commodity prices could also suffer, although agricultural commodities (two-thirds of Uruguay's exports) would likely be less impacted than metals/energy.	• Use exchange rate as a shock absorber. • Pass-through declines in oil import prices to households. • Adjust fiscal and monetary policies to stabilize aggregate demand, where space allows.
Tighter global financial conditions.	**High**	**Medium (↓)** • Normalization of U.S. monetary policy could increase borrowing costs for Uruguayan public and private sectors. • Higher yields in advanced economies could also potentially trigger capital outflows.	• Maintain flexible exchange rate as an automatic stabilizer. • Maintain solid macroeconomic fundamentals. • Use liquidity buffers if necessary.
Insufficient investment, as completing the planned fiscal consolidation while boosting capital spending could prove challenging.	**Medium**	**Medium** • Insufficient investment could reduce Uruguay's potential growth.	• Create fiscal space by rationalizing current expenditure.
Fragmentation/security dislocation in parts of the Middle East, Africa, Asia, and Europe.	**High**	**Low (↓)** • Potential supply disruptions could lead to higher oil prices, which would raise import and fiscal costs.	• Use the oil price hedges. • Pass through oil price changes to households over the medium term.

13. The authorities underscored the combination in 2017 of a rebound in growth and lower inflation, within the target range. They considered that the decline in nontradables inflation was particularly important. They emphasized the economic risks stemming from developments in neighboring countries, as well as the risk that the search for yield in international markets might come to an end. At the same time, they considered that Uruguay was well positioned to manage such shocks, with a flexible exchange rate and ample financial buffers. The authorities stressed that the expected investments in a third paper pulp mill would offer a major impulse to investment and growth. They concurred that eroding competitiveness for parts of the export sector was a cause for some concern.

POLICY DISCUSSIONS

14. The authorities are in a position to consolidate the macroeconomic gains of 2017 and to address the medium-term growth bottlenecks. With a positive outlook for growth in the near term, both fiscal and monetary policy should be kept tight, in order to secure a stable and sustainable path for public debt as well as lower inflation within the target range. In the medium term, however, a persistent decline in public and private investment would result in lower potential growth (currently estimated at 3 percent). Staff recommends steps to (i) reinforce the de-indexation of wages; (ii) increase investment in infrastructure and strengthen the predictability of fiscal policy over the medium term; (iii) facilitate the de-dollarization process; and (iv) explore structural reforms aimed at raising Uruguay's growth potential.

A. Keeping Inflation Low

15. The recent moderation of nontradables inflation and inflation expectations confirm the favorable prospects for enhancing price stability. After currency appreciation propelled the sharp decrease in inflation from its peak at 11 percent in May 2016, that impact has tapered since the summer of this year. However, the multi-year wage agreements reached in 2015–17—which put nominal wage increases on a declining path through 2018, replacing the earlier wage indexation mechanism—are expected to help anchor nontradables prices and temper inflation inertia.[6] Inflation expectations revealed in surveys and in the yields on nominal versus inflation-linked government bonds foresee inflation declining after 2017 to 5–7 percent.

16. Some monetary tightening would be appropriate as expected demand pressure materialize in order to bring inflation close to the middle of the central bank's 3-to-7 percent target range. The baseline projection of gradually falling inflation is predicated on prudent monetary policies, with short-term real interest rates staying above 2½ percent.

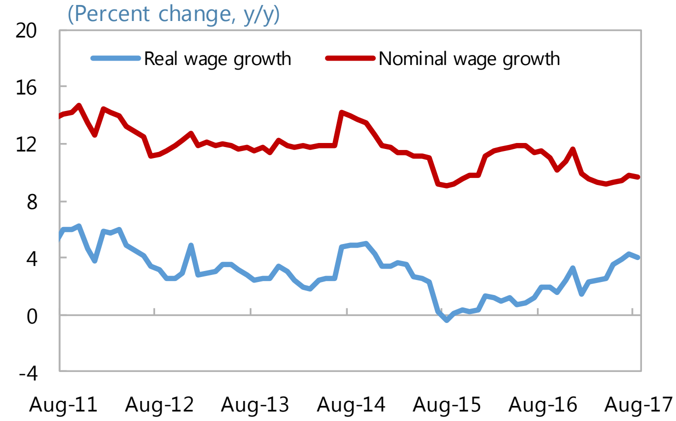
[6] The agreements replaced the direct link between wage increases and inflation with a schedule of annual nominal wage increases that can subsequently be adjusted upward if inflation turns out to exceed the wage increase or a pre-set trigger.

17. The transmission of monetary policy has been constrained by the high degree of dollarization and low level of peso credit, the volatility of the short-term interest rates, and wage indexation.

- *Keeping inflation within the target range would support central bank credibility and could set the stage for broader efforts towards de-dollarization*. Dollarization has been engrained in the Uruguayan economy for decades. Experience of other countries indicates that in order to de-dollarize successfully, complementary policies can be helpful once macroeconomic stability has been achieved (see Box 2). Staff welcomed the restoration in August of higher reserve requirements on foreign currency (relative to domestic currency) deposits. The authorities could also foster de-dollarization by promoting that prices for domestic transactions are quoted in local currency.

- *Strengthening the policy signal.* While the monetary stance has been broadly appropriate and inflation is on a downward trend, short-term interest rates have been relatively volatile since the 2013 move to an operational framework for monetary policy that includes a reference range for M1+ growth. The authorities have regularly adjusted the reference range and allowed money growth to deviate from it, informed by interest rate developments. Nonetheless the volatility of interest rates has increased due to the difficulty of predicting money demand (especially given the ongoing changes in deposit dollarization). The authorities should (i) continue to closely monitor and accommodate changes in money demand; and (ii) explore options to reduce the volatility of short-term interest rates further, for example by using standing facilities to create an interest rate corridor.

Uruguay: Wage Growth
(Percent change, y/y)



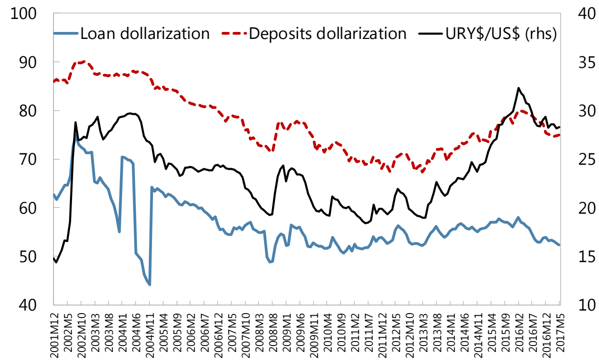
Source: Haver Analytics and Fund staff calculations.

- *Eliminating the remaining wage indexation provisions.* The move to nominal wage increases in the last wage round was a welcome step. While real wages are estimated to have risen sharply in 2017 due to the lower-than-expected inflation, wage growth is expected to moderate starting next year. Continued moderation of annual nominal wage growth in the 2018 (multi-year) wage agreements will be important for anchoring inflation expectations over the medium term (and real wage restraint could also help stem the trend decline in employment). Removing the remaining provisions that involve backward-looking wage indexation in case of higher-than expected inflation would be another step to reduce inflation inertia, and improve the effectiveness of monetary policy.

Box 2. Options for Supporting De-Dollarization in Uruguay 1/

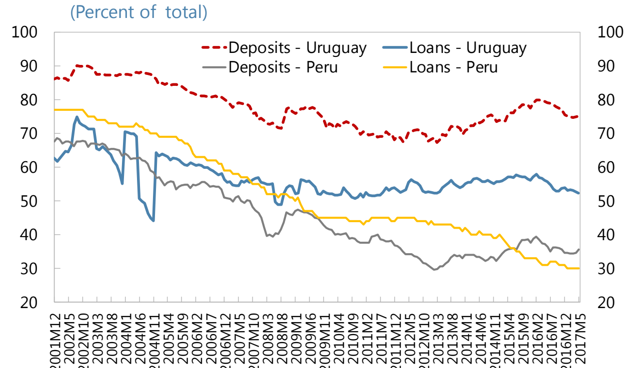
Uruguay has a long history of financial dollarization. Many studies have found macroeconomic stabilization, especially lower inflation, to be a necessary ingredient for de-dollarization. Several found that nominal appreciation of the exchange rate was also a strong contributor, particularly for deposits; a trend that can be confirmed in the case of Uruguay (see chart).

Uruguay: Dollarization and the Exchange Rate
(Percent of total)



Sources: BCU and Fund Staff calculations.

Uruguay and Peru: Dollarization
(Percent of total)



Sources: BCU and Fund Staff calculations.

However, multiple studies have found that dollarization is a persistent phenomenon. In the case of Peru, for example, it took various prudential, supervisory, and pricing policies, to complement the macroeconomic environment, and successfully de-dollarize. Prudential policies to better internalize the risks of dollarization were put in place in the 1990s. Between 2000–05, the Peruvian authorities introduced a requirement for prices of goods and services to be listed in domestic currency. These measures, together with the introduction of inflation targeting in 2002 and the development of the domestic capital market, all played a role in the gradual de-dollarization.

More could be done in Uruguay to capitalize on current conditions in favor of de-dollarization. The BCU should maintain higher reserve requirements (RRs) foreign currency deposits relative to local currency deposits at the central bank, together with the higher provisioning and capital requirements on foreign currency loans, to help internalize the costs of dollarization. (Such prudential measures should not aim at restricting capital flows.) In addition, the authorities could consider mandating the listing of prices of goods and services in local currency, to start the long process of de-dollarizing popular "mentality". Government communications could consistently refer to prices and amounts in terms of domestic currency rather than U.S. dollars.

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1/ Based on Singh, D., "Next Steps for Promoting De-Dollarization in Uruguay," Selected Issues Paper, *forthcoming*.

18. **The authorities noted that that keeping inflation within the target range was an important challenge, against the background of ongoing strong demand**. To help achieve this, monetary policy had remained reasonably contractionary, albeit less so than when inflation was still at higher levels. The results of the upcoming wage round would also be an important factor. The authorities emphasized that they had accommodated a large increase in money demand in 2017, with money growth rising beyond the central bank's reference range. In this

context, in August they had reduced the reserve requirements for domestic currency deposits, which could support the provision of peso credit.

B. A Flexible Exchange Rate

19. Sizeable and abrupt portfolio shifts by financial institutions have posed risks of large, sudden, and disruptive exchange rate movements, that can justify the recent interventions in the exchange market. In addition to portfolio inflows by nonresidents, significant portfolio shifts by domestic pension funds and other domestic players into pesos added to upward pressures on the exchange rate, especially during the second and third quarters of 2017. The central bank accommodated these portfolio adjustments by buying foreign currency directly in exchange for peso *letras* (central bank paper), in particular from the pension funds. Indeed, such portfolio shifts by domestic pension funds alone accounted for US$3 billion (5 percent of GDP, and equivalent to the increase in net reserves during this period), with sharp peaks in May and August. Without these interventions, the relatively small exchange market—with an average daily turnover of about US$25 million, well below the size of many of the specific portfolio shifts—would have likely experienced disruption involving undue exchange rate volatility. At the same time, staff emphasized that exchange rate flexibility remained important for stabilizing the economy in the face of shocks.

20. The authorities stressed that large capital flows and domestic portfolio shifts would have put excessive pressure on the country's small exchange market, and therefore had to be absorbed. They noted that residents could switch between foreign and domestic currency assets without restrictions. The authorities confirmed the importance of maintaining a flexible exchange rate.

C. Reconciling Fiscal Consolidation and Investment Support

21. With the approved 2018 budget, the authorities' deficit objective is within reach. Staff estimates that the cumulative structural fiscal effort during the current government period (2015–17) has amounted to 1.4 percent of GDP—split between years 2015 and 2017 (with minimal adjustment in 2016). The 2018 budget delineates relatively small changes—higher pension and education outlays, amounting to 0.4 percent of GDP—which will be offset by higher revenues due to the better-than-expected macroeconomic outcomes, as well as a temporary 3 percentage points increase in import fees for consumer goods and higher taxes on gambling. While the authorities viewed the import fees purely as a revenue measure, the staff argued against these as they go against Uruguay's ongoing trade integration efforts that have supported productivity growth, and would have preferred alternative revenue measures. In addition, the 2018 outturn is expected to benefit from the full impact of the 2017 tax reform. The budget envisages a decline in the overall deficit from 4.0 percent of GDP in 2016 to 2.9 percent in 2018. The budget also reaffirms the government's commitment to reducing the deficit to 2.5 percent of GDP by 2019.

22. Staff encouraged the authorities to reach their 2019 deficit target earlier. Historically, election years—such as 2019—have seen higher spending and deficits, suggesting that it could be challenging to rely on further adjustment in 2019 to reach the deficit target. Furthermore, staff argued that the steadfast implementation of the spending allocations in the budget combined with a stronger-than-expected recovery would allow the authorities to achieve their 2.5-percent-of-GDP fiscal deficit objective already in 2018 with a limited additional effort, and helped by lower interest costs.[7] Staff advised the authorities to save the revenue windfall, should GDP growth exceed expectations. In addition, since the introduction of a mixed pension system in 1996, the implicit fiscal liability stemming from future deficits of the defined benefits pillar of the system has increased as a result of successive adjustments. The authorities should restore the sustainability of the system as soon as possible, in particular through parametric reforms.[8]

23. Reversing the reduction in public investment is becoming increasingly urgent. Starting in 2015, the authorities have reduced public investment by close to 1 percent of GDP—with the expectation that public-private partnerships (PPPs) would more than pick up the slack. However, a rapid rise in PPPs has not materialized, notwithstanding Uruguay's well-documented infrastructure gaps, notably for transportation[9] Staff's estimates of fiscal multipliers support the notion that higher public investments could also invigorate private investment and growth[10]. Staff advised reorienting budget spending from the public wage bill to investment, and accelerating the preparation of PPPs (without relaxing safeguards). Furthermore, and regardless of the financing modality, it will be important to assess carefully the costs and benefits—including potential synergies—of each project, as well as of incentives to attract private investment.

24. As the end of the government term approaches, amending the existing fiscal rule could strengthen confidence in the sustainability of Uruguay's public finances**.** A continuation of present fiscal plans would stabilize gross and net debt as a share of GDP (see Annex II). However, the government's fiscal commitment only covers its term, which runs out in 2019. Moreover, even though the existing fiscal rule limits the annual increase in net debt, the frequent use of escape clauses accommodated a substantial increase in net debt before the current government period. An enhanced fiscal rule could include: (i) further safeguards to limit the use of escape clauses, (ii) constrain annual deficits (or debt increases) specified in structural terms to allow for the operation of automatic stabilizers, and (iii) be anchored on a medium-term objective for the level of debt.

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[7] In particular, the macroeconomic framework underpinning the 2018 budget assumed the real GDP growth of 2.0 percent in 2017 and 2.5 percent in 2018, below the staff's forecast of 3.1 and 3.4 percent, respectively.

[8] See *IMF Country Report 17/29*.

[9] See, for example, World Bank. 2015. *Uruguay—Systematic Country Diagnostic*. Washington, D.C.: World Bank Group.

[10] See Endegnanew, Y., "Uruguay: Estimates of Fiscal Multipliers," Selected Issues Paper, *forthcoming*.

25. Uruguay's state-owned enterprises (SOEs) have to be carefully managed. SOEs have traditionally played an important role in economic life. However, SOEs require strong governance to avoid the accumulation of quasi-fiscal costs (such as the recent need to recapitalize the state oil company ANCAP).[11] Ensuring that governance of SOEs is improved—with the focus on fiscal savings, investment prioritization, and strengthening management practices—would be an important step towards limiting fiscal risks.[12] Furthermore, staff reiterated its advice to pass through changes in international oil prices to the domestic fuel prices charged by ANCAP, based on a transparent formula, now that the company has been brought back to financial soundness. This would promote efficiency in the use of fuel and remove fiscal risks—which can be alleviated only partly though the current practice of hedging oil import prices.

26. The authorities confirmed their fiscal objectives, involving a reduction in the public sector deficit to 2.5 percent of GDP by 2019, which they considered challenging but attainable. They noted that they were fully aware of the spending pressures that could arise in the coming pre-election and election years. The authorities explained that autonomous increases in pension costs had been the main driver of increases in fiscal spending, and they consider it necessary to assess parametric changes of the system to control its costs. The authorities highlighted the important contribution made by public enterprises to the improvement in the fiscal results during the current government period. In this context, they noted that in setting administered prices both the costs borne by the public utility companies and broader macroeconomic consequences were taken into account.

D. A More Functional Financial Sector

27. Even though Uruguay's banking sector is well capitalized, bank credit remains weak. With the regulatory capital to risk-weighted assets ratio increasing since December 2015, the banking sector has comfortable buffers. At the same time, the extensive dollarization and a high degree of market segmentation render bank credit expensive and limited, especially in the peso market, where it could be most beneficial to the nascent business ventures. In particular, the large public bank BROU dominates the peso market, while the foreign banks have highly dollarized deposit bases and mostly engage in the dollar lending to commercial and higher-income segments.[13]

28. The ongoing implementation of the 2014 Financial Inclusion Law should help the banking sector to expand its reach. By promoting electronic transactions, generalized payroll deposit accounts, and encouraging competition in the banking sector, the law is expected to

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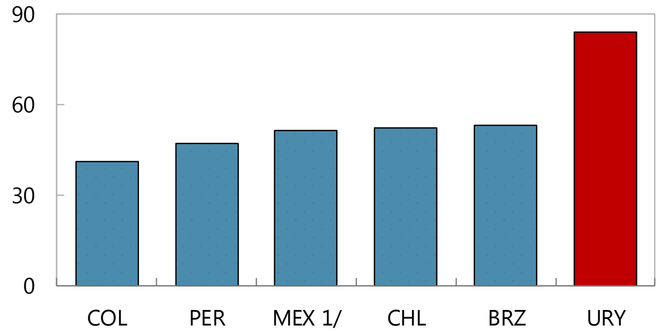
[11] The recapitalization of ANCAP involved the forgiveness of its \$0.6-billion (1 percent of GDP) debt to the government and the restructuring of some \$0.7 billion of the company's debt to commercial banks. See *IMF Country Report 16/62*.

[12] For further discussion, see World Bank. 2015. *Uruguay - Country partnership framework for the period FY16–20*. Washington, D.C.: World Bank Group.

[13] For a detailed discussion of Uruguay's banking sector and firms' access to credit, see *IMF Country Report 16/63*.

increase the supply of peso funding and access to credit by consumers—including in low-income and rural segments—and small businesses. At the same time, the use of new capital market instruments to finance public infrastructure, including through PPPs, and expected regulatory changes to facilitate the issuance of bonds by medium-sized private enterprises (rather than relying on self-financing), can help develop domestic financial markets, and promote competition within the financial system.

Banks: Non-Interest Expenses to Gross Income, 2016
(Percent)



Source: IMF, Financial Soundness Indicators database.
1/ For Mexico, data for 2015.

29. Maintaining the stability of the banking sector is a priority. Banks' operating costs are high; non-performing loans have risen; and bank profitability declined in the wake of the peso appreciation in 2016 (since most banks were long in U.S. dollars). Nonetheless, stability risks to the banking system remain limited, as evidenced by the authorities' stress tests, and supported by rising capital-asset ratios (Table 1). Supervision should continue to closely monitor banks' exposures, assisted by the implementation of the International Financial Reporting Standards (slated for 2018). The recent steps to implement Basel III—including the phased introduction of the 2.5-percent capital conservation buffer, capital surcharges for larger banks, and of liquidity ratio regulations—are useful risk-mitigation measures.

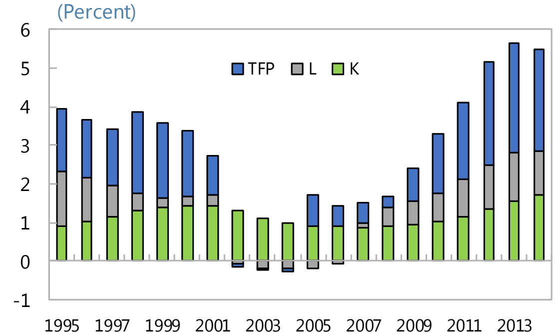
30. The authorities considered that the financial system was stable and well-supervised. They noted that self-financing and foreign direct investment had been key sources of funding for private investment, while bank credit had played a relatively less important role. They mentioned their initiative to enhance the domestic securities market, with a joint public-private working group to prepare a blueprint for reform. They authorities had also created a fintech working group to analyze Uruguay's noticeable position in this sector. The authorities also highlighted their six-month "e-peso" pilot project, for digital currency issued by the central bank.

E. Structural Issues

31. Uruguay's business climate is backed by the country's strong institutions and stability. Furthermore, the country has become increasingly integrated in world markets, benefitting from large inward FDI on most years, often for companies operating within free zones. There is also an ongoing transition into knowledge-intensive services, including fintech. The country has shifted to renewable sources for its power supply, in particular, hydropower and, to a lesser degree, wind energy, and has developed connections for exporting excess supply to Argentina and Brazil. It is also implementing a comprehensive care system that supports women's participation in the broader economy. Nevertheless, Uruguay is ranked relatively low in the ease of doing business—94th worldwide according to the World Bank.

32. No single factor could account for Uruguay's record of strong growth over the past two decades. A standard (Cobb-Douglas) decomposition shows that, unlike in other Latin American countries, growth in Uruguay has been largely driven by total factor productivity (TFP), which is typically the result of productivity improvements in some sectors or favorable terms-of-trade shocks, but can also result from underinvestment in capital (see Box 3).

Contributions to Growth in Uruguay
(Percent)



Sources: Penn World Tables version (PWT) 9.0 and IMF staff calculations.

33. Ambitious structural reforms could help maintain robust medium-term growth against the background of a declining workforce due to population aging. The large contribution of TFP to growth in the past introduces a layer of uncertainty around the medium-term growth projections, and the high growth rates observed in the past may not necessarily persist in the future. To forestall such an outcome, the staff urged the authorities to (i) undertake reforms to improve both educational attainment and the quality of education—for instance, via enhancing teacher qualifications and expanding vocational training; and (ii) facilitate further economic integration with the countries in the region and elsewhere by upgrading the country's transport and logistic infrastructure; (iii) enhance the flexibility of labor markets, to facilitate shifts to relatively productive sectors and firms and to ensure that wage increases reflect productivity improvements.[14]

34. The authorities explained their initiatives for supporting public and private investment. They highlighted the forthcoming public investment in railroads, associated with the expected FDI in a third paper pulp mill, and the major positive spillovers of this project for investments more broadly. They were also reviewing their investment promotion regime, with a view to enhancing its prioritization and management. They highlighted that Uruguay had become a major producer of international services, in particular software. The authorities confirmed that education reform remained a crucial policy priority. They welcomed and supported the renewed momentum in Mercosur for its further integration into the world economy, including through the negotiations on a free trade agreement with the European Union.

[14] For further discussion, see *IMF Country Report 16/62* and World Bank, 2015, *Uruguay: Trade Competitiveness Diagnostic*, Washington, D.C., World Bank Group.

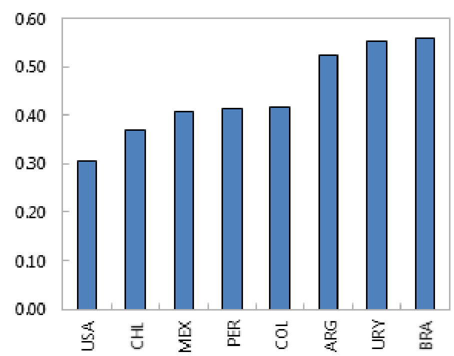
Box 3. Sources of Growth in Uruguay 1/

Despite robust growth during the present decade, relative living standards of the average Uruguayan (compared with U.S. counterparts) are only now catching up to where they were in the 1960s. Furthermore, swings in living standards are more than twice what can be explained by movements in the available stocks of factors of production alone. The labor force and the physical capital stock together grew at about twice the rate of the Uruguayan economy during the 1980s. Then, in the decade since the 2001–2 economic crisis, these magnitudes reversed.

The excess volatility in Uruguayan production points to the importance of trends in productivity in the economy. One hypothesis for the post-crisis experience is that increasing global demand for Uruguayan products has benefited the terms at which Uruguayan exports can be traded for imports. The analysis supports this view somewhat, but finds that this feature can only explain about ½ of a percentage point of increased yearly growth since the crisis.

An explanation for Uruguay's lack of long-run convergence could be that labor resources may not be efficiently allocated to sectors of production. Our research shows that labor productivities are almost twice as spread out across Uruguayan sectors as they are across sectors in the United States. In theory, such differences in productivity across sectors could reflect a lack of flexibility in the labor market.

Spread in Labor Productivities Across Sectors
(average coefficient of variation)



Sources: Groningen Growth and Development Center (GGDC) 10-Sector Database, INE and IMF Staff calculations.
Note: the chart shows the average over time of the coefficient of variation across sectors of the level of labor productivity. In turn, labor productivity is measured as GDP per worker in 2005 U.S. dollars, using constant national prices and market exchange rates.

1/ Based on Sher, G., "Productivity, Foreign Demand and Factor Allocation in Uruguay," Selected Issues Paper, *forthcoming*.

STAFF APPRAISAL

35. **Through prudent policies, the authorities have capitalized on favorable external conditions to achieve good macroeconomic outcomes in 2017.** As GDP accelerated, a combination of a tight monetary policy stance and an earlier exchange rate appreciation brought inflation within the central bank's target range. The fiscal adjustment is proceeding broadly as planned, with the authorities' 2.5-percent of GDP deficit target being within reach. On the upside, the envisaged paper pulp-processing plant could significantly boost growth beyond what is currently projected. Uruguay's large buffers and exchange rate flexibility would allow the country to adjust to beneficial or adverse shocks in an orderly fashion.

36. To reinforce Uruguay's resilience to shocks further, and to provide the conditions for sustained robust and inclusive growth, ongoing fiscal and monetary prudence should be combined with structural reforms. The country's record of strong institutions and hard-won economic stability are recognized by financial markets as well as investors in the real economy. However, there is still scope to boost the credibility of monetary and fiscal anchors over the medium term. Furthermore, weakness in transportation infrastructure, skills formation, labor market flexibility, and access to foreign markets, constrain the economy's ability to adapt to new opportunities in the face of rapid technological advances, and changes in global production patterns.

37. The loss of competitiveness in manufacturing and agriculture poses a longer-term policy challenge. While staff assesses the external position to be stronger than consistent with fundamentals and desirable policy settings, the outlook may change and further appreciation pressures could arise with the expected foreign investments in a new paper pulp plant. At a structural level, reforms to enhance the business climate will be critical for supporting a vibrant and diverse economic base. Enhancing firms' access to credit and hedging instruments would also strengthen their resilience. As the public petroleum company regains its financial health, there could also be scope to adjust administered fuel prices.

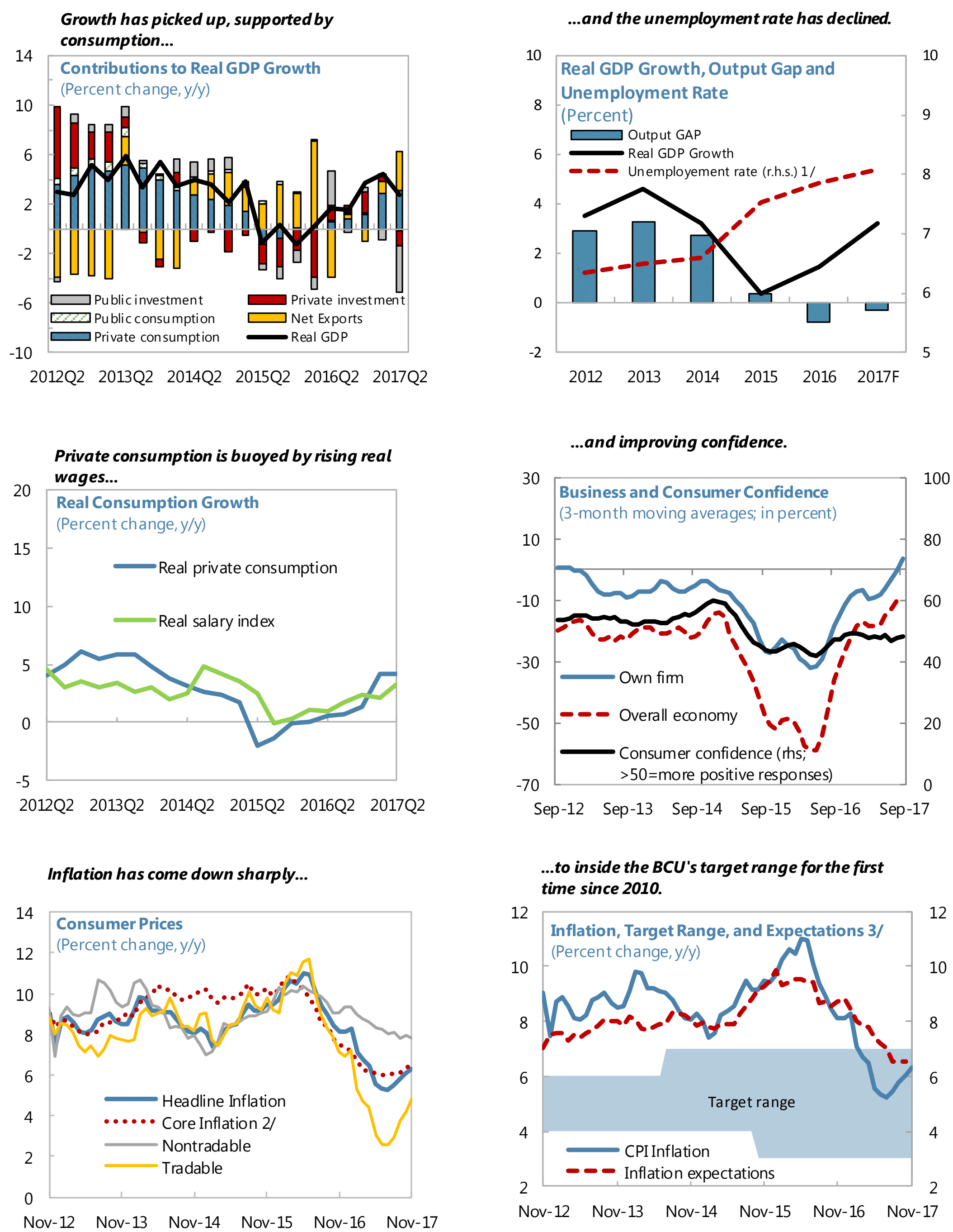
38. Keeping inflation on a downward path over the medium term would greatly enhance the credibility of the central bank. To this end, some monetary tightening would be appropriate as expected demand pressure materializes. It would also set the stage for broader efforts towards de-dollarization. Keeping nominal wage growth on a declining path would be important for anchoring inflation over the coming years. The authorities may also wish to explore options to reduce the volatility of short-term interest rates.

39. Exchange rate flexibility should remain an important stabilizer for the Uruguayan economy in the face of shocks. Interventions should be limited to countering disorderly market conditions, and cannot substitute for necessary structural reforms to enhance productivity and flexibility. Clear communications are important to ensure that the interventions do not undermine the credibility of the central bank's commitment to reducing inflation.

40. Uruguay's main fiscal challenges are of a medium-term nature. In the short term, the authorities should seek to save the expected revenue windfalls and aim at achieving their 2.5-percent of GDP fiscal deficit target before the 2019 election year. In the medium term, an enhanced fiscal rule could be helpful to keep net debt on a sustainable and declining path, while the viability of the pension system will require further reforms. In view of Uruguay's infrastructure gaps, reversing the reduction in public investment is becoming key. It will be important, however, to assess carefully the costs and benefits of each public and public-private project, as well as of incentives to attract private investment. Relatedly, strong governance of SOEs will be important for limiting fiscal risks.

41. Staff proposes that Uruguay remains on the 12-month Article IV consultation cycle.

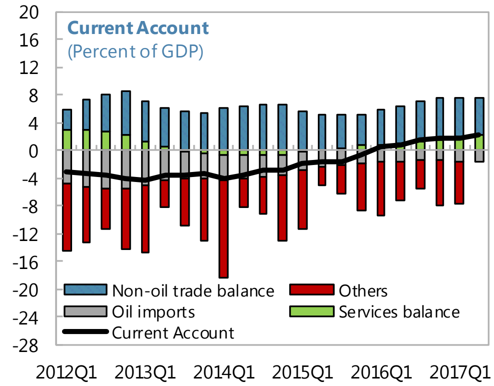
Figure 1. Uruguay: Real Activity and Inflation



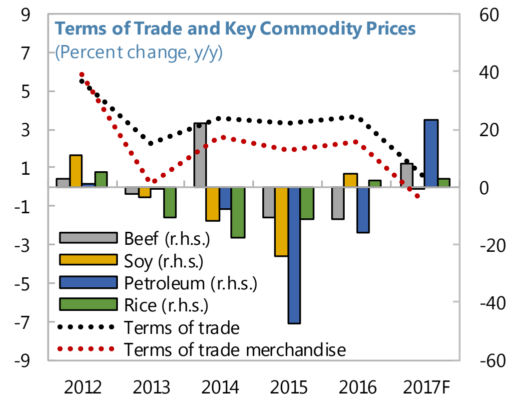
Sources: World Economic Outlook, Haver Analytics, Banco Central del Uruguay (BCU), Instituto Nacional de Estadistica, Bloomberg L.P., and Fund staff estimates and calculations.
1/ For 2017, an average of monthly figures as of August is used.
2/ The definition of Core Inflation follows BCU's definition and excludes administered prices, fruits and vegetables, and tobacco.
3/ BCU survey, median of expected inflation for the 12 months ahead.

Figure 2. Uruguay: External Accounts

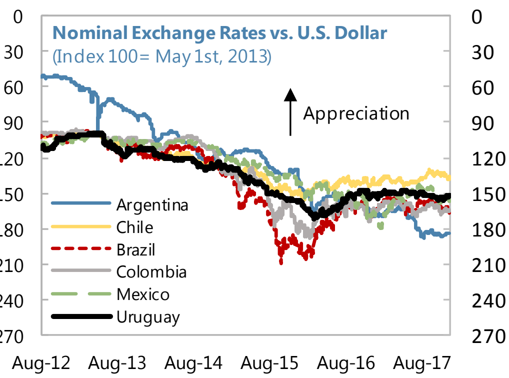
The current account turned to surplus in 2016...



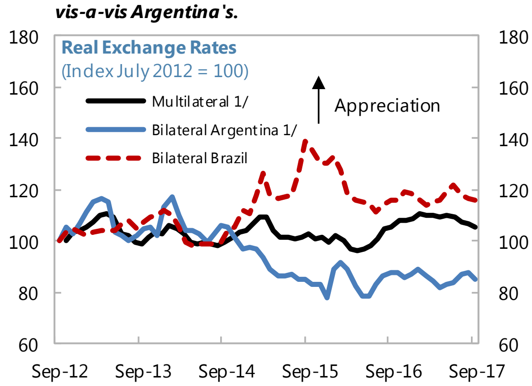
...supported by favorable terms of trade.



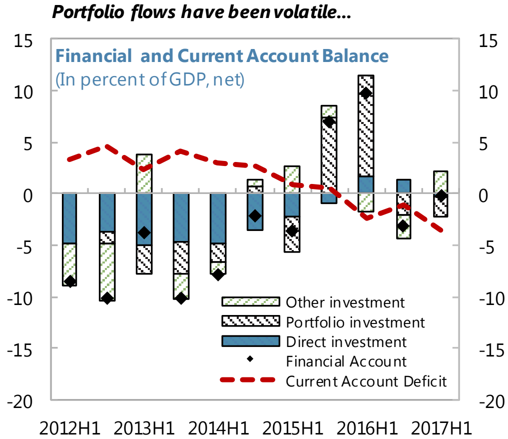
The peso exchange rate against the U.S. dollar mimicked that of most regional currencies.



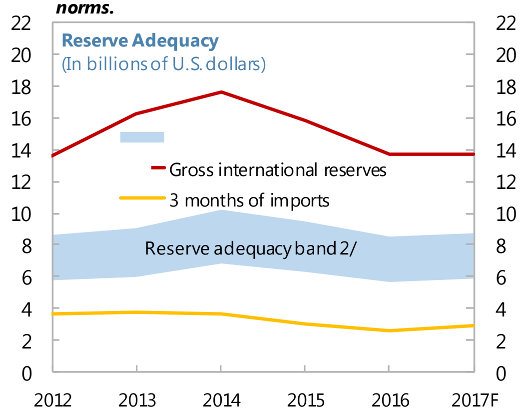
However, Uruguay's real exchange rate depreciated vis-a-vis Argentina's.



Portfolio flows have been volatile...



...and reserves remained well above prudential norms.

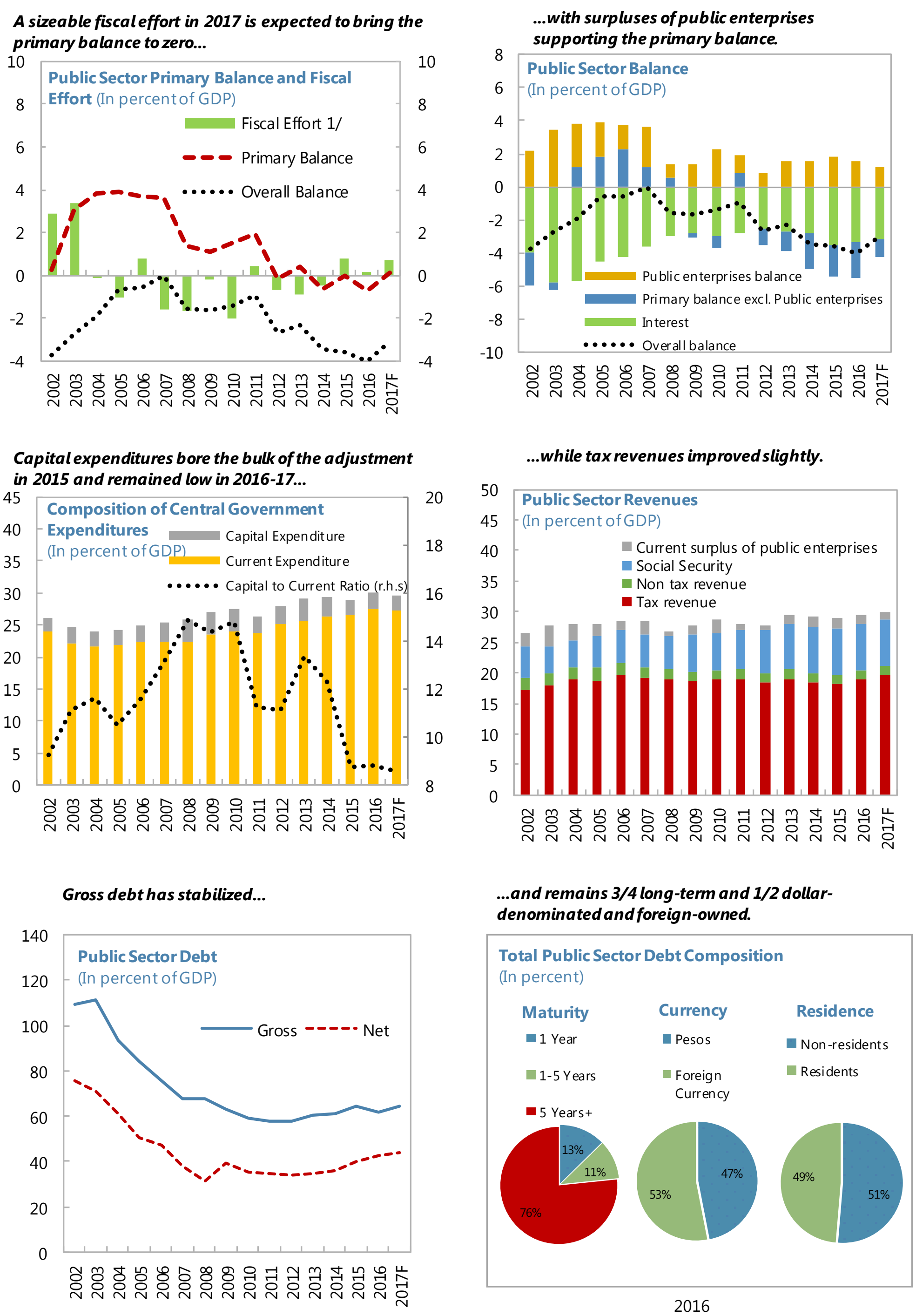


Sources: Banco Central de Uruguay (BCU), World Economic Outlook, Instituto Nacional de Estadistica data, Haver Analytics, and Fund staff calculations.

1/ The real exchange rate against Argentina is calculated using the unofficial CPI for Argentina until April 2016 and the official onwards; and the average of the unofficial and official exchange rates for the Argentine peso until November 2015 and the official exchange rate onwards.

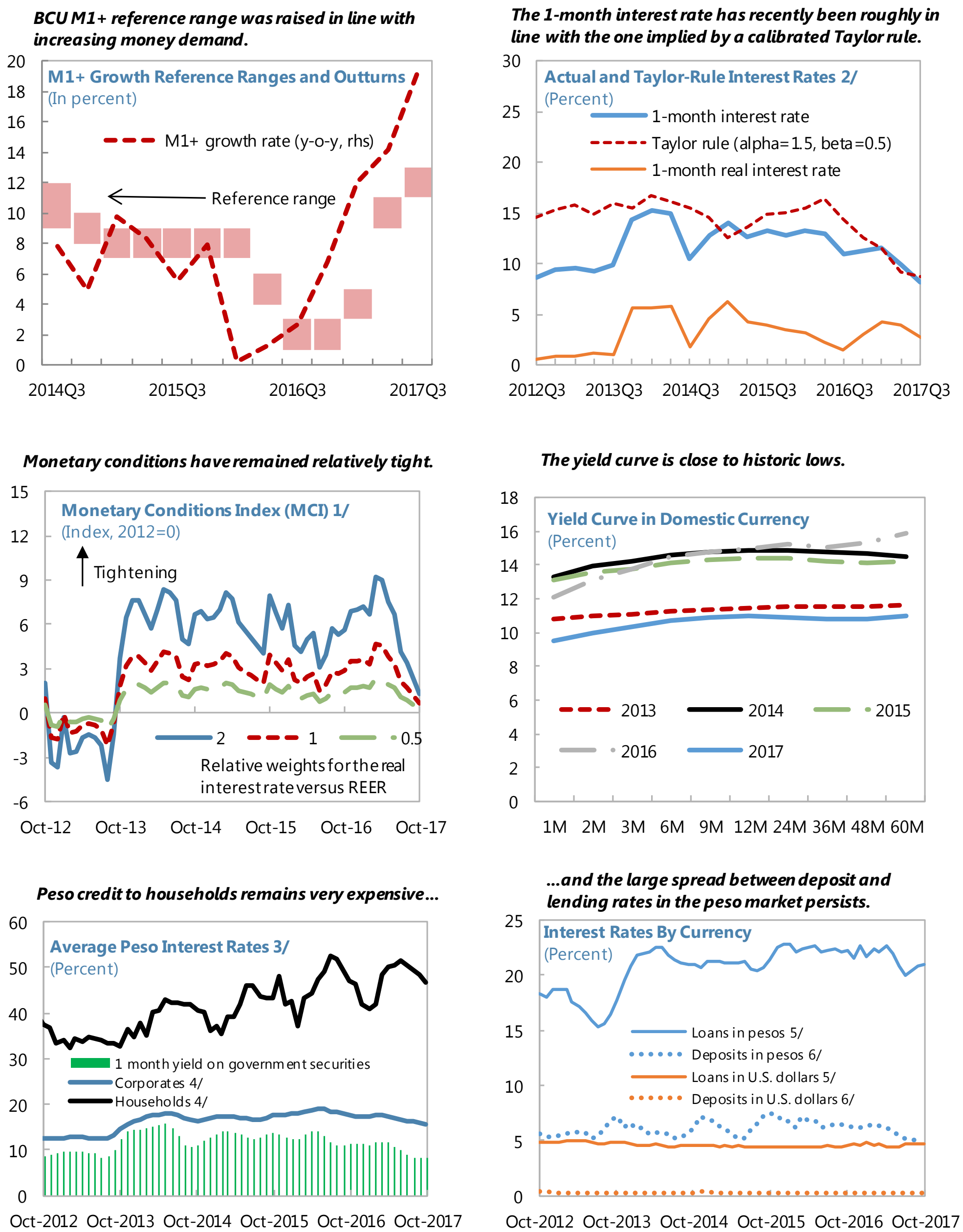
2/ Band spans 100 to 150 percent of the Fund's reserve adequacy metric.

Figure 3. Uruguay: Fiscal Developments and Projections



Sources: World Economic Outlook, Banco Central del Uruguay, Haver Analytics, and Fund staff calculations.
1 / Fiscal effort is defined as the change in the Structural Primary Balance.

Figure 4. Uruguay: Monetary Policy



Sources: IMF, World Economic Outlook; Banco Central del Uruguay (BCU); and Fund staff estimates and calculations.

1/ The MCI is a weighted average of the changes in the real interest rate of 12-month Central Bank securities and the real effective exchange rate (REER) relative to their values in a base period, January 2012.

2/ A standard Taylor Rule was calibrated $i_t = c + \alpha(\pi_t - \pi^*) + \beta(y_t - y_t^*)$, where c is the nominal neutral rate calculated as the sum of the mid-point of the official inflation target range and the real potential growth rate; π^* is the mid-point of the official inflation target range; $(y-y^*)$ is the estimated output gap.

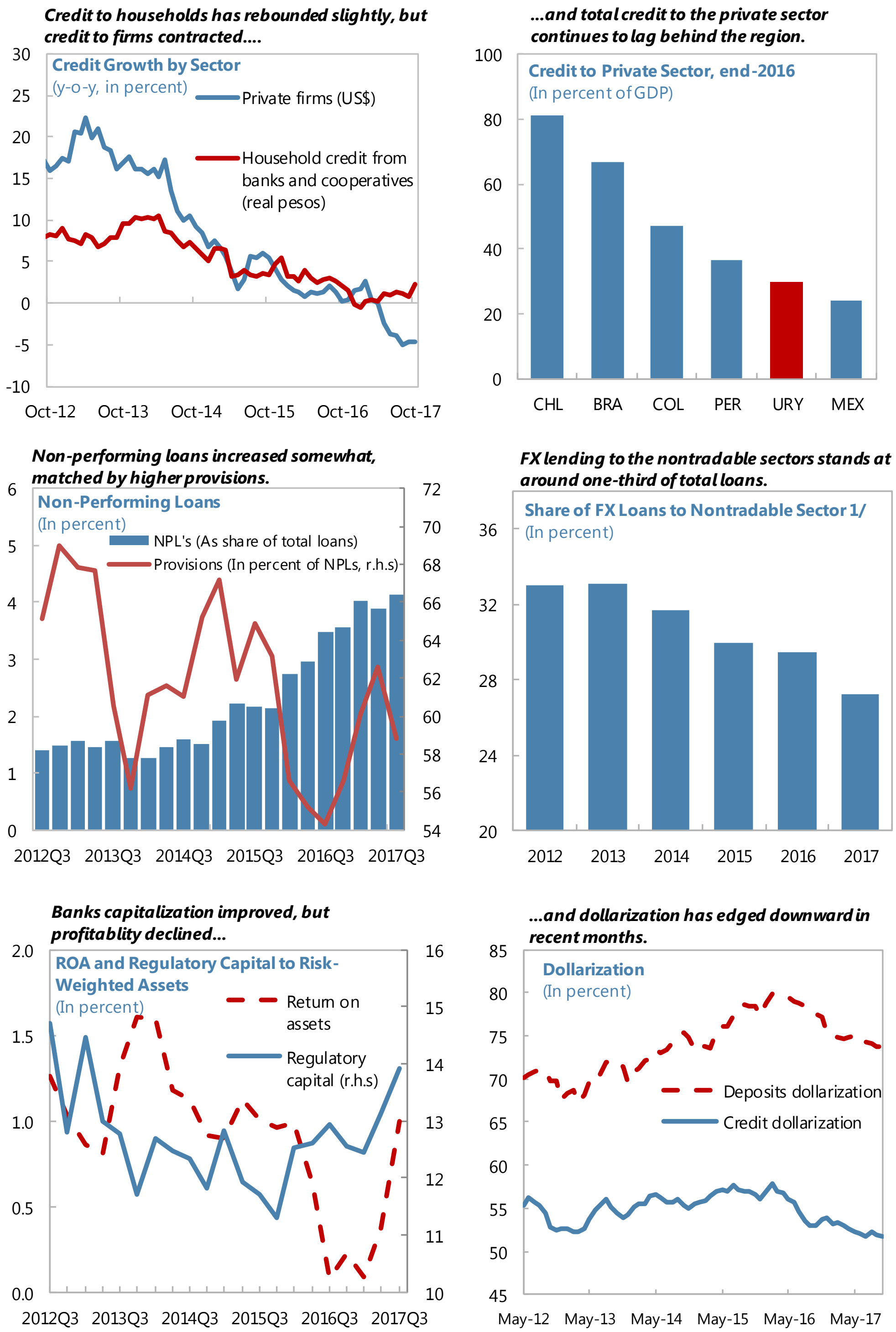
3/ 3-month moving average.

4/ Average interest rates on new peso loans of up to one year.

5/ Annual effective interest rates, monthly weighted average, excluding restructured operations.

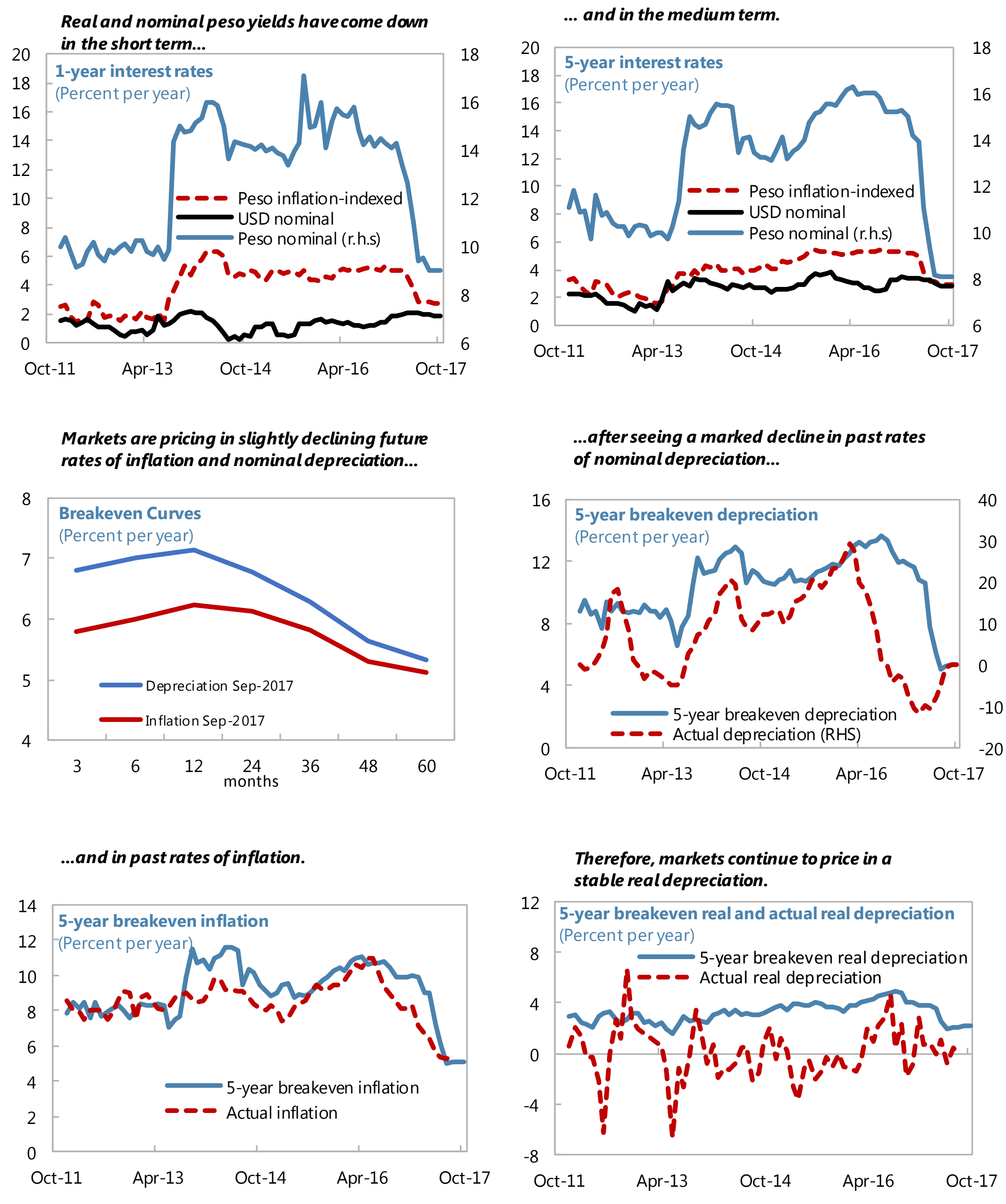
6/ Weighted average rate on totality of fixed term deposits.

Figure 5. Uruguay: Credit and Banking



Sources: IMF, *World Economic Outlook*; Banco Central del Uruguay (BCU); and Fund staff estimates and calculations.
1/ Share of FX Loans to borrowers in the nontradable sector; data is through 2017Q3.

Figure 6. Uruguay: Yield Differentials



Sources: BCU, Bloomberg, and Fund staff calculations.

Table 1. Uruguay: Selected Financial Soundness Indicators

	2011	2012	2013	2014	2015	2016	2017 1/
Currency composition							
Dollar loans in percent of total loans	58.5	57.9	59.6	59.0	60.5	57.1	55.4
Loan dollarization (constant exchange rate, January 2013) 2/	52.9	52.3	51.4	49.6	44.9	43.3	42.0
Dollar deposits in percent of total deposits	71.9	71.9	73.5	76.8	80.0	76.4	74.4
Deposit dollarization (constant exchange rate, January 2013) 2/	67.2	67.4	67.2	68.4	68.6	66.7	65.6
Credit cycle							
Private sector credit in percent of GDP	19.8	21.6	22.6	24.7	26.9	27.9	27.9
Private sector credit growth in percent	24.0	16.3	17.3	8.8	1.5	1.9	-0.7
Bank soundness							
Regulatory capital in percent of risk-weighted assets	13.7	12.8	11.7	11.8	11.3	12.5	13.9
Asset quality							
Non-performing loans in percent of total loans	1.3	1.5	1.3	1.5	2.1	3.6	4.2
Specific loan-loss provisions in percent of non-performing loans	71.1	69.0	56.2	65.2	63.1	56.6	58.4
Implicit exchange rate risk 3/	29.0	33.0	33.1	31.7	30.0	27.5	27.0
Profitability							
Return on assets	0.8	1.0	1.6	0.9	1.0	0.2	1.2
Return on equity	7.9	12.6	19.7	11.4	11.8	2.6	14.4
Operating costs in percent of gross income	83.4	81.0	83.1	86.0	86.0	80.5	66.5
Liquidity							
Liquidity ratio 4/	47.8	52.6	52.6	54.8	56.0	53.0	52.2
Non-resident deposits in percent of total deposits	14.6	15.2	15.0	14.7	15.8	12.0	10.2
Deposits/Loans ratio in national currency 5/	1.0	1.1	1.0	0.9	0.8	0.8	0.9
Deposits/Loans ratio in foreign currency 5/	2.2	2.3	2.0	2.0	2.0	2.4	2.5

Sources: Banco Central del Uruguay, IMF Global Financial Stability Report, and Fund staff calculations.

1/ Latest available data (October, unless otherwise specified).

2/ For 2017 data as of August.

3/ Foreign currency bank credit to borrowers without natural hedges as a share of total bank loans to the private sector. For 2017, data as of June.

4/ Liquid assets with maturity up to 30 days in percent of total. liabilities

5/ For 2017, data as of August.

Table 2. Uruguay: Selected Economic Indicators

						Projections					
	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Output, prices, and employment											
Real GDP (percent change)	3.5	4.6	3.2	0.4	1.5	3.1	3.4	3.1	3.0	2.9	3.0
GDP (US$ billions)	51.3	57.5	57.2	53.3	52.4	58.6	63.6	67.2	71.0	74.7	78.8
Unemployment (in percent, eop)	6.3	6.5	6.6	7.5	7.9	7.4	7.1	7.1	7.1	7.2	7.2
Output gap (percent of potential output)	2.9	3.3	2.7	0.4	-0.8	-0.4	0.1	0.2	0.1	0.0	0.0
CPI inflation (in percent, average)	8.1	8.6	8.9	8.7	9.6	6.2	6.4	6.7	6.6	6.5	6.1
CPI inflation (in percent, end of period))	7.5	8.5	8.3	9.4	8.1	6.4	6.7	6.5	6.4	6.3	6.2
Exchange rate (UY$/US$, average)	20.3	20.5	23.2	27.3	30.2	…	…	…	…	…	…
Real effective exchange rate (percent change, eop)	4.4	7.7	-2.9	1.9	-1.2	…	…	…	…	…	…
				(Percent change, unless otherwise specified)							
Monetary and banking indicators 1/											
Base money	26.7	12.9	1.4	7.2	9.7	…	…	…	…	…	…
Broader M1 (M1 plus savings deposits)	11.2	15.0	3.7	5.6	8.4	…	…	…	…	…	…
M2	10.3	13.7	6.4	9.0	14.4	…	…	…	…	…	…
Growth of credit to households (in real UY$)	7.3	9.9	4.7	6.3	-0.5	…	…	…	…	…	…
Growth of credit to firms (in US$)	17.5	16.2	6.8	2.8	1.5	…	…	…	…	…	…
Bank assets (in percent of GDP)	57.1	60.8	63.6	72.5	65.9	…	…	…	…	…	…
Private credit (in percent of GDP) 2/	23.5	26.0	27.1	30.2	28.2	…	…	…	…	…	…
				(Percent of GDP, unless otherwise specified)							
Public sector indicators											
Revenue 3/	27.7	29.5	29.1	29.0	29.4	29.6	29.8	30.0	30.1	30.2	30.3
Non-interest expenditure 3/	28.0	29.1	29.5	28.8	30.0	29.7	29.6	29.5	29.5	29.5	29.5
Wage bill	5.0	4.9	5.0	5.0	5.2	5.1	5.1	5.0	5.0	4.9	5.0
Primary balance 4/	-0.2	0.4	-0.6	0.0	-0.7	-0.1	0.2	0.5	0.5	0.7	0.8
Structural primary balance 4/	0.0	-0.9	-1.4	-0.6	-0.5	0.0	0.1	0.4	0.5	0.7	0.8
Interest 4/	2.5	2.7	2.8	3.6	3.3	3.2	2.9	3.0	3.1	3.2	3.3
Overall balance 4/	-2.7	-2.3	-3.5	-3.6	-4.0	-3.3	-2.7	-2.5	-2.5	-2.5	-2.5
Gross public sector debt	58.0	60.2	61.4	64.6	61.9	64.9	65.0	63.8	63.7	63.9	63.8
Public sector debt net of liquid financial assets 5/	34.0	34.4	35.9	39.7	42.7	44.1	44.3	44.6	44.7	44.9	44.8
Net public sector debt 4/	25.9	24.2	22.9	25.8	30.1	32.1	33.3	33.2	33.6	34.0	34.0
External indicators											
Merchandise exports, fob (US$ millions)	13,093	13,289	13,772	11,145	10,766	11,574	12,317	12,912	13,542	14,215	14,901
Merchandise imports, fob (US$ millions)	12,744	12,165	11,755	9,801	8,427	9,196	10,061	10,699	11,371	12,161	12,924
Terms of trade (percent change)	5.8	0.2	2.6	1.9	2.3	-0.9	0.6	0.9	0.7	0.4	0.6
Current account balance	-4.0	-3.3	-2.8	-0.7	1.7	1.9	1.3	0.6	0.3	-0.1	-0.7
Foreign direct investment	4.3	4.9	4.1	1.6	-1.5	1.4	1.3	1.2	1.2	1.1	1.0
Overall balance of payments (US$ millions)	3,239	2,778	1,357	-1,867	-2,190	2,000	340	340	630	935	950
Total external debt + non-resident deposits	67.7	69.0	74.9	89.5	74.8	68.5	70.1	70.4	70.6	71.1	71.3
Of which: External public debt	30.3	31.9	33.7	37.1	31.8	30.6	32.3	32.6	32.9	33.5	33.7
External debt service (in percent of exports of g&s)	10.1	6.5	5.8	6.0	9.1	7.1	9.3	9.5	10.0	10.7	12.3
Gross official reserves (US$ millions)	13,604	16,279	17,574	15,637	13,473	15,473	15,813	16,153	16,783	17,718	18,668
In months of imports of goods and services	9.8	11.3	12.6	13.5	13.8	14.5	13.5	12.8	12.5	12.3	12.1
In percent of:											
Short-term external (STE) debt	154.5	173.2	167.8	166.3	169.4	201.2	207.8	202.3	194.8	176.4	202.0
STE debt plus banks' non-resident deposits	108.5	120.5	119.8	113.9	120.2	144.3	146.4	142.5	138.2	128.9	142.2

Sources: Banco Central del Uruguay, Ministerio de Economia y Finanzas, Instituto Nacional de Estadistica, and Fund staff calculations.
1/ Percent change of end-of-year data on one year ago.
2/ Includes bank and non-bank credit.
3/ Non-financial public sector excluding local governments.
4/ Total public sector. Includes the non-financial public sector, local governments, Banco Central del Uruguay, and Banco de Seguros del Estado.
5/ Gross debt of the public sector minus liquid financial assets of the public sector. Liquid financial assets are given by deducting from total public sector assets the part of central bank reserves held as a counterpart to required reserves on foreign currency deposits.

Table 3. Uruguay: Balance of Payments and External Sector Indicators

						Projections					
	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
	(In millions of U.S. dollars, unless otherwise indicated)										
Balance of Payments											
Current account	-2,070	-1,906	-1,611	-395	888	1,112	821	436	207	-48	-589
Trade balance	349	1,124	2,017	1,343	2,339	2,379	2,256	2,212	2,171	2,054	1,977
Exports, f.o.b.	13,093	13,289	13,772	11,145	10,766	11,574	12,317	12,912	13,542	14,215	14,901
Imports, f.o.b.	12,744	12,165	11,755	9,801	8,427	9,196	10,061	10,699	11,371	12,161	12,924
Of which: Fuel products	2,851	2,055	1,722	1,031	736	1,039	1,277	1,303	1,347	1,419	1,512
Of which: Non-fuel products	9,893	10,110	10,034	8,771	7,691	8,157	8,783	9,397	10,023	10,743	11,412
Services balance	1,205	-222	-361	412	856	1,386	1,107	1,039	1,029	1,007	842
Exports, f.o.b.	5,053	4,827	4,623	4,488	4,181	5,001	5,099	5,431	5,778	6,143	6,396
Imports, f.o.b.	3,848	5,049	4,984	4,077	3,325	3,614	3,992	4,392	4,749	5,136	5,554
Income balance (net)	-3,749	-2,987	-3,447	-2,327	-2,494	-2,840	-2,729	-3,002	-3,180	-3,295	-3,595
Transfers (net)	125	180	181	176	187	187	187	187	187	187	187
Financial and capital account	4,790	4,046	2,806	-897	-1,525	1,444	-481	-96	423	982	1,539
Foreign direct investment	2,179	2,793	2,373	842	-784	812	814	816	816	815	814
Portfolio investment	323	1,682	312	-993	-1,854	1,562	259	445	710	489	697
Other capital flows (net)	2,288	-428	120	-745	1,114	-931	-1,554	-1,357	-1,103	-322	28
Reserve assets (- increase)	-3,239	-2,778	-1,357	1,867	2,190	-2,000	-340	-340	-630	-935	-950
Reserve Adequacy and External Indicators											
Gross official reserves (stock)	13,604	16,279	17,574	15,637	13,473	15,473	15,813	16,153	16,783	17,718	18,668
In months of imports of goods and services	9.8	11.3	12.6	13.5	13.8	14.5	13.5	12.8	12.5	12.3	12.1
In percent of short-term debt	154.5	173.2	167.8	166.3	169.4	201.2	207.8	202.3	194.8	176.4	202.0
	(As percent of GDP)										
Balance of Payments											
Current account	-4.0	-3.3	-2.8	-0.7	1.7	1.9	1.3	0.6	0.3	-0.1	-0.7
Trade balance	0.7	2.0	3.5	2.5	4.5	4.1	3.5	3.3	3.1	2.7	2.5
Exports of goods	25.5	23.1	24.1	20.9	20.5	19.7	19.4	19.2	19.1	19.0	18.9
Imports of goods	24.9	21.1	20.5	18.4	16.1	15.7	15.8	15.9	16.0	16.3	16.4
Of which: Fuel products	5.6	3.6	3.0	1.9	1.4	1.8	2.0	1.9	1.9	1.9	1.9
Of which: Non-fuel products	19.3	17.6	17.5	16.5	14.7	13.9	13.8	14.0	14.1	14.4	14.5
Services balance	2.4	-0.4	-0.6	0.8	1.6	2.4	1.7	1.5	1.5	1.3	1.1
Exports	9.9	8.4	8.1	8.4	8.0	8.5	8.0	8.1	8.1	8.2	8.1
Imports	7.5	8.8	8.7	7.7	6.3	6.2	6.3	6.5	6.7	6.9	7.1
Financial and capital account	9.3	7.0	4.9	-1.7	-2.9	2.5	-0.8	-0.1	0.6	1.3	2.0
Foreign direct investment	4.3	4.9	4.1	1.6	-1.5	1.4	1.3	1.2	1.2	1.1	1.0
Other capital flows (net)	4.8	-0.7	0.3	-2.0	2.0	-1.6	-2.4	-2.0	-1.6	-0.4	0.0
Reserve assets (- increase)	-6.3	-4.8	-2.4	3.5	4.2	-3.4	-0.5	-0.5	-0.9	-1.3	-1.2
Total external debt + non-resident deposits	67.7	69.0	74.9	89.5	74.8	68.5	70.1	70.4	70.6	71.1	71.3
Of which: Short-term debt (residual maturity)	17.2	16.3	18.3	17.6	15.2	13.1	12.0	11.9	12.1	13.4	11.7
Of which: External public debt	30.3	31.9	33.7	37.1	31.8	30.6	32.3	32.6	32.9	33.5	33.7
	(As percent of annual exports of goods and services)										
External Debt											
Total external debt (including non-resident deposits)	36.3	38.0	40.9	43.5	40.3	40.3	43.8	46.4	49.1	52.2	55.1
Debt service	10.1	6.5	5.8	6.0	9.1	7.1	9.3	9.5	10.0	10.7	12.3
Of which: Interest payments	27.5	24.3	23.0	19.6	21.7	21.2	18.3	19.1	19.7	19.4	19.8
	(Annual percent changes)										
External Trade											
Exports of goods in US$	41.2	1.5	3.6	-19.1	-3.4	7.5	6.4	4.8	4.9	5.0	4.8
Imports of goods in US$	19.1	-4.5	-3.4	-16.6	-14.0	9.1	9.4	6.3	6.3	7.0	6.3
Export prices in US$	5.9	-2.0	0.6	-9.5	-4.2	3.6	2.9	1.1	1.2	1.3	0.8
Import prices in US$	0.0	-2.2	-1.9	-11.1	-6.3	4.6	2.3	0.2	0.5	0.9	0.3
Terms of trade for goods	5.8	0.2	2.6	1.9	2.3	-0.9	0.6	0.9	0.7	0.4	0.6
Export volume (goods and non-factor services)	33.3	3.5	3.0	-10.6	0.8	3.7	3.4	3.7	3.6	3.6	3.9
Import volume (goods and non-factor services)	19.0	-2.4	-1.5	-6.2	-8.2	4.3	7.0	6.2	5.7	6.0	6.0
Export volume (goods)	33.3	3.5	3.0	-10.6	0.8	3.7	3.4	3.7	3.6	3.6	3.9
Import volume (goods)	19.0	-2.4	-1.5	-6.2	-8.2	4.3	7.0	6.2	5.7	6.0	6.0
Of which: Non-fuel products	2.5	14.1	1.5	-7.4	-7.6	3.2	6.8	6.0	5.6	5.8	5.8
Of which: Fuel products	40.4	-27.3	-9.4	13.4	-15.3	20.2	23.3	1.3	2.3	3.6	4.3

Sources: Banco Central del Uruguay and Fund staff calculations and projections.

Table 4. Uruguay: Main Fiscal Aggregates

	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
								Projections			
						(In billions of pesos, unless otherwise indicated)					
I. Primary balance of the non-financial public sector (A+B+C)	-1.3	5.4	-7.3	0.9	-9.8	-0.9	5.2	12.3	14.0	19.4	23.5
A. Primary balance of central government, BPS and NFPE 1/ 2/	-2.4	4.4	-4.6	3.2	-9.0	-0.9	3.9	10.8	12.9	18.6	22.7
Revenues	288.6	347.4	387.2	422.3	465.4	507.3	561.3	620.3	681.5	750.9	824.7
Taxes	191.3	222.5	244.2	263.3	298.8	335.0	371.1	408.4	448.0	490.4	537.1
Non tax	16.2	20.9	21.6	23.4	24.3	20.9	28.5	31.2	34.2	37.4	41.0
Social security	72.6	86.0	101.0	108.7	118.5	130.5	142.4	157.0	172.4	189.1	207.0
NFPE operating balance 2/	8.5	18.0	20.4	26.8	23.9	20.9	19.3	23.7	27.0	33.9	39.6
Primary expenditures	291.0	343.1	391.9	419.1	474.4	508.2	557.4	609.5	668.6	732.2	802.0
Current	261.9	302.6	348.9	385.4	435.9	468.0	512.2	557.8	612.0	670.2	734.1
Capital	29.1	40.4	43.0	33.7	38.5	40.2	45.2	51.6	56.6	62.0	67.9
B. Primary balance of local governments	-0.8	-0.8	-2.0	1.7	0.9	0.0	0.8	0.8	0.7	0.5	0.5
C. Primary balance of BSE 3/	1.9	1.8	-0.6	-4.0	-1.8	0.0	0.6	0.6	0.5	0.2	0.3
II. Primary balance of the BCU 4/	-0.4	-0.8	-1.0	-1.4	-1.5	-1.6	-1.7	-1.9	-2.1	-2.3	-2.5
III. Primary balance of the public sector (I+II)	-1.8	4.6	-8.2	-0.5	-11.3	-2.5	3.5	10.3	11.9	17.1	21.0
IV. Interest	26.4	31.9	37.9	51.8	52.5	54.1	54.3	61.6	69.7	80.0	89.1
of which: BCU 4/	3.0	4.4	7.4	18.4	10.5	9.2	5.5	7.7	8.7	10.6	11.7
V. Overall balance of the public sector (III-IV)	-28.1	-27.4	-46.1	-52.3	-63.8	-56.6	-50.8	-51.2	-57.8	-62.9	-68.1
						(In percent of GDP, unless otherwise indicated)					
I. Primary balance of the non-financial public sector (A+B+C)	**-0.1**	**0.5**	**-0.5**	**0.1**	**-0.6**	**-0.1**	**0.3**	**0.6**	**0.6**	**0.8**	**0.9**
A. Primary balance of central government, BPS and NFPE 1/ 2/	-0.2	0.4	-0.3	0.2	-0.6	-0.1	0.2	0.5	0.6	0.8	0.8
Revenues	27.7	29.5	29.1	29.0	29.4	29.6	29.8	30.0	30.1	30.2	30.3
Taxes	18.4	18.9	18.4	18.1	18.9	19.6	19.7	19.8	19.8	19.8	19.7
Non tax	1.6	1.8	1.6	1.6	1.5	1.2	1.5	1.5	1.5	1.5	1.5
Social security	7.0	7.3	7.6	7.5	7.5	7.6	7.6	7.6	7.6	7.6	7.6
NFPE operating balance 2/	0.8	1.5	1.5	1.8	1.5	1.2	1.0	1.1	1.2	1.4	1.5
Primary expenditures	28.0	29.1	29.5	28.8	30.0	29.7	29.6	29.5	29.5	29.5	29.5
Current	25.2	25.7	26.2	26.5	27.6	27.4	27.2	27.0	27.0	27.0	27.0
Capital	2.8	3.4	3.2	2.3	2.4	2.4	2.4	2.5	2.5	2.5	2.5
B. Primary balance of local governments	-0.1	-0.1	-0.2	0.1	0.1	0.0	0.0	0.0	0.0	0.0	0.0
C. Primary balance of BSE 3/	0.2	0.2	0.0	-0.3	-0.1	0.0	0.0	0.0	0.0	0.0	0.0
II. Primary balance of BCU 4/	**0.0**	**-0.1**	**-0.1**	**-0.1**	**-0.1**	**-0.1**	**-0.1**	**-0.1**	**-0.1**	**-0.1**	**-0.1**
III. Primary balance of the public sector (I+II)	**-0.2**	**0.4**	**-0.6**	**0.0**	**-0.7**	**-0.1**	**0.2**	**0.5**	**0.5**	**0.7**	**0.8**
IV. Interest	**2.5**	**2.7**	**2.8**	**3.6**	**3.3**	**3.2**	**2.9**	**3.0**	**3.1**	**3.2**	**3.3**
Of which: BCU 4/	0.3	0.4	0.6	1.3	0.7	0.5	0.3	0.4	0.4	0.4	0.4
V. Overall balance of the public sector (III-IV)	**-2.7**	**-2.3**	**-3.5**	**-3.6**	**-4.0**	**-3.3**	**-2.7**	**-2.5**	**-2.5**	**-2.5**	**-2.5**
Memorandum Items:											
Real revenues growth (in percent)	2.2	11.3	1.9	0.0	3.0	3.8	4.0	3.8	3.1	3.5	3.3
Real primary spending growth (in percent)	9.9	6.1	5.7	1.1	1.3	2.6	3.0	2.1	2.9	2.8	3.3
GDP (in billions of pesos)	1,041	1,178	1,331	1,456	1,581	1,711	1,883	2,066	2,267	2,482	2,720

Sources: Ministerio de Economia y Finanzas, Banco Central del Uruguay, and Fund staff calculations.
1/ Banco de Prevision Social (BPS).
2/ Non-financial public enterprises (NFPE).
3/ Banco de Seguros del Estado (BSE).
4/ Banco Central del Uruguay (BCU).

Table 5. Uruguay: Public Sector Debt and Assets 1/

						Projections					
	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
	(In billions of U.S. dollars, unless otherwise indicated)										
Public Sector Debt											
Gross debt of the public sector	31.1	33.1	33.5	31.4	33.3	38.3	40.6	42.1	44.3	46.9	49.3
of which:											
Non-financial public sector debt	23.5	23.8	24.5	25.6	27.7	30.4	32.1	33.8	35.6	37.5	39.4
Central bank debt	7.7	9.3	9.1	5.8	5.6	7.8	8.4	8.3	8.7	9.4	9.9
External debt of the public sector	16.2	17.6	18.4	18.1	17.1	18.1	20.1	21.5	22.9	24.6	26.0
Domestic debt of the public sector	14.9	15.5	15.1	13.3	16.2	20.2	20.4	20.5	21.4	22.3	23.2
Public Sector Assets											
Gross assets of the public sector	17.2	19.8	21.0	18.9	17.1	19.4	19.8	20.2	20.9	22.0	23.0
of which:											
Financial assets of the non-financial public sector	2.8	2.7	2.5	2.3	2.7	2.9	3.0	3.1	3.2	3.3	3.4
Reserve assets of the central bank	14.4	17.1	18.5	16.6	14.4	16.4	16.8	17.1	17.7	18.7	19.6
Liquid reserve assets of the central bank	10.1	11.5	11.4	9.8	7.6	9.4	9.9	9.6	10.0	10.7	11.2
Liquid assets of the public sector 2/	12.9	14.2	13.9	12.1	10.3	12.3	12.9	12.7	13.2	14.0	14.6
Net Public Sector Debt											
Gross debt minus liquid financial assets 2/	18.3	18.9	19.6	19.3	23.0	26.0	27.6	29.4	31.1	32.9	34.7
Authorities' definition 3/	13.9	13.3	12.5	12.5	16.2	18.9	20.8	21.9	23.4	24.9	26.3
	(In percent of GDP, unless otherwise indicated) 1/										
Public Sector Debt											
Gross debt of the public sector	58.0	60.2	61.4	64.6	61.9	64.9	65.0	63.8	63.7	63.9	63.8
of which:											
Non-financial public sector debt	43.7	43.3	44.8	52.6	51.4	51.6	51.5	51.3	51.1	51.1	50.9
Central bank debt	14.3	16.9	16.6	12.0	10.4	13.3	13.5	12.5	12.6	12.8	12.8
External debt of the public sector	30.3	31.9	33.7	37.1	31.8	30.6	32.3	32.6	32.9	33.5	33.7
Domestic debt of the public sector	27.7	28.3	27.7	27.4	30.0	34.3	32.7	31.2	30.8	30.4	30.1
Public Sector Assets											
Gross financial assets of the public sector	32.1	36.0	38.5	38.8	31.8	32.9	31.7	30.6	30.1	30.0	29.8
of which:											
Financial assets of the non-financial public sector	5.2	4.8	4.7	4.7	5.0	5.0	4.8	4.7	4.6	4.5	4.4
Reserve assets of the central bank	26.8	31.2	33.8	34.1	26.8	27.9	26.9	25.9	25.5	25.5	25.4
Liquid reserve assets of the central bank 2/	18.7	20.9	20.8	20.1	14.1	15.9	15.9	14.5	14.4	14.5	14.5
Liquid assets of the public sector 2/	24.0	25.7	25.5	24.9	19.1	20.9	20.7	19.2	19.0	19.0	18.9
Net Public Sector Debt											
Gross debt minus liquid financial assets 2/	34.0	34.4	35.9	39.7	42.7	44.1	44.3	44.6	44.7	44.9	44.8
Authorities' definition 3/	25.9	24.2	22.9	25.8	30.1	32.1	33.3	33.2	33.6	34.0	34.0
Memorandum Items											
GDP (in billions of pesos)	1,041	1,178	1,331	1,456	1,581	1,711	1,883	2,066	2,267	2,482	2,720

Sources: Ministerio de Economia y Finanzas, Banco Central del Uruguay, and Fund staff calculations.

1/ Stocks are converted into pesos using the end of period exchange rate and divided by GDP.

2/ Liquid financial assets are given by deducting from total public sector assets the part of central bank reserves held as a counterpart to required reserves on foreign currency deposits.

3/ Gross debt minus total financial assets of the public sector.

Table 6. Uruguay: Statement of Operations of the Central Government 1/

	2010	2011	2012	2013	2014	2015	2016
	(In percent of GDP, based on the 2001 GFS Manual)						
Revenue	29.9	30.0	30.0	31.1	28.9	30.4	41.6
Taxes	18.9	19.1	18.8	19.0	18.6	18.5	23.8
Social contributions	8.9	9.1	9.7	10.1	8.5	10.4	10.6
Grants	0.0	0.0	0.0	0.0	0.0	0.0	5.2
Other revenue	2.1	1.8	1.5	2.0	1.8	1.5	1.9
Expense	29.4	29.1	30.5	31.2	29.8	31.9	43.9
Compensation of employees	6.8	6.9	7.1	7.2	7.4	7.4	12.6
Use of goods and services	3.7	3.4	3.5	3.7	3.7	3.4	3.9
Consumption of fixed capital 2/	….	….	….	0	0	0	0
Interest	2.4	2.4	2.3	2.4	2.3	2.2	2.7
Subsidies	0.2	0.2	0.3	0.2	0.2	0.3	0.4
Grants	0.0	0.0	0.0	0.0	0.0	0.0	5.2
Social benefits	13.4	13.4	14.2	14.5	13.3	15.3	15.9
Other expenses	2.9	2.7	3.1	3.2	2.9	3.3	3.2
Net acquisition of nonfinancial assets	1.4	1.5	1.4	1.4	1.4	1.2	1.4
Gross operating balance	0.5	0.9	-0.6	-0.1	-0.9	-1.5	-2.3
Net operating balance 2/	….	….	….	-0.1	-0.9	-1.5	-2.3
Net lending (+) borrowing (-)	-0.9	-0.6	-2.0	-1.5	-2.3	-2.7	-3.7
Net acquisition of financial assets	-2.3	3.5	0.7	-0.3	0.2	2.1	-1.8
By instrument							
Monetary gold and SDRs	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Currency and deposits	-2.1	3.2	0.2	-0.9	0.7	1.8	-1.0
Debt securities	0.1	0.3	0.0	-0.1	0.0	-0.1	-0.1
Loans	-0.3	-0.1	0.4	0.8	-0.4	0.4	-0.7
Equity and shares	0.0	0.0	0.0	0.0	0.0	0.0	0.0
By residency							
Domestic	-2.3	3.2	0.2	-0.3	0.2	2.1	-1.8
External	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Net incurrence of liabilities	-1.2	4.1	2.7	1.3	2.5	5.1	3.1
By instrument							
SDRs	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Currency and deposits	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Debt securities	0.0	4.6	2.2	2.1	2.3	4.9	2.3
Loans	-1.1	-0.5	0.5	-0.8	0.2	0.2	0.8
Equity and shares	0.0	0.0	0.0	0.0	0.0	0.0	0.0
By residency							
Domestic	-0.8	4.3	0.6	-1.4	0.1	3.0	4.4
External	-0.4	-0.2	2.1	2.7	2.5	2.1	-1.3
Memorandum items:							
Public sector net lending (+) borrowing (-)	-1.4	-0.9	-2.7	-2.3	-3.5	-3.6	-4.0
Public sector primary balance	1.5	1.9	-0.2	0.4	-0.6	0.0	-0.7

Sources: Banco Central del Uruguay, and Fund staff calculations.

1/ Central government and Social Security Bank. Collection of above the line data for municipalities is not feasible at this moment. The below-the-line data for 2013 - 16 are not consolidated.

2/ Not compiled by the authorities until 2013.

Table 7. Uruguay: Central Government Stock Positions 1/

	2010	2011	2012	2013	2014	2015	2016
	(In percent of GDP, based on the 2001 GFS Manual)						
Net financial worth	-35.6	-35.0	-33.5	-33.8	-35.3	-41.7	-41.5
Financial assets	8.6	10.4	9.9	8.9	9.1	9.5	9.4
By instrument							
Monetary gold and SDRs	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Currency and deposits	4.4	6.8	6.6	4.7	5.3	5.8	6.5
Debt securities	2.0	2.5	2.5	2.2	2.2	2.1	2.1
Loans	1.6	0.6	0.5	1.7	1.2	1.3	0.5
Equity and shares	0.6	0.5	0.4	0.3	0.3	0.3	0.2
By residency							
Domestic	8.6	10.3	9.9	8.9	9.1	9.5	9.4
External	0.0	0.0	0.0	0.0	0.0	0.0	0.1
Liabilities	44.2	45.4	43.4	42.7	44.4	51.2	51.0
By instrument							
SDRs	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Currency and deposits	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Debt securities	32.5	34.6	34.3	35.1	37.0	44.2	44.0
Loans	11.7	10.7	9.1	7.6	7.4	7.0	7.0
Equity and shares	0.0	0.0	0.0	0.0	0.0	0.0	0.0
By residency							
Domestic	17.9	21.0	19.4	16.9	16.9	19.4	23.0
External	26.3	24.3	24.0	25.9	27.5	31.8	28.0

Sources: Banco Central del Uruguay, and Fund staff calculations.

1/ Central government and Social Security Bank. Data for 2013 - 16 are not consolidated.

Table 8. Uruguay: Monetary Survey

	2012	2013	2014	2015	2016	2017 P
	(End of period, in billions of pesos)					
Banco Central del Uruguay (BCU) 1/						
Net foreign assets	254.4	330.6	407.8	458.1	398.5	453.9
Gross international reserves	263.9	348.2	427.6	467.1	394.2	448.9
Net domestic assets	-153.5	-209.7	-286.4	-352.7	-285.1	-329.9
Net credit to the public sector	43.0	75.6	70.8	31.4	59.6	64.7
Net credit to the financial system	-82.5	-128.9	-192.2	-250.5	-202.5	-208.1
Credit to the private sector	0.3	0.3	0.5	0.6	0.6	0.6
Securities issued by the BCU	-155.2	-202.4	-202.0	-126.4	-125.1	-182.1
Other	38.3	30.2	10.8	-48.6	-54.7	-41.9
Peso monetary liabilities 2/	100.9	120.9	121.4	105.5	113.4	124.0
Public and Private Banks 3/						
Net foreign assets	70.9	64.7	74.2	144.5	176.7	180.8
Net domestic assets	346.2	438.3	530.6	615.2	611.0	679.4
Net credit to the public sector	25.1	19.9	33.3	37.7	38.8	49.0
Net credit to the financial system	148.6	190.2	231.7	251.3	250.0	282.6
Credit to the private sector	243.9	305.9	359.3	437.8	444.7	449.7
Other	-71.4	-77.7	-93.6	-111.7	-122.5	-101.9
Liabilities to the private sector (residents)	417.1	503.0	604.8	759.6	787.6	860.2
Banking System (Central, Private, and Public Banks)						
Net foreign assets	325.3	395.3	482.0	602.6	575.2	634.7
Net domestic assets	115.0	133.8	148.4	177.3	235.5	227.1
Credit to the public sector	68.1	95.5	104.1	69.1	98.4	113.6
Credit to the rest of financial system	-9.0	-18.0	-30.7	-43.6	-5.9	-11.0
Credit to the private sector	244.2	306.7	360.3	439.5	446.5	451.1
Other	440.4	529.1	630.3	780.0	810.7	861.8
Broad money (M-3)	440.4	529.1	630.3	780.0	810.7	805.2
	(In percent of total private credit) 4/					
Composition of Credit						
Credit to firms	56.8	57.4	59.3	61.3	60.9	n.a.
Credit to households	43.2	42.6	40.7	38.7	39.1	n.a.
Consumption	63.7	63.1	61.8	61.2	60.3	n.a.
Car loans	0.7	1.0	1.3	1.4	1.7	n.a.
Mortgages	35.6	35.9	36.9	37.5	38.0	n.a.
	(Percentage change) 5/					
Memorandum Items:						
Base money	26.7	12.9	1.4	7.2	9.7	10.0
M-1	9.2	13.1	1.0	5.2	6.6	10.0
Broader M1 (M1 plus savings deposits)	11.2	15.0	3.7	5.6	8.4	10.0
M-2	10.3	13.7	6.4	9.0	14.4	10.0
M-3	10.0	19.2	19.3	23.7	3.9	6.3
Credit to firms (in US$)	17.5	16.2	6.8	2.8	1.5	-4.0
Credit to households (in real UY$)	7.3	9.9	4.7	6.3	-0.5	0.6

Source: Banco Central del Uruguay.

1/ Latest available data (August 2017).

2/ Peso monetary liabilities include base money and non-liquid liabilities.

3/ The Banco de la Republica Oriental de Uruguay (BROU), Banco Hipotecario de Uruguay (BHU; mortgage institution), private banks, financial houses and cooperatives. Latest available data (August 2017).

4/ For 2017, latest available data (August 2017).

5/ Percent change since one year ago. For 2017, latest available data. In pesos, unless indicated otherwise.

Table 9. Uruguay: Medium-Term Macroeconomic Framework

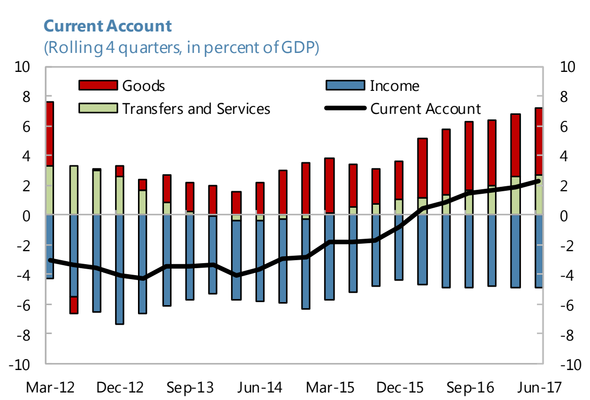
						Projections					
	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
					(Annual percent change, unless otherwise indicated)						
National Accounts											
Real GDP	3.5	4.6	3.2	0.4	1.5	3.1	3.4	3.1	3.0	2.9	3.0
Total domestic demand	7.0	5.3	2.3	-2.0	0.8	2.8	5.3	4.4	4.0	4.0	4.3
Final consumption expenditure	5.1	5.5	2.9	-0.2	0.8	3.1	5.4	3.8	4.1	4.0	4.1
Private final consumption expenditure	4.9	5.5	3.0	-0.5	0.7	3.7	5.9	4.1	4.1	4.1	4.1
Public final consumption expenditure	6.0	4.9	2.5	2.2	1.6	-1.5	1.7	1.1	3.7	3.9	3.7
Gross capital formation	14.5	4.8	0.0	-9.0	0.7	2.0	5.2	6.9	4.0	4.0	5.1
Gross fixed capital formation	18.2	3.8	2.4	-9.2	0.9	2.0	5.2	6.9	4.0	4.0	5.1
Private fixed capital formation	21.9	2.1	-2.8	-8.5	-0.8	1.9	4.6	6.4	4.0	4.1	5.4
Public fixed capital formation	0.5	13.6	28.7	-12.2	7.9	2.1	7.5	8.5	3.9	3.7	3.9
Change in inventories (contribution to growth)	-0.6	0.2	-0.6	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Net exports (contribution to growth)	-3.8	-1.1	0.7	2.6	0.6	0.1	-2.2	-1.6	-1.4	-1.5	-1.7
Consumer Prices											
CPI inflation (average)	8.1	8.6	8.9	8.7	9.6	6.2	6.4	6.7	6.6	6.5	6.1
CPI inflation (end of period)	7.5	8.5	8.3	9.4	8.1	6.4	6.7	6.5	6.4	6.3	6.2
Balance of Payments											
Current account balance (percent of GDP)	-4.0	-3.3	-2.8	-0.7	1.7	1.9	1.3	0.6	0.3	-0.1	-0.7
Exports of goods and services (volume)	3.6	-0.1	3.5	-0.6	-1.4	6.2	1.0	2.6	2.5	2.5	2.1
Export of goods (volume)	1.0	5.5	0.2	-2.9	-3.7	2.0	4.2	4.8	5.2	4.8	4.8
Imports of goods and services (volume)	19.0	-2.4	-1.5	-6.2	-8.2	4.3	7.0	6.2	5.7	6.0	6.0
Imports of goods (volume)	14.7	-3.4	-1.1	-6.3	-7.9	6.1	7.2	7.2	7.3	7.0	7.0
Terms of trade (goods)	99.8	100.0	102.6	104.5	107.0	106.0	106.6	107.6	108.3	108.7	109.3
					(In percent of GDP, unless otherwise indicated)						
Public Sector Finance											
Primary balance 1/	-0.2	0.4	-0.6	0.0	-0.7	-0.1	0.2	0.5	0.5	0.7	0.8
Revenue 2/	27.7	29.5	29.1	29.0	29.4	29.6	29.8	30.0	30.1	30.2	30.3
Primary expenditure 2/	28.0	29.1	29.5	28.8	30.0	29.7	29.6	29.5	29.5	29.5	29.5
Structural primary balance	0.0	-0.9	-1.4	-0.6	-0.5	0.0	0.1	0.4	0.5	0.7	0.8
Overall balance	-2.7	-2.3	-3.5	-3.6	-4.0	-3.3	-2.7	-2.5	-2.5	-2.5	-2.5
Public sector gross debt	58.0	60.2	61.4	64.6	61.9	64.9	65.0	63.8	63.7	63.9	63.8
Gross Debt (NFPS)	43.7	43.3	44.8	52.6	51.4	51.6	51.5	51.3	51.1	51.1	50.9
Assets of the public sector	32.1	36.0	38.5	38.8	31.8	32.9	31.7	30.6	30.1	30.0	29.8
NFPS	5.2	4.8	4.7	4.7	5.0	5.0	4.8	4.7	4.6	4.5	4.4
BCU	26.8	31.2	33.8	34.1	26.8	27.9	26.9	25.9	25.5	25.5	25.4
Liquid assets of the public sector 3/	24.0	25.7	25.5	24.9	19.1	20.9	20.7	19.2	19.0	19.0	18.9
Net public sector debt (gross debt minus liquid assets)	34.0	34.4	35.9	39.7	42.7	44.1	44.3	44.6	44.7	44.9	44.8
External Debt											
Gross external debt	67.7	69.0	74.9	89.5	74.8	68.5	70.1	70.4	70.6	71.1	71.3
Public sector gross external debt	31.1	32.8	34.7	39.0	33.3	31.9	33.6	33.9	34.0	34.6	34.7
Gross international reserves (US$ billions)	13.6	16.3	17.6	15.6	13.5	15.5	15.8	16.2	16.8	17.7	18.7
Saving and Investment											
Gross domestic investment	22.9	22.5	21.2	19.7	18.7	18.0	18.0	18.5	18.7	18.7	18.8
Public sector gross investment	3.8	4.2	4.9	4.6	4.5	4.3	4.4	4.6	4.6	4.6	4.6
Private sector gross investment	19.1	18.3	16.3	15.1	14.2	13.7	13.6	13.9	14.0	14.1	14.2
Gross national saving	18.9	19.2	18.4	19.0	20.4	19.9	19.3	19.2	18.9	18.6	18.1
Public sector gross saving	0.1	1.1	-0.2	-1.3	-1.6	-1.0	-0.3	0.0	-0.1	0.0	0.0
Private sector gross saving	18.8	18.1	18.6	20.2	22.0	20.9	19.6	19.1	19.0	18.7	18.1
Unemployment and Output Gap											
Population (Mil)	3.4	3.4	3.5	3.5	3.5	3.5	3.5	3.5	3.5	3.5	3.6
Labor force participation (percent)	64.0	63.6	64.7	63.8	63.4	63.9	63.9	63.9	63.9	63.9	63.9
Employment growth (percent)	1.6	0.8	-1.2	0.4	0.4	0.4	0.4	0.4	0.4	0.3	0.3
Unemployment rate (percent)	6.3	6.5	6.6	7.5	7.9	7.4	7.1	7.1	7.1	7.2	7.2
Output gap (percent of potential output)	2.9	3.3	2.7	0.4	-0.8	-0.4	0.1	0.2	0.1	0.0	0.0

Sources: Banco Central del Uruguay, Haver Analytics and Fund staff calculations.
1/ Total public sector. Includes the non-financial public sector, local governments, Banco Central del Uruguay, and Banco de Seguros del Estado.
2/ Non-financial public sector excluding local governments.
3/ Liquid financial assets are given by deducting from total public sector assets the part of central bank reserves held as a counterpart to required reserves on foreign currency deposits.

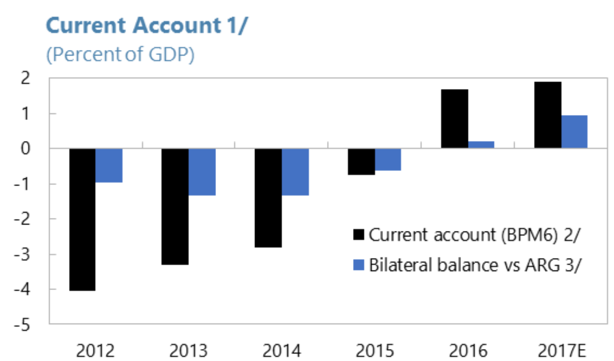
Annex I. External Sector Assessment

Due to a sizeable gap indicated by the standardized External Balance Assessment (EBA) current account model, staff assesses that the external position appears stronger than justified by fundamentals. At the same time, Uruguay is overvalued according to the EBA lite real effective exchange rate (REER) model. External stability risks remain contained given the sufficient level of reserves and the projected current account surplus in 2017.

The current account has achieved a historic surplus in 2016–17, due to strong demand from Argentina, weak FDI, and low import price valuation effects.[1] The current account has steadily improved since 2014, to a surplus of 1.7 percent of GDP in 2016 and an expected surplus of 1.9 percent of GDP in 2017. The improvement in the current account is due to price and volume effects, as well as weak investment spending. The main price effect was the sharp fall in oil prices that reduced the value of imports between 2014 and 2016. The value of fuel imports fell by 1.5 percent of GDP over this period. A strongly appreciated Argentinean real exchange rate led to record net tourism inflows from that country in the first quarters of 2016 and, and even more so, 2017. The sharp improvement in the bilateral trade balance with Argentina explains much of the increase in the overall current account balance through 2017 (based on available data). Weak foreign investment inflows and weak government investment have also contributed to weakness in import volumes (given the high import component of investment spending). As the temporary foreign investment and bilateral trade imbalances unwind over the medium term, the current account balance is expected to worsen gradually to a deficit of ¾ percent of GDP.



Sources: Haver Analytics, Central Bank data, and Fund staff calculations.



Sources: Banco Central de Uruguay (BCU) and Fund staff calculations.
1/ 2017E denotes an estimate.
2/ The current account balance for 2017 reflects data until June 2017 under the recently published BPM6 method.
3/ The bilateral balance against Argentina reflects merchandise trade and tourism only.

[1] In September 2017, substantial methodological changes led to an upward revision in the current account balance and more volatile net FDI inflows. These changes are discussed in detail in Annex IV.

Uruguay: Merchandise Trade Balance

	2013	2014	2015	2016	2017 1/
			(in percent of GDP)		
Trade balance	2.0	3.5	2.5	4.4	4.5
Exports	23.1	24.1	20.9	20.5	19.2
Imports	21.1	20.6	18.4	16.0	14.7
Fuel	4.5	3.5	2.5	2.0	1.9
Non-fuel	16.7	17.1	15.9	14.1	12.8
Capital	3.4	3.7	3.4	3.0	2.2
Consumption	4.9	5.1	5.0	4.8	4.6
Intermediary	8.4	8.2	7.4	6.4	6.0

Sources: Banco Central del Uruguay and Fund staff calculations.
1/ 4 quarters through 2017Q2

Net FDI flows were negative in 2016, weighed down by diminished export competitiveness and recessions in key neighbors, while portfolio and other investment flows have been volatile. Net FDI inflows (excluding the activity of merchanting firms) completely dried up in 2016, potentially reflecting the weakened competitive position of manufacturing and agricultural activities in Uruguay (see below) and deep recessions in Argentina and Brazil, which have been key sources of investment in the past decade, and contributing to weak import numbers in the current account. On the portfolio side, 2016 saw net capital outflows due to nonresident sales in the first half of the year that were part of a wider emerging market trend, although this trend reversed from the third quarter with strong portfolio inflows. In 2017, the first quarter saw sizeable outflows given nonresident sales of government securities, but this was reversed in the second and third quarters with strong nonresident interest in the government's global bond issuances of June and September. Other investment inflows remained positive through the end of 2016 despite over US$1 billion in nonresident deposit outflows after August 2016 related to Argentina's tax amnesty, as Uruguayan banks reduced their foreign assets. In the first half of 2017, Argentine nonresident deposits further reduced by US$1 billion, leading to net other investment outflows. The peso has remained stable relative to the U.S. dollar in 2017, appreciating by about 1 percent in the year through September. The sizeable nonresident portfolio outflows in the first quarter were more than offset by a shift by domestic pension funds into peso assets. These institutions continued this portfolio shift in the second and third quarters, reducing their foreign currency exposure by an estimated US$3 billion in favor of peso assets (to a large degree by shifting out of dollar deposits held at the central bank). The central bank facilitated such large and abrupt portfolio shifts by directly purchasing U.S. dollars from the pension funds and other large investors in exchange for central bank peso-denominated paper, without which the relatively small market may have experienced disruptions.

Uruguay faces a difficult confluence of relative depreciation vis-à-vis Argentina and a historically strong domestic multilateral real effective exchange rate. The multilateral real effective exchange rate has appreciated by some 10 percent since the beginning of 2012, worsening competitiveness relative to countries outside the region, and spurring worries about the continued viability of various export industries, especially in agriculture and manufacturing. Over the same period, the bilateral real exchange rate has depreciated by some 10 percent against Argentina, reflecting a sharp appreciation of that country's real effective exchange rate, and the multilateral real effective exchange rate with trading partners excluding Argentina has appreciated by some 12 percent. The high sensitivity of regional tourism flows to relative prices has led to a bilateral current account surplus with Argentina despite the historically strong multilateral real effective exchange rate.

Staff assesses that the external position appears stronger than justified by fundamentals. This assessment is based, primarily, on a sizeable current account gap according to the standardized External Balance Assessment (EBA) current account model. At the same time, Uruguay is overvalued according to the EBA lite real effective exchange rate (REER) model.

- The EBA current account model assesses the REER to be 14 percent undervalued, based on a 5.6 percent of GDP excess of the current account balance over the model's current account norm. The model indicates a minimal 0.2 percent of GDP contribution of policy gaps to this current account gap. Staff judges that this estimate of the gap could be overly high. First, for this exercise, the reported current account balance may need to be adjusted for reported merchanting activities that may not reflect domestic value added (see also Annex IV), but that have raised the most recent reported annual current account surplus by 0.8 percent of GDP for 2016. Until corresponding revisions to the national accounts data have been made (planned for 2019) it is difficult to assess the new data and the appropriate magnitude of such adjustment. Second, the model exaggerates the strength of the external position due to rapid improvements in the trade balance vis-à-vis Argentina. The estimated bilateral trade balance with Argentina in 2017 is 2.6 percent of GDP above its historical average,[2] which is almost half the size of the model's current account gap. This reflects a stronger and faster adjustment of trade balances against Argentina than against other countries, with the latter balances expected to be relatively slow to adjust. In turn, this differential response is due to the large share of Argentina in tourism receipts (see charts). Implementing these two adjustments yields a staff estimate of the current account gap of 2.2–3.0 percent of GDP, and a corresponding REER undervaluation of 5.3–7.2 percent.[3]

- The EBA lite REER model assesses the REER to be 11 percent overvalued, driven mostly by its actual appreciation. The model's REER norm is lowered by a weak level of private sector credit.

- The EBA External Sustainability (ES) model assesses the REER to be broadly neutral, because the projected medium-term current account balance (a 0.7 percent of GDP deficit) is close to

[2] This measure is similar to the estimated increase in the bilateral balance with Argentina between 2014 and 2017, which is 2.3 percent of GDP.

[3] To calculate this adjustment, the initial current account gap of 5.6 percent of GDP is reduced by 2.6–3.4 percentage points, to reflect temporary factors. The remaining current account gap is 2.2–3.0 percent of GDP, which translates into the stated REER undervaluation using an elasticity of 0.415.

the balance (a 0.9 percent of GDP deficit) that would stabilize the long-term value of net foreign assets relative to GDP.

- To some extent, these varying results can be reconciled by the delayed response of non-Argentina trade to the loss of competitiveness, and the associated decline in FDI (which immediately lowers imports but constrains export capacity only in the longer run).

Uruguay: Exchange Rate Assessment

	Deviation from equilibrium (in percent) 1/	CA norm	CA projection	Difference
I. EBA - Current Account model 2/ 4/	-13.5	-3.5 5/	2.1 6/	5.6
II. External Sustainability (ES) approach 3/ 4/	-0.3	-0.9 7/	-0.7 8/	0.13
III. EBA-lite REER model	10.7			

Source: Fund staff calculations
1/ Positive values indicate overvaluation.
2/ Based on the October 2017 EBA results.
3/ Desk calculations based on the EBA ES approach.
4/ Using a CA elasticity of 0.415 (see IMF Country Report No. 15/81).
5/ Cyclically-adjusted. Derived by adjusting the current account data for Uruguay prior to 2012 in line with revisions to the data since 2012.
6/ Cyclically adjusted.
7/ CA balance required to stabilize NFA in the medium-term.
8/ 2022 CA balance projection.

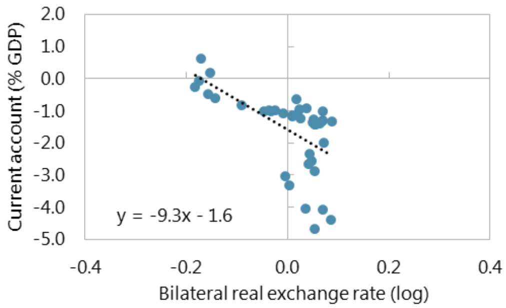
External stability risks for Uruguay remain contained. As of end-October, gross reserves had increased by US$1.8 billion since the start of 2017 to US$15.3 billion, and the BCU's own reserves (net of the BCU's foreign currency liabilities) had increased by US$3.2 billion to US$7.4 billion. Reserves remain well above the upper bound of the IMF reserve adequacy metric range, and various other prudential benchmarks. Staff considers this to be appropriate given that gross reserves, in part, reflect the high degree of dollarization and, hence, banks' required reserves in foreign currency, while net reserves appear more than adequate to offset possible disorderly conditions in the foreign exchange market, if needed. The sum of the foreign assets of the central bank and commercial banks far exceeds the sum of non-resident deposits and short-term external debt, and amounts to 115 percent of the sum of foreign currency denominated bank deposits (resident and non-resident) and short-term external debt. Given the ample level of reserves, and the projected current account surplus this year, external stability risks remain contained.

Uruguay: Gross International Reserves

In billions of U.S. dollars (October 27, 2017)	15.3
In months of imports (2016)	15.6
In percent of:	
GDP (2016) 1/	29.2
Short-term external (STE) debt (2016)	192.3
STE debt and foreign currency deposits (2016)	63.7
STE debt and nonresident deposits (2016)	136.4
M2 (latest)	176.7
M3 (latest)	55.2
Memo items:	
IMF's new reserve adequacy metric range in US$, billions (2017 Q2) 2/	5.8 to 8.8
Banks' gross foreign assets (US$, billions, 2016)	12.3
Ratio of gross reserves plus banks' foreign assets to STE debt and foreign currency deposits (percent)	114.9

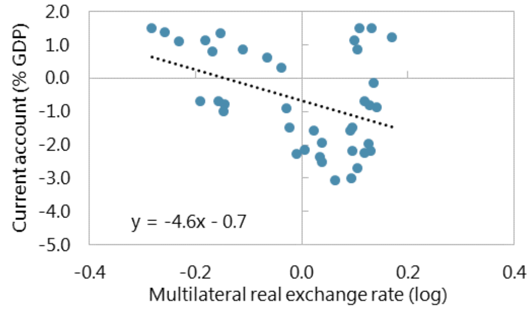
Sources: Banco Central del Uruguay and Fund staff calculations.
1/ Reserves-to-GDP ratio calculated after converting GDP to U.S. dollars.
2/ Reserve adequacy metric range is the minimum reserve adequacy to 1.5 times the minimum.

Uruguay: Current Account Elasticity Against Argentina



Sources: BCU and IMF Staff estimates.

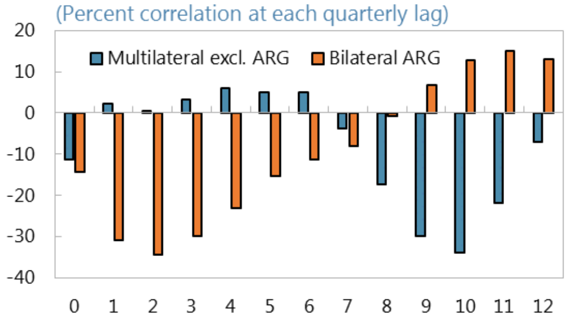
Uruguay: Current Account Elasticity Excluding Argentina



Sources: BCU and IMF Staff estimates.

Uruguay: Correlation Between Current Account and Lags of the RER

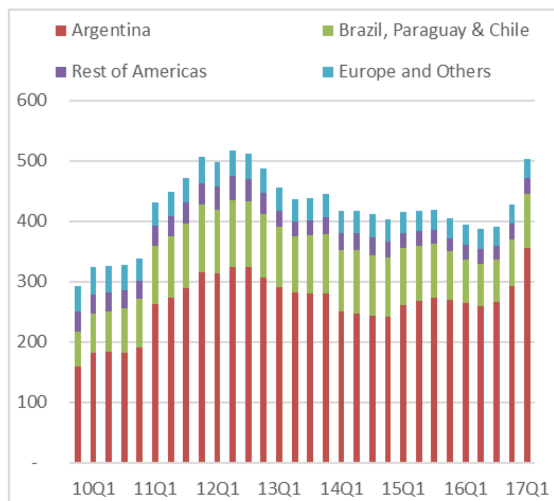
(Percent correlation at each quarterly lag)



Sources: BCU and IMF Staff estimates.

Tourist Spending in Uruguay

(USD million; 4-quarter moving average)



Source: Banco Central del Uruguay

Annex II. Public Sector Debt Sustainability Analysis (DSA)

Uruguay is one of the few countries to report debt figures on a consolidated basis for the whole public sector, excluding public commercial banks, but including the central bank. Owing to this breadth of coverage, Uruguay is classified as higher scrutiny country, with gross financing needs and debt ratios exceeding the relevant benchmarks.[1] Under the baseline scenario, gross debt of Uruguay's public sector is projected to stabilize at around 63 percent of GDP in 2022. The long average maturity, favorable currency composition of the debt, as well as the high level of liquid financial assets of the public sector—19 percent of GDP at end-2016—mitigate short-term financing risks.

The gross debt of the public sector has a wide coverage. It includes:[2]

- *Central government debt*, which stood at 47 percent of GDP at end-2016. The average maturity of central government debt was just under 14 years, and the share of local currency-denominated debt was close to one half.

- *Central bank debt*, which declined from 12 to 10 percent of GDP in 2016 as, early in the year, the BCU used the proceeds from reserves sales to reduce its debt. The debt of the central bank is 2/3 short-term and 2/3 local currency-denominated. Its primary purpose is to manage liquidity.

- *Public enterprises' debt*, which stood at 3 percent of GDP at end-2016.

- *The debt of local governments and other public sector entities (such as Banco de Seguros del Estado)*, which represented less than one percent of GDP at end-2016.

Overall, 47 percent of the debt of the public sector at end-2016 was in local currency, almost 2/3 of which was in CPI-indexed units.

The public sector holds sizable financial assets (including international reserves), amounting to 32 percent of GDP at end-2016. In addition, the government has access to contingent credit lines from multilateral institutions, which represented 4½ percent of GDP in 2016.

- *The total financial assets of the central bank (including foreign reserve assets, at 25 percent of GDP)* reached close to 27 percent of GDP at end-2016. About 13 percent of GDP in reserves were the counterpart to reserve requirements on foreign currency bank deposits.

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[1] See IMF, *Staff Guidance Note for Public Debt Sustainability Analysis in Market-Access Countries*, May 9, 2013.

[2] The numbers for the debt and assets of various components of the public sector are pre-consolidated and exclude debt and assets vis-à-vis other public sector entities.

- *The financial assets of the non-financial public sector* amounted to 5 percent of GDP at end-2016, most of which held in liquid instruments (e.g., securities and deposits), in line with the government's prefunding policy of holding enough liquid assets to cover at least 12 months of debt service.

The net debt of the public sector, defined as gross debt minus liquid assets, stood at 43 percent of GDP at the end of 2016. The stock of liquid assets of the public sector is computed as total gross public sector assets minus the reserves held by banks at the BCU against foreign currency deposits. This stock stood at 19 percent of GDP at end-2016.

Baseline scenario

With the primary deficit close to zero, debt dynamics in 2017 are largely driven by the projected accumulation of reserves, which is to some extent offset by strong growth. Accordingly, gross debt is projected to increase by almost 3 percent of GDP, while the stock of net debt will rise by only 1 percent GDP. In the outer years, both grows and net debt are projected to remain broadly stable as a share of GDP, as the small primary surpluses and the favorable growth/real interest differential support the steady accumulation of assets of the central bank. Assuming that real GDP growth, real interest rates, and other identified debt-creating flows remain at the level projected for 2022, the debt-stabilizing primary balance is estimated at close to 0.5 percent of GDP, broadly in line with the projected medium-term level of the primary balance.

The baseline assumptions are broadly plausible. Staff's forecast track record is not systematically biased, as reflected in projection errors generally not being consistently on one side. Although inflation forecasts tended to underestimate actual inflation through 2016, growth forecasts were largely on target, and the median forecast errors over the period 2008–16 were broadly in line with those observed in other countries. The projected fiscal adjustment is consistent with experiences across surveillance countries.

The fan charts show limited uncertainty around the baseline. The width of the symmetric fan chart, estimated at around 15 percent of GDP, illustrates a certain degree of confidence for equal-probability upside and downside shocks.

Alternative scenario

A "historical" scenario, assuming that the key macroeconomic variables behave as in the last decade, yields a downward-sloping debt path, since Uruguay experienced high growth rates and exchange rate appreciation as it recovered from the 2002 financial crisis.

Vulnerability of the financing profile

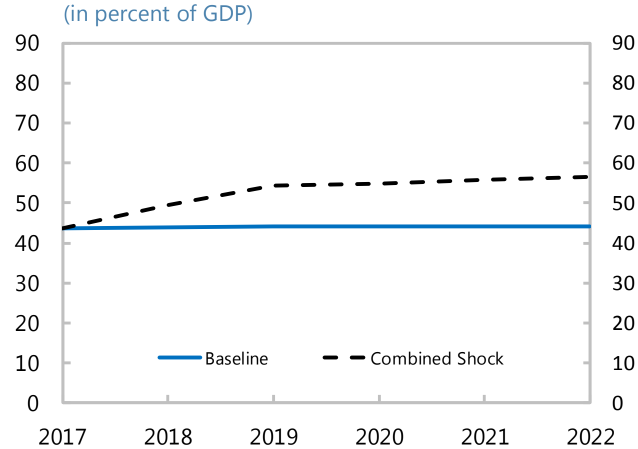
Staff analyzed the vulnerability of the financing profile (as presented in the panel titled "Uruguay Public DSA Risk Assessment") using data for the non-financial public sector only. In other words, debt of the central bank was excluded for this particular exercise, in order to establish a proper comparison of the data for Uruguay against the standardized benchmarks used for identifying possible stresses. In addition, this also makes these results for Uruguay comparable to those for the vast majority of countries that do not include debt of the central bank in their respective calculations of public sector debt.

The public sector's financing needs do not imply near-term vulnerabilities. Even though the share of public sector debt held by nonresidents is above its benchmark, other indicators are within their respective benchmarks. Refinancing risks are limited further by the presence of large liquidity buffers, including the sizable liquid financial assets of the public sector and access to contingent credit lines. These considerations also apply to the assessment of external debt sustainability (Annex III). Short-term debt of the non-financial public sector is negligible, reflecting the authorities' long-standing emphasis on extending maturities and minimizing roll-over risks.

Stress tests

Debt dynamics are moderately sensitive to shocks. In a stylized downside scenario that combines a permanent 20 percent exchange rate depreciation (relative to the baseline) with a temporary drop in growth and primary balances, and a permanent increase in real interest rates, the gross debt ratio rises by about 15 percentage points over the five-year forecast horizon. Net debt rises by 13 percentage points in the same scenario. The sensitivity of net debt to exchange rate shocks is lower than that of gross debt, as the valuation effects on assets from exchange rate changes partially offset the valuation effects on foreign-currency denominated debt. Fan charts of the projected debt distribution confirm that debt dynamics are generally manageable under statistical distributions of combined shocks. Gross public debt would remain below 73 percent of GDP in 90 percent of the cases, while net public debt would remain below 56 percent of GDP under the combined shock scenario previously described.

Dynamics of Net Public Debt
(in percent of GDP)



Source: Fund staff calculations.
Note: Combined shock as described in the text.

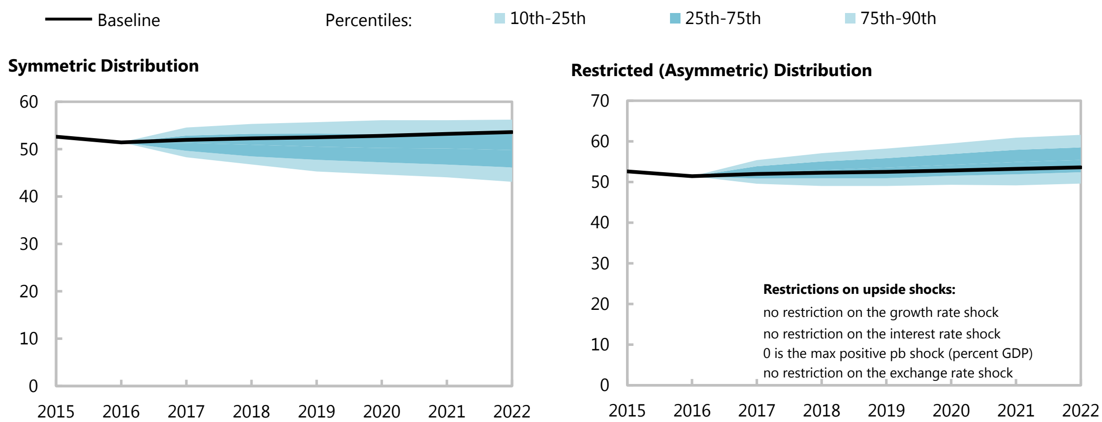
Uruguay Public DSA Risk Assessment

Heat Map

Debt level 1/	Real GDP Growth Shock	Primary Balance Shock	Real Interest Rate Shock	Exchange Rate Shock	Contingent Liability shock
Gross financing needs 2/	Real GDP Growth Shock	Primary Balance Shock	Real Interest Rate Shock	Exchange Rate Shock	Contingent Liability Shock
Debt profile 3/ 4/	Market Perception	External Financing Requirements	Change in the Share of Short-Term Debt	Public Debt Held by Non-Residents	Foreign Currency Debt

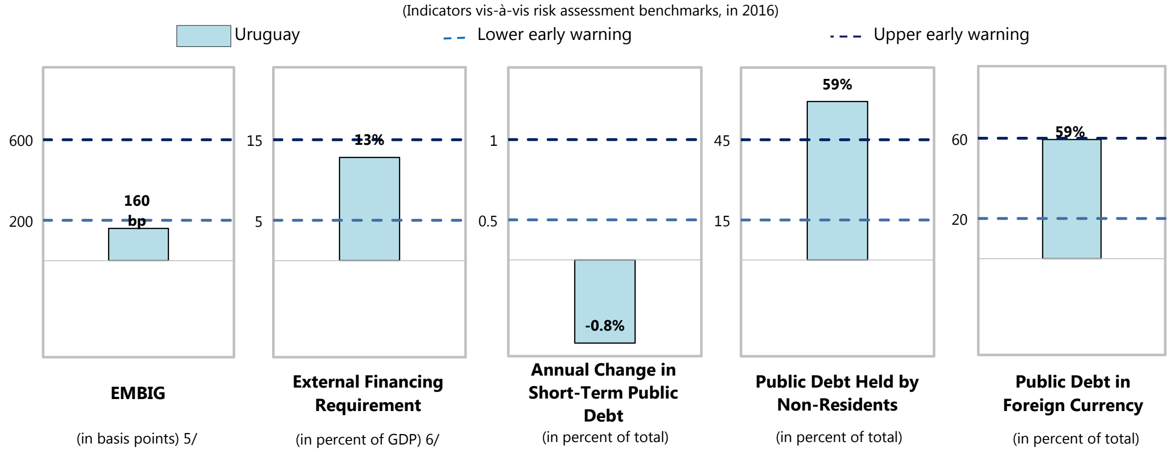
Evolution of Predictive Densities of Gross Nominal Public Debt

(in percent of GDP)



Debt Profile Vulnerabilities

(Indicators vis-à-vis risk assessment benchmarks, in 2016)



Source: IMF staff.

1/ The cell is highlighted in green if debt burden benchmark of 70% is not exceeded under the specific shock or baseline, yellow if exceeded under specific shock but not baseline, red if benchmark is exceeded under baseline, white if stress test is not relevant.

2/ The cell is highlighted in green if gross financing needs benchmark of 15% is not exceeded under the specific shock or baseline, yellow if exceeded under specific shock but not baseline, red if benchmark is exceeded under baseline, white if stress test is not relevant.

3/ The debt profile indicators are based on data for 2015 (except for the market perception indicators; see footnote 5).

4/ The cell is highlighted in green if country value is less than the lower risk-assessment benchmark, red if country value exceeds the upper risk-assessment benchmark, yellow if country value is between the lower and upper risk-assessment benchmarks. If data are unavailable or indicator is not relevant, cell is white.

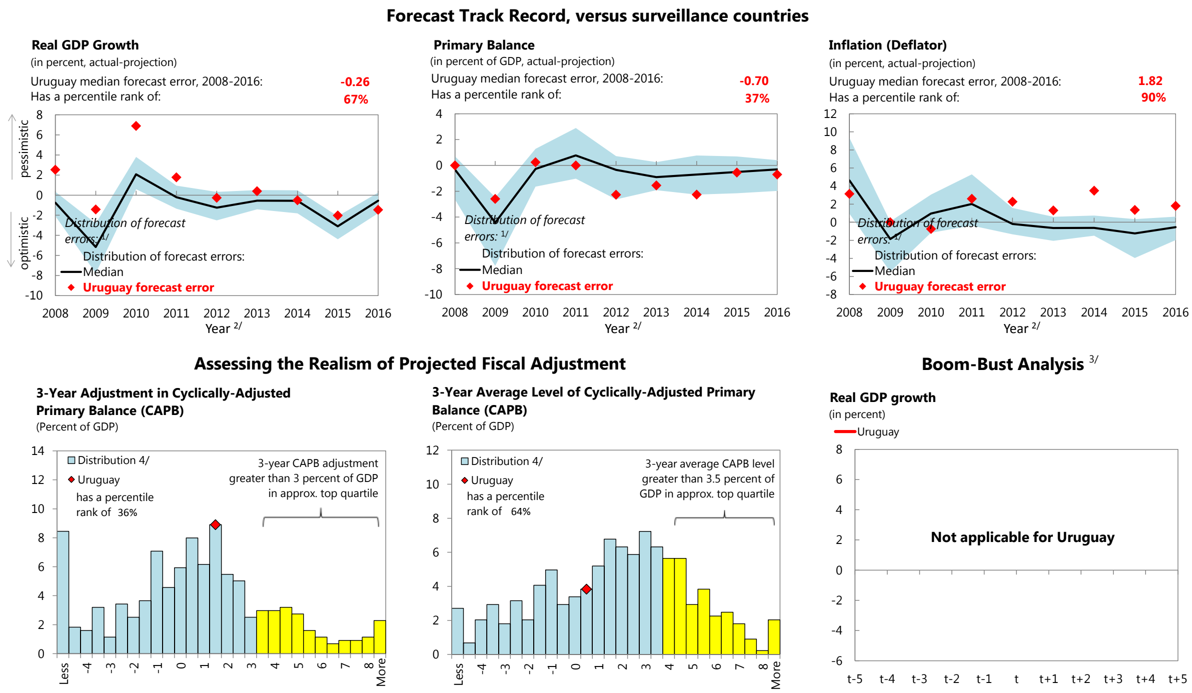
Lower and upper risk-assessment benchmarks are:

200 and 600 basis points for bond spreads; 5 and 15 percent of GDP for external financing requirement; 0.5 and 1 percent for change in the share of short-term debt; 15 and 45 percent for the public debt held by non-residents; and 20 and 60 percent for the share of foreign-currency denominated debt.

5/ EMBIG, an average over the last 3 months, 07-Sep-17 through 06-Dec-17.

6/ External financing requirement is defined as the sum of current account deficit, amortization of medium and long-term total external debt, and short-term total external debt at the end of previous period.

Uruguay Public DSA - Realism of Baseline Assumptions



Source : IMF Staff.

1/ Plotted distribution includes surveillance countries, percentile rank refers to all countries.

2/ Projections made in the spring WEO vintage of the preceding year.

3/ Not applicable for Uruguay, as it meets neither the positive output gap criterion nor the private credit growth criterion.

4/ Data cover annual obervations from 1990 to 2011 for advanced and emerging economies with debt greater than 60 percent of GDP. Percent of sample on vertical axis.

Uruguay Public Sector Debt Sustainability Analysis (DSA) - Baseline Scenario

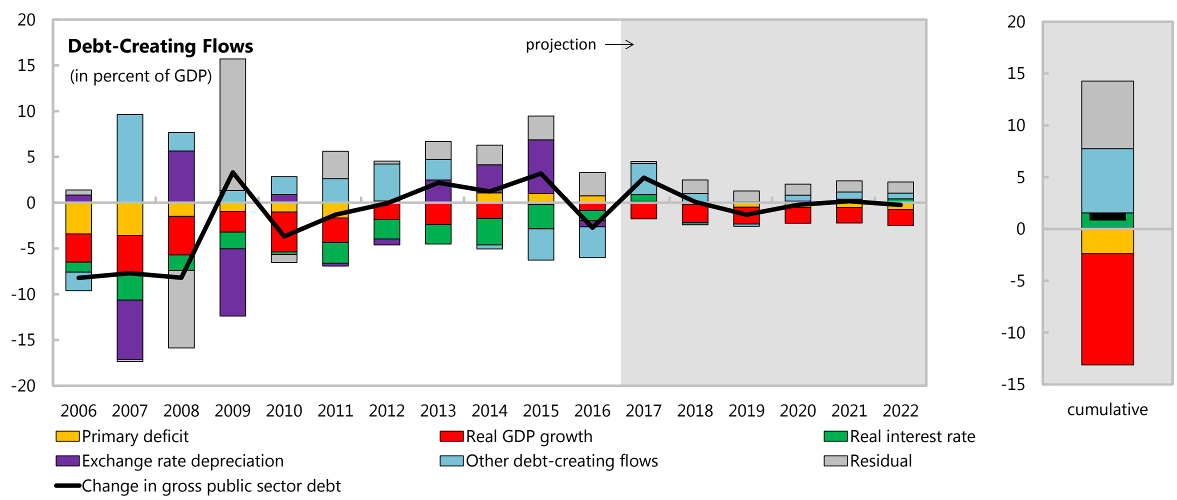
(in percent of GDP unless otherwise indicated)

Debt, Economic and Market Indicators [1/]

	Actual			Projections						As of December 06, 2017		
	2006-2014 [2/]	2015	2016	2017	2018	2019	2020	2021	2022	Sovereign Spreads		
Nominal gross public debt	62.6	64.6	61.9	64.6	64.6	63.3	63.1	63.3	63.0	EMBIG (bp) 3/		146
Public gross financing needs	11.5	20.5	14.3	14.3	12.6	14.5	15.0	14.1	15.5	5Y CDS (bp)		104
Net public debt	36.4	39.7	42.7	43.7	43.9	44.1	44.1	44.2	44.1			
Real GDP growth (in percent)	5.2	0.4	1.5	3.1	3.4	3.1	3.0	2.9	3.0	Ratings	Foreign	Local
Inflation (GDP deflator, in percent)	8.0	9.0	7.0	5.0	6.4	6.4	6.5	6.4	6.4	Moody's	Baa2	Baa2
Nominal GDP growth (in percent)	13.5	9.4	8.6	8.2	10.1	9.7	9.7	9.5	9.6	S&Ps	BBB	BBB
Effective interest rate (in percent) [4/]	4.9	4.6	5.5	6.4	6.4	6.9	7.1	7.3	7.4	Fitch	BBB-	BBB

Contribution to Changes in Public Debt

	Actual			Projections							
	2006-2014	2015	2016	2017	2018	2019	2020	2021	2022	cumulative	debt-stabilizing primary balance [9/]
Change in gross public sector debt	-2.5	3.2	-2.7	2.7	0.1	-1.3	-0.2	0.2	-0.2	1.2	
Identified debt-creating flows	-3.9	0.6	-5.3	2.5	-1.4	-2.5	-1.4	-1.1	-1.5	-5.4	
Primary deficit	-1.2	1.0	0.8	0.1	-0.2	-0.5	-0.5	-0.6	-0.8	-2.4	0.5
Primary (noninterest) revenue and grants	28.3	29.0	29.4	29.6	29.8	30.0	30.1	30.2	30.3	180.1	
Primary (noninterest) expenditure	27.1	30.0	30.2	29.8	29.6	29.5	29.5	29.7	29.6	177.7	
Automatic debt dynamics [5/]	-5.1	3.0	-2.6	-1.0	-2.2	-1.7	-1.6	-1.3	-1.3	-9.2	
Interest rate/growth differential [6/]	-4.9	-2.9	-2.0	-1.0	-2.2	-1.7	-1.6	-1.3	-1.3	-9.2	
Of which: real interest rate	-1.9	-2.6	-1.1	0.7	-0.2	0.1	0.2	0.4	0.4	1.6	
Of which: real GDP growth	-3.0	-0.2	-0.9	-1.8	-2.0	-1.8	-1.7	-1.7	-1.7	-10.7	
Exchange rate depreciation [7/]	-0.2	5.9	-0.7	…	…	…	…	…	…	…	
Other identified debt-creating flows	2.4	-3.4	-3.4	3.4	1.0	-0.3	0.7	0.8	0.6	6.2	
Net privatization receipts (negative)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Contingent liabilities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Other debt flows (incl. asset purchases)	2.4	-3.4	-3.4	3.4	1.0	-0.3	0.7	0.8	0.6	6.2	
Residual [8/]	1.4	2.6	2.5	0.2	1.5	1.2	1.2	1.2	1.2	6.5	



Source: IMF staff.

1/ Public sector is defined as consolidated public sector.

2/ Based on available data.

3/ EMBIG.

4/ Defined as interest payments divided by debt stock (excluding guarantees) at the end of previous year.

5/ Derived as $[(r - \pi(1+g) - g + ae(1+r)]/(1+g+\pi+g\pi))$ times previous period debt ratio, with r = interest rate; π = growth rate of GDP deflator; g = real GDP growth rate; a = share of foreign-currency denominated debt; and e = nominal exchange rate depreciation (measured by increase in local currency value of U.S. dollar).

6/ The real interest rate contribution is derived from the numerator in footnote 5 as $r - \pi(1+g)$ and the real growth contribution as -g.

7/ The exchange rate contribution is derived from the numerator in footnote 5 as $ae(1+r)$.

8/ Includes valuation changes and interest revenues (if any). For projections, includes exchange rate changes during the projection period.

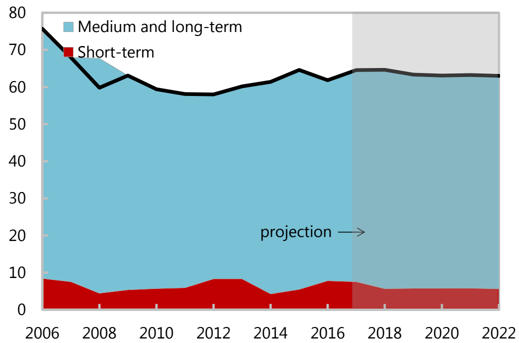
9/ Assumes that key variables (real GDP growth, real interest rate, and other identified debt-creating flows) remain at the level of the last projection year.

Uruguay Public DSA - Composition of Public Debt and Alternative Scenarios

Composition of Public Debt

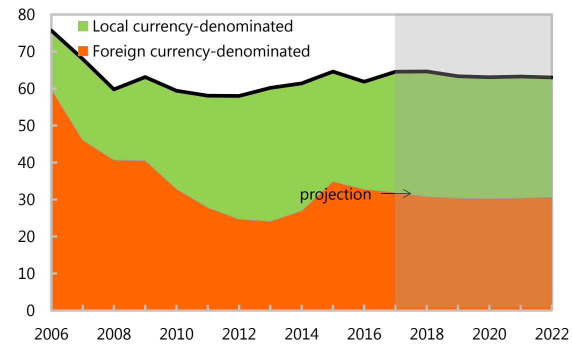
By Maturity

(in percent of GDP)



By Currency

(in percent of GDP)

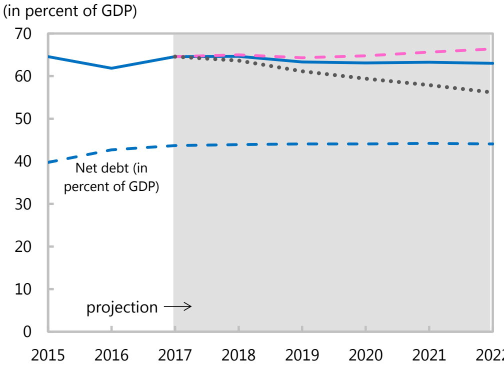


Alternative Scenarios

Baseline — Historical — Constant Primary Balance

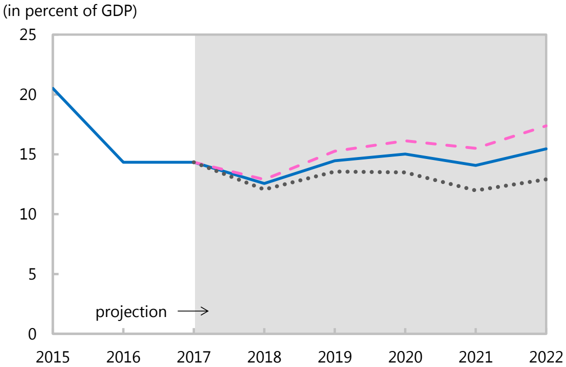
Gross Nominal Public Debt

(in percent of GDP)



Public Gross Financing Needs

(in percent of GDP)



Underlying Assumptions

(in percent)

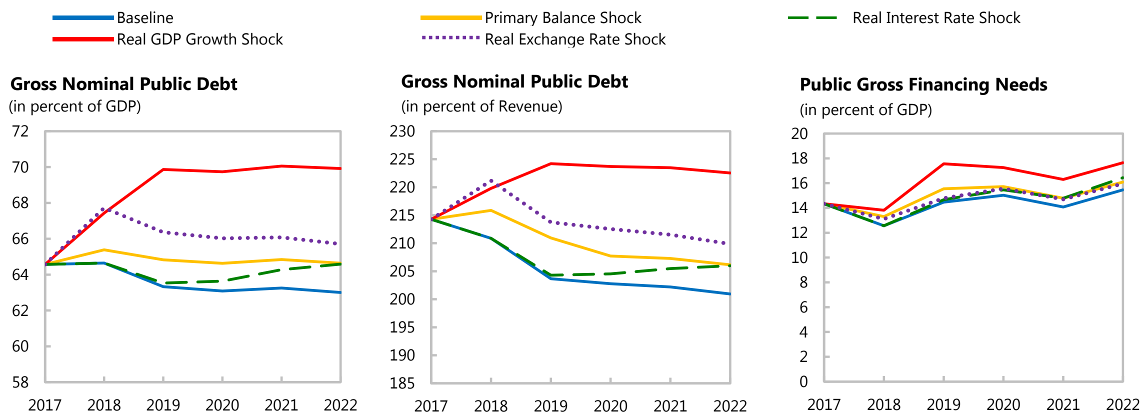
Baseline Scenario	2017	2018	2019	2020	2021	2022
Real GDP growth	3.1	3.4	3.1	3.0	2.9	3.0
Inflation	5.0	6.4	6.4	6.5	6.4	6.4
Primary Balance	-0.1	0.2	0.5	0.5	0.6	0.8
Effective interest rate	6.4	6.4	6.9	7.1	7.3	7.4
Constant Primary Balance Scenario						
Real GDP growth	3.1	3.4	3.1	3.0	2.9	3.0
Inflation	5.0	6.4	6.4	6.5	6.4	6.4
Primary Balance	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1
Effective interest rate	6.4	6.4	6.9	7.1	7.4	7.4

Historical Scenario	2017	2018	2019	2020	2021	2022
Real GDP growth	3.1	4.4	4.4	4.4	4.4	4.4
Inflation	5.0	6.4	6.4	6.5	6.4	6.4
Primary Balance	-0.1	0.6	0.6	0.6	0.6	0.6
Effective interest rate	6.4	6.4	6.3	6.0	5.9	5.8

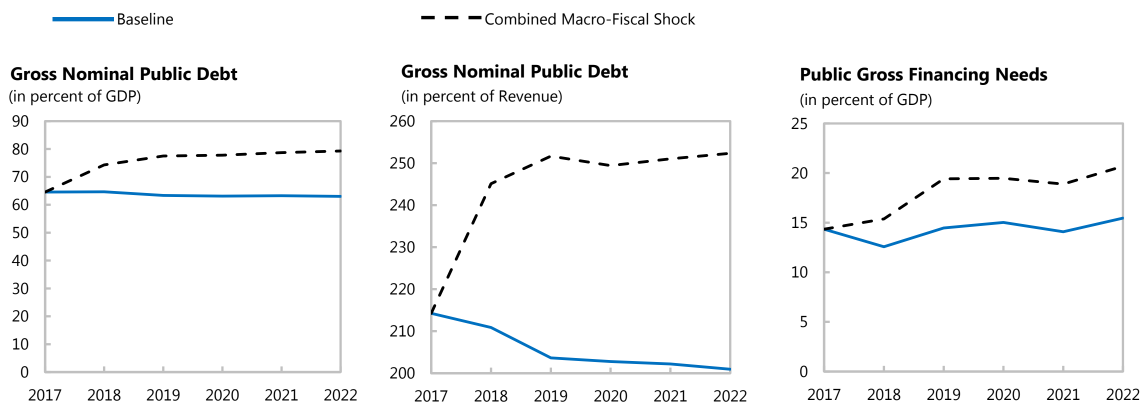
Source: IMF staff.

Uruguay Public DSA - Stress Tests

Macro-Fiscal Stress Tests



Additional Stress Tests



Underlying Assumptions

(in percent)

Primary Balance Shock	2017	2018	2019	2020	2021	2022
Real GDP growth	3.1	3.4	3.1	3.0	2.9	3.0
Inflation	5.0	6.4	6.4	6.5	6.4	6.4
Primary balance	-0.1	-0.5	-0.2	0.5	0.6	0.8
Effective interest rate	6.4	6.4	6.9	7.2	7.4	7.4
Real Interest Rate Shock						
Real GDP growth	3.1	3.4	3.1	3.0	2.9	3.0
Inflation	5.0	6.4	6.4	6.5	6.4	6.4
Primary balance	-0.1	0.2	0.5	0.5	0.6	0.8
Effective interest rate	6.4	6.4	7.2	7.7	8.1	8.3
Combined Shock						
Real GDP growth	3.1	1.0	0.7	3.0	2.9	3.0
Inflation	5.0	5.8	5.8	6.5	6.4	6.4
Primary balance	-0.1	-1.1	-1.6	0.5	0.6	0.8
Effective interest rate	6.4	6.8	7.1	7.8	8.2	8.3

Real GDP Growth Shock	2017	2018	2019	2020	2021	2022
Real GDP growth	3.1	1.0	0.7	3.0	2.9	3.0
Inflation	5.0	5.8	5.8	6.5	6.4	6.4
Primary balance	-0.1	-0.7	-1.3	0.5	0.6	0.8
Effective interest rate	6.4	6.4	6.9	7.3	7.5	7.5
Real Exchange Rate Shock						
Real GDP growth	3.1	3.4	3.1	3.0	2.9	3.0
Inflation	5.0	11.4	6.4	6.5	6.4	6.4
Primary balance	-0.1	0.2	0.5	0.5	0.6	0.8
Effective interest rate	6.4	6.8	6.8	7.0	7.3	7.3

Source: IMF staff.

Annex III. External Debt Sustainability Analysis

Improvements in the authorities' data collection methods have led to an upward revision in Uruguay's external debt relative to what was shown in last year's Staff Report. These upward revisions amounted to some 20 percent of GDP in 2016, almost entirely due to wider survey coverage of firms in the non-financial private sector. It should be noted that revisions back to 2012 now create a structural break in the statistics on gross external debt between 2011 and 2012.[1] It is questionable whether Uruguay's external risk has risen with these data revisions, because gross external assets have been revised up commensurately and the new debt is predominantly owed to foreign parent firms within a larger corporate structure.[2]

Driven by exchange rate volatility, gross external debt peaked in 2015 at 90 percent of GDP and then fell to 75 percent of GDP in 2016 (see Table). In parallel, an improving current account balance in recent years has put slight downward pressure on the external debt. Some 45 percent of the external debt is owed by the public sector.

Gross external debt is projected to have declined in 2017 to 69 percent of GDP, attributable primarily to a current account surplus and exchange rate appreciation. In subsequent years, staff expects a stable ratio of external debt to GDP, where current account surpluses and favorable automatic debt dynamics are offset by reserve accumulation. In turn, reserve accumulation reflects continued de-dollarization transactions that are expected to be accommodated by the BCU.

Gross external financing needs are expected to increase gradually over the medium term with an amortization of longer-term debt and the normalization of the non-interest current account. Nevertheless, favorable debt dynamics from (non-debt creating) capital inflows and real GDP growth are expected to support a stable long-term ratio of gross external debt to GDP even in the event of current account deficits as high as 4.4 percent of GDP.

The main risk to this outlook is an exchange rate depreciation. A counterfactual one-off devaluation of 30 percent could increase the gross external debt-to-GDP ratio by a similar number of percentage points of GDP, but would not lead to unstable subsequent debt dynamics, holding other things equal (see Figure).

[1] The historical gross external debt statistics now double between the value available for 2011, which is under the old methodology, and the value available for 2012, which has been republished this year under the new methodology.

[2] A detailed description of the change in methodology and its resulting data revisions appears in Annex IV.

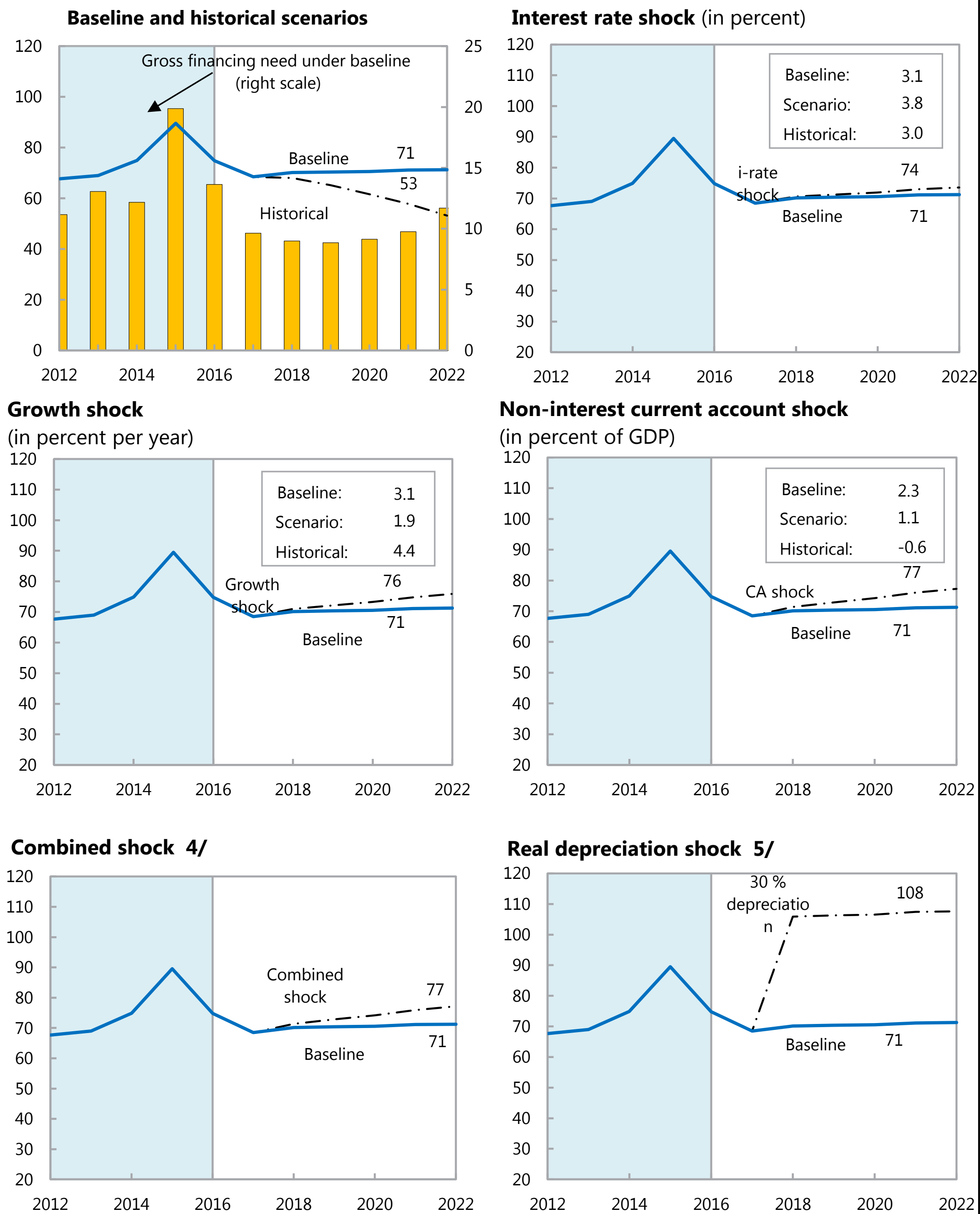
Uruguay: External Debt Sustainability Framework, 2012-2022
(In percent of GDP, unless otherwise indicated)

	Actual							Projections						
	2012	2013	2014	2015	2016			2017	2018	2019	2020	2021	2022	Debt-stabilizing non-interest current account 7/
Baseline: External debt 1/	67.7	69.0	74.9	89.5	74.8			**68.5**	**70.1**	**70.4**	**70.6**	**71.1**	**71.3**	**-4.4**
Change in external debt	...	1.3	5.9	14.6	-14.8			-6.3	1.7	0.2	0.2	0.6	0.1	
Identified external debt-creating flows (4+8+9)	-10.7	-6.9	-13.0	-3.0	1.5			-7.3	-6.7	-5.8	-5.3	-4.7	-4.0	
Current account deficit, excluding interest payments	2.1	1.5	0.9	-1.7	-3.8			-3.9	-3.3	-2.7	-2.3	-2.0	-1.3	
Deficit in balance of goods and services	-2.9	-1.6	-3.0	-3.6	-5.9			-6.4	-5.4	-4.9	-4.6	-4.2	-3.6	
Exports	33.8	32.9	33.7	32.2	27.7			28.1	27.9	27.8	27.8	27.8	27.6	
Imports	30.9	31.3	30.7	28.5	21.8			21.7	22.5	22.9	23.2	23.6	23.9	
Net non-debt creating capital inflows (negative)	-11.3	-1.2	-6.7	-4.9	0.6			-3.3	-3.2	-3.1	-3.0	-2.9	-2.8	
Automatic debt dynamics 2/	-1.5	-7.2	-7.2	3.5	4.7			-0.2	-0.2	0.0	0.0	0.1	0.0	
Contribution from nominal interest rate	1.1	1.7	1.8	2.3	2.4			2.0	2.0	2.0	2.0	2.0	2.0	
Contribution from real GDP growth	-1.5	-2.7	-1.9	-0.3	-1.3			-2.1	-2.2	-2.1	-2.0	-1.9	-2.0	
Contribution from price and exchange rate changes 3/	-1.1	-6.2	-7.0	1.6	3.6			...	...	...	...	...	...	
Residual, incl. change in gross foreign assets (2-3) 4/	...	8.2	18.9	17.7	-16.2			1.0	8.4	6.1	5.4	5.3	4.2	
External debt-to-exports ratio (in percent)	200.1	209.5	222.3	278.4	269.6			243.4	251.2	253.0	254.3	256.2	258.6	
Gross external financing need (in billions of US dollars) 5/	6.0	7.2	6.6	9.7	7.4			5.7	5.6	5.8	6.4	7.2	9.0	
in percent of GDP	11.2	13.1	12.2	19.9	13.6			9.6	9.0	8.9	9.1	9.8	11.7	
Scenario with key variables at their historical averages 6/						10-Year Historical Average	10-Year Standard Deviation	**68.5**	**68.0**	**65.1**	**61.6**	**57.8**	**53.1**	**-9.3**
Key Macroeconomic Assumptions Underlying Baseline														
Real GDP growth (in percent)	3.5	4.6	3.2	0.4	1.5	4.4	2.4	3.1	3.4	3.1	3.0	2.9	3.0	
GDP deflator in US dollars (change in percent)	2.5	10.1	11.4	-2.1	-3.8	6.9	13.9	7.6	2.3	2.6	2.4	2.3	2.3	
Nominal external interest rate (in percent)	2.5	2.9	3.0	3.0	2.7	3.0	1.4	2.9	3.1	3.0	3.0	3.1	3.0	
Growth of exports (US dollar terms, in percent)	...	-0.2	1.5	-15.0	-4.4	8.2	16.9	10.9	5.1	5.3	5.3	5.4	4.6	
Growth of imports (US dollar terms, in percent)	...	3.8	-2.8	-17.1	-15.3	7.2	24.3	9.0	9.7	7.4	6.8	7.3	6.8	
Current account balance, excluding interest payments	-2.1	-1.5	-0.9	1.7	3.8	-0.6	2.5	3.9	3.3	2.7	2.3	2.0	1.3	
Net non-debt creating capital inflows	11.3	1.2	6.7	4.9	-0.6	5.2	3.3	3.3	3.2	3.1	3.0	2.9	2.8	

1/ External debt includes non-resident deposits.
2/ Derived as [r - g - r(1+g) + ea(1+r)]/(1+g+r+gr) times previous period debt stock, with r = nominal effective interest rate on external debt; r = change in domestic GDP deflator in US dollar terms, g = real GDP growth rate, e = nominal appreciation (increase in dollar value of domestic currency), and a = share of domestic-currency denominated debt in total external debt.
3/ The contribution from price and exchange rate changes is defined as [-r(1+g) + ea(1+r)]/(1+g+r+gr) times previous period debt stock. r increases with an appreciating domestic currency (e > 0) and rising inflation (based on GDP deflator).
4/ For projection, line includes the impact of price and exchange rate changes.
5/ Defined as current account deficit, plus amortization on medium- and long-term debt, plus short-term debt at end of previous period.
6/ 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.
7/ 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.

Uruguay: External Debt Sustainability: Bound Tests 1/ 2/ 3/

(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/ For historical scenarios, the historical averages are calculated over the ten-year period, and the information is used to project debt dynamics five years ahead.
3/ External debt includes non-resident deposits.
4/ Permanent 1/4 standard deviation shocks applied to real interest rate, growth rate, and current account balance.
5/ One-time real depreciation of 30 percent occurs in 2017.

Annex IV. The Revised BOP[1]

On 29 September 2017, the Banco Central de Uruguay (BCU) released a new version of Balance of Payments (BOP) and International Investment Position (IIP) data going back to 2012. These new data conform for the first time to the principles outlined in the sixth edition of the Balance of Payments Manual (BPM6). The BCU took advantage of the opportunity to make other improvements to its data collection methodology, with a widening of the sample of firms surveyed, from some 200 corporate groups to approximately 490. Uruguay's system of national accounts currently published by the BCU does not yet reflect these data revisions.

Effects on the BOP and IIP

In broad terms, the two main data revisions are an upward shift in the current account balance (of approximately US$0.8 billion, on average) and an increase in gross external debt of the non-financial private sector (of approximately US$14 billion). Both of these effects are caused by the wider coverage of the sample of firms surveyed.

The increase in the current account balance in the BOP is due to primarily to an increase in measured exports. Many of the new survey firms responsible for this increase are so-called *compraventas*, or merchants (see below). Since many of these new exporters are owned by non-residents, the balance of the primary income account was revised downward to reflect profits accruing to these non-residents.

The widening of the sample of surveyed firms revised up the gross external debt of private sector non-financial firms. Much of the additional debt is held by parent companies within larger corporate ownership structures, and these newly surveyed firms hold significant external assets that limit the upward revision in the net external debt. The offsetting effect of external assets can be seen in the difference between the small upward revision in the net external debt of direct investment enterprises (US$2 billion in 2016) and the large upward revision in the gross external debt of the non-financial private sector (US$14 billion in 2016). Overall the net IIP is revised down by some US$2.5 billion.

Compraventas/Merchants

An important source of compositional changes in the BOP data occurs through expanded coverage of so-called 'compraventas' or merchant firms in the new surveys. Merchant firms purchase goods from non-residents and subsequently resell them to non-residents, without the goods entering the economic territory of Uruguay. Approximately four-fifths of Uruguayan merchant firms operate in grains, while the remainder sell industrial components for manufacturing processes, like pipes for petroleum refining processes. A merchant firm may not conduct merchanting activities every year, and may only engage in merchanting as a secondary business, so that any estimates of the effects of

[1] Prepared by Galen Sher (WHD) in October 2017. For more information, see BCU, 2017, "Uruguay: Principales resultados Balanza de Pagos y Posición de Inversión Internacional 2012–2016," mimeo, September.

merchanting on the balance of payments are inherently uncertain. In Uruguay, merchant firms typically operate as subsidiaries of foreign-owned parent companies. And for those, the balance of payments would be affected by primary income transfers and transactions in financial assets. The authorities are assessing the impact of merchanting activities on GDP as part of updating the national accounts to the latest standards. The authorities' calculations of balance of payments data including and excluding compraventas do show a sizable net current account impact of some 0.8 percent of GDP in 2016.

Uruguay: impact of merchanting/compraventas on the BOP
(percent of GDP)

	2012	2013	2014	2015	2016
Trade Balance	0.7%	2.0%	3.5%	2.5%	4.4%
Trade Balance excl compraventas	-3.0%	-1.0%	-0.2%	0.8%	2.1%
Services Balance	2.3%	-0.4%	-0.6%	0.8%	1.6%
Services Balance excl compraventas	3.0%	0.5%	0.3%	1.5%	2.1%
Factor income	-7.3%	-5.2%	-6.0%	-4.4%	-4.7%
Income excl compraventas	-4.5%	-3.3%	-3.9%	-3.7%	-3.8%
Current account	-4.0%	-3.3%	-2.8%	-0.7%	1.7%
CA excl compraventas	-4.2%	-3.5%	-3.5%	-1.1%	0.9%
FDI	-4.2%	-4.8%	-4.1%	-1.6%	1.5%
FDI excl compraventas	-4.1%	-3.8%	-4.5%	-2.6%	0.2%

Source: national authorities and Fund staff calculations.

INTERNATIONAL MONETARY FUND

URUGUAY

December 20, 2017

STAFF REPORT FOR THE 2017 ARTICLE IV CONSULTATION—INFORMATIONAL ANNEX

Prepared By

The Western Hemisphere Department
(in consultation with other departments)

CONTENTS

FUND RELATIONS

(As of November 30, 2017)

Membership Status: Joined: March 11, 1946 Article VIII

General Resources Account:	**SDR Million**	**% Quota**
Quota	429.10	100.00
Fund holdings of currency	354.89	82.71
Reserve Tranche Position	74.21	17.30

SDR Department:	**SDR Million**	**% Allocation**
Net cumulative allocation	293.26	100.00
Holdings	214.99	73.31

Outstanding Purchases and Loans: None

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

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

	2017	2018	2019	2020	2021
Principal					
Charges/Interest		0.58	0.58	0.58	0.58
Total		0.58	0.58	0.58	0.58

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).

Exchange Rate Arrangement. The currency is the Uruguayan peso (UY$). Uruguay's de jure and de facto exchange rate arrangements are classified as floating. Since June 2013, monetary policy targets the growth rate of M1 plus saving deposits as the intermediate instrument. On December 11 2017, the exchange rate in the official market was UY$ 29.05 per U.S. dollar. Uruguay has accepted the

[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.

obligations of Article VIII and maintains an exchange rate system free of restrictions on payments and transfers for current international transactions.

FSAP participation and ROSCs. A Financial Sector Stability Assessment (FSSA) was considered by the Executive Board on June 28, 2006 (Country Report No. 06/187). An FSAP Update was conducted in 2012 and the FSSA was published on May 31, 2013 (Country Report No. 13/152). A ROSC module on fiscal transparency was published on March 5, 2001. A ROSC module on data dissemination practices was published on October 18, 2001. A ROSC on Anti-Money Laundering and Combating the Financing of Terrorism (AML/CFT) was published on December 12, 2006 (Country Report No. 06/435). A data module ROSC was published on February 11, 2014 (Country Report No. 14/42).

Technical Assistance 2008–17.

DPT	Purpose	Date of Delivery
FAD	Revenue Administration (Follow-up)	November 2017
	Assist with strengthening customs' reform strategy and implementation of the governance framework	November 2015
	Tax Administration, PFM (Follow-up)	October 2015
	Treasury Management	August 2014
	Tax, customs, and social security administration	August 2014, March 2014, November 2012, November 2011, September 2010
	Performance Informed Budgeting	March 2011
	Private public partnership	May 2010
LEG	Structures and tools for strengthening the AML/CFT capacity of the Superintendency of Financial Services and the Financial Intelligence Unit	October 2017
	Structure and tools for strengthening the AML/CFT capacity of the Superintendency of Financial Services and the Financial Intelligence Unit	November 2016
	Structure and tools for strengthening the AML/CFT capacity of the Superintendency of Financial Services and the Financial Intelligence Unit	March 2016
	Structure and tools for strengthening the AML/CFT capacity of the Superintendency of Financial Services and the Financial Intelligence Unit	October 2015

	Structure and tools for strengthening the AML/CFT capacity of the Superintendency of Financial Services and the Financial Intelligence Unit	March 2015
	Assist the authorities on strengthening the AML/CFT capacity of the Superintendency of Financial Services and the Financial Intelligence Unit	October 2014
	Follow up of the implementation of the AML/CFT National Strategy	October 2013
	Assist the authorities on the launch of the recently designed AML/CFT national strategy	June 2012
	Assist the authorities on the elaboration of a risk-based national strategy enhancing the AML/CFT regime	December 2010
	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	Sovereign Asset and Liability Management and Development of the Local Currency Government Bond Market	September 2016
	Bank resolution	June 2014
	FSAP update	September 2012
STA	Trade Margins and Commercialization Channels	September 2016
	International Investment Position Statistics. BOP and external debts stats.	October 2015
	Data ROSC reassessment	August 2012
	Government Finance Statistics, to assist in improving the quality of public debt data	February 2008

RELATIONS WITH THE WORLD BANK UNDER JMAP

(As of November 20, 2017)

Title	Products	Provisional timing of Missions	Expected delivery date*
World Bank work program	**A. Lending**		
	A. UY Improving service delivery to citizens and businesses through E-Government	December 2017	December 31st, 2021
	B. UY OSE Sustainable and Efficient	March 2018	December 31st, 2019
	C. Sustainable Management of Natural Resources and Climate Change	March 2018	June 30th, 2018
	D. Road Rehabilitation and Maintenance Program	April 2018	June 30th, 2020
	E. Improving the Quality of Initial and Primary Education in Uruguay	April 2018	May 31st, 2022
	F. Public Sector Management and Social Inclusion Development Policy Loan	December 2017	June 30th, 2019
	G. 2nd. Programmatic Public Sector, Competitiveness and Social Inclusion Development Policy Loan with Drawdown Option	December 2017	June 25th, 2018
	B. Lending pipeline		
	1. Sustainable Management of Natural Resources and Climate Change – Additional Financing		
	C. ASA		
	1. Uruguay Green Growth		January 31st, 2018
	2. Uruguay Governance of SOEs		March 30th, 2018
	3. Labor, Markets, Productivity and Skills in UY		November 30th, 2018
	4. Uruguay Policy Dialogue on Competitiveness and Global Value Chains		June 6th, 2018
	5. Smarter Urban Mobility for Montevideo		April 30th, 2018
	6. Uruguay FCPF REDD Readiness Preparation		TBC
	7. Accessible Tourism for UY		December 31st, 2017

RELATIONS WITH THE INTER-AMERICAN DEVELOPMENT BANK

(As of November 16, 2017)

The Inter-American Development Bank's Board of Executive Directors approved in December 2015 the Country Strategy with Uruguay (2016–20). Sovereign-guaranteed lending under the program is expected to reach approximately US$1.8 billion, which is considered to be consistent with Uruguay's five year budget. The program includes additional non reimbursable financing for technical assistance and analytical work. Approved lending under the previous Country Strategy (2010–15) reached approximately US$1.9 billion in sovereign guaranteed loans and US$1 billion in non- sovereign guaranteed loans.

The objectives of the country strategy for 2016–20 are to: (i) boost productivity and competitiveness by promoting innovation, improving productive infrastructure, and supporting an integrated and coordinated policy for international positioning; (ii) promote equity and social inclusion by strengthening the human capital and employability of the population, supporting health care reform, improving habitat, and supporting the early childhood and youth segments of the most vulnerable population groups; and (iii) strengthen public sector management by supporting greater efficiency in public institutions and strengthening urban and departmental management.

As of October 31st 2017, the Bank's portfolio in execution in Uruguay includes 41 sovereign guaranteed loans for US$2.2 billion. Of this total, 37 are investment loan operations totaling US$1.4 billion, and 4 are policy-based loans for US$800.8 million with a deferred drawdown option. The main sectors comprising the active public sector portfolio are: productive infrastructure (36%), international positioning (26%); habitat improvement (13%); urban and departmental management (7%); public sector management (7%); human capital and employability (6%); innovation (3%); and early childhood and youth (2%). As of September 30th, 2017, the active private sector portfolio is composed of 24 loans totaling US$744.1 million, primarily concentrated in the energy (59%) and agribusiness sectors (36%).

Financial Relations with the Inter-American Development Bank [1]

(In millions of U.S. dollars)

Total outstanding loans: US$1,801 (As of October 31, 2017)

Loan transactions

	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016
Disbursement	242.3	114.8	112.9	337.2	477.3	54.3	138.2	121.6	195.9	166.3	182.5	174.4
Amortization	220.0	519.6	133.8	140.0	162.0	465.1	115.4	120.7	591.7	99.2	110.1	118.9
Net Loan Flows	**22.3**	**-404.8**	**-21.0**	**197.2**	**315.2**	**-410.8**	**22.8**	**0.8**	**-395.8**	**67.1**	**72.4**	**55.5**

Source: Inter-American Development Bank.

[1] Only loans with sovereign guarantee are considered.

STATISTICAL ISSUES

(As of December 12, 2017)

I. Assessment of Data Adequacy for Surveillance
General: Data provision has some shortcomings, but is 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 (SNA) 1993*. However, national accounts statistics still have some shortcomings: limited coverage of the enterprise survey, partial update of business register, poor quality source data for some components of GDP, inadequate information on the informal economy, and incomplete quarterly accounts. Long-time series are not available on the BCU website. There is no regular schedule for updating the base year of the national accounts. The causes of the current revisions to the quarterly national accounts are not explained to users. For the national accounts there is a need to plan adoption of the 2008 SNA and updating of the base year.
Prices: The new base period for the consumer price index is December 2010 = 100. The CPI has national coverage and includes more than forty thousand price quotations. It does not cover either the implicit rent or the net acquisitions of owner-occupied dwellings. For the CPI, reselection of the sample of detailed products has not been done for an extended period. The base of the wholesale price index has been updated to 2001. Producer price indices (March 2010 =100) for national products have been recently disseminated. The PPI does not cover utilities, construction, business and other services and exported output. For both the CPI and PPI, statistical outputs/intermediate results are not validated with available information from alternative sources. The CPI and PPI would benefit from a more regular and frequent schedule of weight updates.
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 for local governments. 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, but no information is reported for publication in the *International Financial Statistics*. The information reported for publication in the *Government Finance Statistics Yearbook* covers transactions on revenue and expense for the consolidated central government (data on revenue and expense for local governments have not been reported since 1994), and the general government's operations on financial assets and liabilities, both in terms of flows (financing) and stocks (debt).
Monetary and financial statistics: Monetary and financial statistics are prepared in accordance with the IMF's *Monetary and Financial Statistics Manual (2000).* The authorities report monetary data for the central bank, other depository corporations, and other financial corporations (OFCs) using the standardized reporting forms (SRFs). However, data for the OFCs are limited to off-shore financial institutions. A mission could be fielded to expand the institutional coverage of OFCs and compile the SRF for OFCs with full institutional coverage.

Financial sector surveillance: The authorities participate in the IMF's Coordinated Direct Investment Survey (CDIS), Coordinated Portfolio Investment Survey (CPIS), and Financial Soundness Indicators (FSIs) databases. However, only annual FSIs data from 2009 through 2013 have been reported, and the authorities have not responded to requests for more current data. FSIs on nonfinancial corporations, households, market liquidity, and real estate markets are not available. The BCU disseminates FSIs for individual banks on a monthly basis and generates FSIs for the banking system weighting individual bank FSIs by their asset share.	
External sector statistics: Balance of payments and international investment position statistics are compiled and published on a quarterly basis. Data are compiled following the recommendations of the sixth edition of the *Balance of Payments Manual*. Uruguay disseminates the international reserves and foreign currency liquidity data template, submits quarterly external debt statistics to the Quarterly External Debt Statistics (QEDS) database, and participates in the Coordinated Portfolio Investment Survey (CPIS) and the Coordinated Direct Investment Survey (CDIS).	
II. Data Standards and Quality	
Uruguay subscribed to the SDDS in February 2004 and is in observance.	Data ROSC published on October 1, 2001. A data reassessment ROSC on CPI, PPI and NA was published in February 2014.
III. Reporting to STA (Optional)	
Both the consumer and wholesale price indices are reported on a regular and timely basis for publication in the *International Financial Statistics (IFS)*. The authorities do not provide trade price and volume indices for publication in the *IFS*. Annual GFS are regularly reported to STA for publication in the *Government Finance Statistics Yearbook.* No high frequency GFS are reported for publication in the *International Financial Statistics*. Uruguay reports to STA balance of payments and IIP data for publication in the *IFS* and the *Balance of Payments Statistics Yearbook.*	

Uruguay: Common Indicators Required For Surveillance (As of December 12, 2017)							
	Date of latest observation	Date received	Frequency of Data 7/	Frequency of Reporting 7/	Frequency of Publication 7/	Memo items:	
						Data Quality – Methological Soundness 8/	Data Quality – Accuracy and Reliability 9/
Exchange Rates	12/12/17	12/12/17	D	D	D		
International Reserve Assets and Reserve Liabilities of the Monetary Authorities 1/	12/12/17	12/12/17	D	D	D		
Reserve/Base Money	09/17	11/19/17	M	M	M		
Broad Money	08/17	11/19/17	M	M	M		
Central Bank Balance Sheet	08/17	11/19/17	M	M	M		
Consolidated Balance Sheet of the Banking System	08/17	11/19/17	M	M	M		
Interest Rates 2/	11/27/17	11/27/17	D	D	D		
Consumer Price Index	11/17	12/05/17	M	M	M	O, LO, O, O	LO, O, O, LNO, NO
Revenue, Expenditure, Balance and Composition of Financing 3/– Central Government 4/	10/17	11/30/17	M	M	M		
Stocks of Central Government and Central Government-Guaranteed Debt 4/ 5/	Q2/17	10/1/17	Q	Q	Q		
External Current Account Balance	Q2/17	9/30/17	Q	Q	Q		
Exports and Imports of Goods and Services	Q2/17	9/30/17	Q	Q	Q		
GDP/GNP	Q2/17	09/15/17	Q	Q	Q	LO, LO, LO, LO	LNO, LNO, LO, O,
Gross External Debt	Q2/17	10/1/17	Q	Q	Q		
International Investment Position 6/	Q2/17	11/15/17	Q	Q	Q		

1/ Includes reserve assets pledged or otherwise encumbered as well net derivative positions.
2/ Both market-based and officially-determined, including discount rates, money market rates, rates on treasury bills, notes and bonds.
3/ Foreign, domestic bank, and domestic nonbank financing.
4/ The general government consists of the central government (budgetary funds, extra budgetary funds, and social security funds) and state and local governments.
5/ Including currency and maturity composition.
6/ Includes external gross financial asset and liability positions vis-à-vis nonresidents.
7/ Daily (D); weekly (W); monthly (M); quarterly (Q); annually (A); irregular (I); and not available (NA).
8/ This reflects the reassessment provided in the data ROSC (published in February 2014, and based on the findings of the mission that took place during August 20–31, 2012) for the dataset corresponding to the variable in each row. The assessment indicates whether international standards concerning (respectively) (i) concepts and definitions, (ii) scope, (iii) classification/sectorization, and (iv) basis for recording are fully observed (O); largely observed (LO); largely not observed (LNO); not observed (NO); and not available (NA).
9/ Same as footnote 9, except referring to international standards concerning (respectively) (i) source data, (ii) assessment of source data, (iii) statistical techniques, (iv) assessment and validation of intermediate data and statistical outputs, and (v) revision studies.

Statement by Adrian Armas, Executive Director for Uruguay and David Vogel, Senior Advisor to Executive Director
January 22, 2018

15 years of positive growth…

In 2017, at a rate of about 3 percent, Uruguay recorded its fifteenth consecutive year of economic expansion, the longest period in the country's history.[1] Clearly, the growth rate exhibited last year was below the average of the period (somewhat above 5 percent), but it presents a much better performance compared with the previous two years. A sound reacceleration is ongoing.

Another exceptionality of the process (compared to the past) is the country's decoupling from its main trade partners in the region. Research papers, including from the IMF[2], have often mentioned the high correlation that Uruguay used to show with its larger neighbors' business cycle. However, the very dissimilar paths observed over the past years perfectly attest to the new stage.

How is this performance explained? We can start by underlining Uruguay's constant efforts to implement prudent policies amidst a process of structural transformation in many areas, some of which we will refer to.

…accompanied with substantial enhancements of social conditions

Explanations would not be complete without reiterating once again the authorities' comprehensive concept of stability, which embraces its economic, political, and social dimensions; growth can and should go together with improvements of the entire society's welfare and, especially, with a process of boosting opportunities for everyone.

Social indicators tend to ratify the above-referred notion and reflect some of the country's efforts: poverty rates exhibit a continuous reduction, from 32.5 percent in 2006 to 9.4 percent in 2016, while inequality (Gini Index measured by *Instituto Nacional de Estadística*) declined from 0.45 to 0.38 in the same period. As noted on previous occasions, beyond its intrinsic value, social stability entails substantial benefits by synergistically interacting with economic stability.

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[1] This is definitively not a common record worldwide (about 30 percent of IMF member countries over the past 15 years), and particularly in Latin America and Caribbean where below 20 percent of countries have exhibited only positive rates over the same period.

[2] For instance, Sosa, S., The Influence of "Big Brothers: How Important are Regional Factors for Uruguay?", IMF Working Paper 10/60.

While considerable progress has been made in this area, the authorities are fully aware that much remains to be done; for instance, in the education system, a critical area that presents substantial challenges and opportunities to continue improving social conditions and reducing inequality.

An unambiguous commitment to openness

The authorities would like to reiterate their commitment to deepen Uruguay's insertion into the global economy by using different available mechanisms; Mercosur is relevant for Uruguay, and the authorities consider it as a medium to further integrate the bloc's countries, and particularly Uruguay, into the world. Evidently, these kinds of processes entail complexities and obstacles, and should be assessed from a broad perspective, which includes efforts and results, over an extended period.

In 2017, exports displayed a robust performance; besides its expansion, we highlight the noticeable market diversification Uruguay presents, implying a crucial development for the country. While during the last years of the past century exports of goods to Mercosur countries were about half of Uruguay's total external sales, currently the percentage is a quarter of the total. It is not only by markets, but also a product expansion: Uruguay is selling a much wider spectrum of goods and services; just as an example, the country has become a major exporter of software products.

Consistency, credibility, and stability…

The sustainability of economic and social achievements is only possible in a context of macroeconomic stability, which requires consistency among policies, mainly fiscal, monetary, and income ones.

The fiscal consolidation process is underway and results are heading towards the authorities' target for 2019, which is an overall deficit of 2.5 percent of GDP, and aim at maintaining the sustainability of public finances.[3] In 2017 public enterprises made an important contribution to the fiscal performance and, as noted by staff, the state oil company *Ancap* has been brought back to financial soundness. Meanwhile, public revenues will continue with vigorous results, helped by the—already introduced—revenue measures, and sustained on the pillars of the reforms undertaken in the tax system and revenue administration over the past decade. On this note, it is worth stressing that Uruguay, at about 13 percent in 2015, presents the lowest level of VAT evasion in Latin America.

[3] On Uruguay's debt coverage, it is relevant to remind that, as noted in the staff report's Public Sector Debt Sustainability Analysis (DSA), "Uruguay is one of the few countries to report debt figures on a consolidated basis for the whole public sector, excluding public commercial banks, but including the central bank".

Efforts in the monetary area have been key to combat inflation, which had climbed to 11 percent in May 2016. At that time, the monetary stance became even tighter, which led, along with the contribution from the other policies, to a steep fall in inflation rates which, since March 2017, have been systematically placed in the central bank's target range, ending the year at 6.55 percent. Perhaps even more important than the former figure is that associated with the critical reduction of inflation expectations, which is well anchored and within the target range, as well as the drop in non-tradable inflation (which once had a stubborn resistance to decline). To buttress these positive developments, the Central Bank of Uruguay has announced the continuation of its tight monetary stance.

The authorities view exchange rate flexibility as a key factor to cushion eventual shocks; evidently, it has served the country well, allowing it to withstand difficult circumstances and volatility observed over the past decade at regional and global levels. Interventions in the exchange rate markets have occurred to soften disproportionate temporary movements that would be far from what the fundamentals would indicate and would have had the potential to generate more permanent distortions.

The last wage round brought about a critical flexibility in the labor market, contributing to a significant reduction of inflation inertia. In an environment where credibility prevails, flexibility does not necessarily mean wage reductions; in fact, consistency among policies has reinforced the virtuous cycle in which wage agreements and the decline of inflation and inflationary expectations led to a considerable increase in real wages. Against the background of the 2018 wage agreements, the authorities have highlighted the importance of maintaining flexibility with the aim of helping to foster employment, for which further efforts to enhance workers' training programs are critical.

… reinforcing buffers and reducing risks

Credibility emanated from sound policies has allowed Uruguay to create robust buffers. The profile of the public debt is an eloquent illustration: the average time to maturity of the Central Government Debt is about 14 years, most of the debt (94 percent) is at a fixed rate, and 51 percent is denominated in local currency (much more than, for instance, the 12 percent in 2005 or 26 percent a decade ago). Moreover, in June and September, the country launched two issuances of 5-year and 10-year nominal fixed-rate local currency bonds in international markets (both are included in the JP Morgan GBI-EM benchmark), substantially increasing the composition of Uruguay's public debt in nominal pesos.

Related to the latter, the authorities fully agree with staff on the need to continue promoting de-dollarization in Uruguay (as in Section 2 of the Selected Issues), but the process—always complex—should be assessed from a broader perspective, for instance, considering the above-mentioned progress made in reducing the composition of debt dollarization (once a major vulnerability for the country, especially in the context of a lack of exchange rate flexibility).

Meanwhile, Figure 2 of the staff report shows that international reserves remained well above the Fund's reserve adequacy metric. In times where fundamentals and potential risks at global levels (identified, for instance, in the report's Risk Assessment Matrix, where some events are marked with a high or medium likelihood) are perceived to be somewhat disconnected from the current low levels of global market volatility, a high level of international reserves seems to be a critical insurance for the country. Considerable contingent lines from multilateral and regional institutions are also available.

Keeping in mind its relatively low level and its declining trend observed in 2017, the authorities are closely monitoring developments regarding bank credit, an area in which the authorities are working on from different angles. Beyond these concerns, the staff's assessment that credit has not served as a source of growth would deserve a further elaboration. For more than a decade, Uruguay has waged key structural reforms in the financial system, for instance in the regulatory and supervisory functions, and, needless to say, in the governance, functioning and scope of public banks. Sound policies and reforms have allowed the country to benefit from a critical financial stability amidst a period of robust growth, which is attested by the financial soundness indicators, such as capital adequacy, non-performing loans (remaining at stable low levels after a moderate increase in 2015 and 2016), liquidity, and implicit exchange rate risk.

Based on firm pillars…

As noted on other occasions, institutions are relevant in the explanation of Uruguay's path, constituting the country's strong pillars to build its future. Without being an exhaustive list, it is possible to cite certain indicators that may reflect the soundness of the country's institutions. The Economist Intelligence Unit's Democracy Index classifies Uruguay in the group of full democracies; Uruguay is ranked in the 21st position (out of 176 countries) by Transparency International's Corruption Perception Index; 20th position (out of 135 countries) by World Justice Project's Rule of Law; and 36th position (out of 180 countries) by Heritage Foundation's Index of Economic Freedom. Meanwhile, in the World Bank's Governance Indicators, Uruguay occupies the second place in the Americas (after Canada) in the dimensions of Voice and Accountability, as well as Political Stability and Absence of Violence.

… looking at the future

Uruguay faces considerable risks at global levels and many domestic challenges. The country should continue enhancing its potential growth for which, among other things, it is essential to significantly enhance education levels (its quality must be much closer to the level of resources devoted to the area), and increase investment rates (the authorities will soon deploy a number of policies and changes to boost them; furthermore, public-private partnerships (PPPs) should be more active to help addressing the country's infrastructure gaps); creation of employment has been lagging behind economic activity's developments, posing another important challenge; there are substantial issues to be addressed regarding productivity; and the fiscal deficit is still relatively high, although it is under full control and exhibits a clear decreasing trend.

The staff report perfectly sums up Uruguay's performance in 2017 by saying that it was "a good year". However, there is no room for complacency. Good results simply ratify that policies and continual progress in its modernization are heading in the right direction, and based on them Uruguay is looking to the future: an "e-peso" pilot project (not a cryptocurrency, but a digital bill with the same functioning as a physical one), technology readiness, the substantial shift to renewable sources of energy, excellent progress in terms of financial inclusion, commitment to openness, and efforts to keep attracting investments (and its benign perspectives), among others, provide good hints of the pathway ahead.