INTERNATIONAL MONETARY FUND

IMF Country Report No. 19/64

URUGUAY

February 2019

2018 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 2018 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 February 13, 2019 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 February 13, 2019, following discussions that ended on December 12, 2018, 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 January 29, 2019.
- An **Informational Annex** prepared by the IMF staff.
- A **Statement by the Executive Director** for Uruguay.

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

Selected Issues

The IMF's transparency policy allows for the deletion of market-sensitive information and premature disclosure of the authorities' policy intentions in published staff reports and other documents.

Copies of this report are available to the public from

International Monetary Fund • Publication Services
PO Box 92780 • Washington, D.C. 20090
Telephone: (202) 623-7430 • Fax: (202) 623-7201
E-mail: publications@imf.org Web: http://www.imf.org
Price: $18.00 per printed copy

International Monetary Fund
Washington, D.C.

Press Release No. 19/50
FOR IMMEDIATE RELEASE
February 19, 2019

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

IMF Executive Board Concludes 2018 Article IV Consultation with Uruguay

On February 13, 2019, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation[1] with Uruguay.

Recent Developments and Outlook

In a deteriorating external environment, Uruguay has successfully differentiated itself from its neighbors, thanks to progress in export market diversification, a prudent and coordinated public-sector asset-liability management, pre-financing of sizeable external financing needs, lower banking sector vulnerabilities, and ample reserves. As a result, public sector borrowing costs have remained subdued despite significant depreciation pressures, and, although growth has slowed—to an estimated 2.1 percent—it remains positive. Still, private investment has remained sluggish, and labor market outcomes are weak.

Inflation has risen above the central bank's target range—partly reflecting temporary factors—and is now at around 8 percent. The central bank has reduced the monetary indicative targets, but medium-term inflation expectations remain somewhat above the target range.

Fiscal deficit reduction has stalled, and the time to reach the target of 2.5 percent of GDP has been extended to 2020. The 12-month rolling fiscal deficit stood at 3.8 percent of GDP in November 2018 (excluding the impact of a large transaction related to pension asset transfers), suggesting that attainment of the 2018 objective (3.3 percent of GDP) and 2020 target is difficult.

The current account has turned to deficit in the first three quarters of 2018, because of negative investment income, higher oil prices, lower exports to neighboring countries facing difficulties (such as Argentina and Brazil), and lower agricultural exports due to the drought. High-frequency data point to portfolio outflows during the last quarter of 2018, as seen in many emerging markets. The authorities ably took advantage of favorable financing conditions through mid-2018 by issuing bonds in global markets at long maturities.

[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.

Despite the regional market turmoil, the financial sector has remained resilient, reflecting limited linkages to Argentina and enhanced supervision since the 2002 crisis. With the improvements in regulatory capital to risk-weighted assets ratio and bank profits, the banking sector has comfortable buffers.

There are both sizeable downside and upside risks to the outlook, given the more difficult external environment and large infrastructure projects. An abrupt tightening in global financial conditions, caused by a sharp increase in international risk premia coupled with a further strengthening of the U.S. dollar, could have negative repercussions for Uruguay's economy. A further slowdown in trading partners could also worsen the growth outlook. At the same time, prudent macroeconomic policies and strong institutions have improved Uruguay's ability to withstand regional shocks, and plans for the construction of a large cellulose plant, an associated railway system, and other infrastructure projects are a major upside risk. Over the medium-term, low investment and declining employment, if not reversed, could lower potential growth.

Executive Board Assessment[2]

Executive Directors noted that prudent macroeconomic policies combined with strong reform implementation, and quality institutions have enabled Uruguay to maintain macroeconomic stability, accumulate sizeable buffers, improve social outcomes, and differentiate itself in the region. Directors noted that policy priorities ahead should focus on maintaining resilience, keeping public debt on a sustainable path, sustaining low inflation, and implementing structural reforms to boost the economy's growth potential.

Directors welcomed the authorities' commitment to maintain fiscal sustainability. They considered that the postponement of the fiscal deficit target by a year is appropriate given the current outlook. However, Directors underscored that additional fiscal measures would be needed to achieve the deficit target. They highlighted that fiscal sustainability could benefit from a medium-term fiscal framework which focuses on the nonfinancial public sector and is supported by an appropriate fiscal rule. Directors encouraged the authorities to introduce measures to put public debt on downward path. They also recommended that adjustment efforts should focus on reducing current expenditure while further improving its efficiency to increase capital spending. Priority should also be given to making further progress on the reforms of the pension system and the state-owned enterprises.

Directors welcomed the authorities' commitment to bring inflation to within the central bank's target range. Looking ahead, they encouraged the central bank to further strengthen the monetary policy framework by addressing the high degree of dollarization and enhancing its communication strategies, thereby better anchoring inflation expectations. Directors underscored

[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.

the need to maintain exchange rate flexibility and limit interventions to address disorderly market conditions. They acknowledged the resilience of the financial sector and encouraged the authorities to remain vigilant about the non-performing loans and continue their efforts to increase financial inclusion while ensuring that it remains resilient in the face of regional shocks.

Directors welcomed Uruguay’s success in reducing poverty and inequality. To foster inclusive growth and ensure continued income convergence to advanced country levels, they encouraged the authorities to sustain implementation of structural reforms. Directors highlighted that reform efforts should focus on further increasing public investment, employment and labor force participation, enhancing competitiveness, and improving overall business environment and educational outcomes.

Uruguay: Selected Economic Indicators

	2013	2014	2015	2016	2017	Projections 2018	2019	2020	2021	2022	2023
Output, prices, and employment											
Real GDP (percent change)	4.6	3.2	0.4	1.7	2.7	2.1	1.9	3.0	3.0	3.0	3.0
GDP (US$ billions)	57.5	57.2	53.3	52.7	59.2	60.2	60.1	63.4	66.9	70.5	74.5
Unemployment (in percent, eop)	6.5	6.6	7.5	7.9	7.9	8.3	8.7	8.4	7.8	7.6	7.4
Output gap (percent of potential output)	3.3	2.7	0.2	-0.9	-0.8	-0.9	-1.5	-1.2	-0.8	-0.4	-0.1
CPI inflation (in percent, average)	8.6	8.9	8.7	9.6	6.2	7.6	7.5	7.2	7.2	7.0	7.0
CPI inflation (in percent, end of period))	8.5	8.3	9.4	8.1	6.6	7.8	7.5	7.0	7.0	7.0	7.0
Exchange rate (UY$/US$, average)	20.5	23.2	27.3	30.2	28.7	30.7	...	...	...	...	...
Real effective exchange rate (percent change, eop)	7.7	-2.9	1.0	-5.8	5.7	...	...	...	...	...	...
						(Percent change, unless otherwise specified)					
Monetary and banking indicators 1/											
Base money	12.9	1.4	7.2	9.7	3.6	...	...	...	...	...	...
Broader M1 (M1 plus savings deposits)	15.0	3.7	5.6	8.4	15.2	...	...	...	...	...	...
M2	13.7	6.4	9.0	14.4	13.4	...	...	...	...	...	...
Growth of credit to households (in real UY$)	9.9	4.7	6.3	-0.5	2.5	...	...	...	...	...	...
Growth of credit to firms (in US$)	16.2	6.8	2.8	1.5	-4.2	...	...	...	...	...	...
Bank assets (in percent of GDP)	60.8	63.6	72.5	65.5	61.6	...	...	...	...	...	...
Private credit (in percent of GDP) 2/	26.0	27.1	30.2	28.1	26.3	...	...	...	...	...	...
						(Percent of GDP, unless otherwise specified)					
Public sector indicators											
Revenue 3/	29.5	29.1	29.0	29.3	29.9	31.2	31.0	30.7	30.0	29.9	29.7
of which: *cincuentones* transactions	0.0	0.0	0.0	0.0	0.0	1.2	1.1	1.0	0.4	0.2	0.0
Non-interest expenditure 3/	29.1	29.5	28.8	29.9	30.0	30.1	29.9	29.7	29.7	29.7	29.7
Wage bill	4.9	5.0	5.0	5.1	5.2	5.2	5.1	5.1	5.1	5.1	5.1
Primary balance 4/	0.4	-0.6	0.0	-0.5	-0.2	1.2	1.1	0.9	0.2	0.1	-0.1
Primary balance excluding *cincuentones* transactions	0.4	-0.6	0.0	-0.5	-0.2	0.0	0.0	-0.1	-0.2	-0.1	-0.1
Structural primary balance 5/	-0.9	-1.4	-0.6	-0.7	-0.6	-0.1	0.4	0.2	0.0	0.2	-0.1
Interest 4/	2.7	2.8	3.6	3.3	3.3	3.7	3.5	3.2	3.1	3.2	3.2
Overall balance 4/	-2.3	-3.5	-3.6	-3.8	-3.5	-2.5	-2.4	-2.3	-2.9	-3.1	-3.3
Overall balance excluding *cincuentones* transactions	-2.3	-3.5	-3.6	-3.8	-3.5	-3.7	-3.5	-3.3	-3.3	-3.3	-3.3
Gross non-financial public sector debt	43.3	44.8	52.6	51.2	51.8	54.2	54.2	53.3	53.1	53.1	53.0
Gross public sector debt	60.2	61.4	64.6	61.6	65.8	69.6	70.6	70.0	70.2	70.4	70.4
Public sector debt net of liquid financial assets 6/	34.4	35.9	39.7	42.5	43.4	47.7	48.9	48.4	48.4	48.6	48.7
Public sector debt net of total assets	24.2	22.9	25.8	29.9	32.4	35.9	37.3	37.4	37.7	38.1	38.4
External indicators											
Merchandise exports, fob (US$ millions)	13,277	13,769	11,145	10,380	10,779	11,556	12,000	12,723	13,517	14,350	15,298
Merchandise imports, fob (US$ millions)	12,199	11,783	9,838	8,463	8,671	9,108	9,120	9,919	10,875	11,768	12,750
Terms of trade (percent change)	0.2	2.6	1.8	2.3	-1.1	-2.7	1.1	1.0	0.8	1.0	0.7
Current account balance	-3.6	-3.2	-0.9	0.6	0.7	-0.6	-0.6	-1.0	-1.3	-1.6	-1.8
Foreign direct investment	-4.8	-4.4	-1.6	2.1	3.7	0.3	-0.5	-0.6	-0.8	-1.0	-1.2
Total external debt + non-resident deposits	69.0	74.9	89.5	74.4	68.1	67.8	70.2	70.7	71.2	71.5	72.3
Of which: External public debt	31.9	33.7	37.1	31.6	30.4	32.3	32.4	32.8	33.4	33.8	34.6
External debt service (in percent of exports of g&s)	16.6	16.8	30.2	25.7	24.4	20.5	21.7	22.6	22.7	22.7	22.8

Gross official reserves (US$ millions)	16,279	17,574	15,637	13,473	15,939	15,551	15,891	16,521	17,455	18,405	19,355
In months of imports of goods and services	11	13	13	14	16	15	15	14	14	14	13
In percent of:											
Short-term external (STE) debt	181.8	187.2	173.2	194.6	245.6	234.5	240.2	237.5	238.8	239.8	239.7
STE debt plus banks' non-resident deposits	277.9	227.6	220.4	216.6	320.8	294.5	295.2	288.4	289.3	287.7	283.0

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/ Total public sector. Includes the non-financial public sector, local governments, Banco Central del Uruguay, and Banco de Seguros del Estado. Excludes *cincuentones* and transfers from the Energy Stabilization Fund.

6/ Gross debt of the public sector minus liquid financial assets of the public sector. Liquid financial assets arecalculated by deducting from total public sector assets the part of central bank reserves held as a counterpart to required reserves on foreign currency deposits.

INTERNATIONAL MONETARY FUND

URUGUAY

STAFF REPORT FOR THE 2018 ARTICLE IV CONSULTATION

January 29, 2019

KEY ISSUES

Context. Uruguay has preserved macroeconomic stability in the wake of the turbulence in the region thanks to prudent policies and the accumulation of buffers over the years. The Uruguay peso depreciated since April, but the bond spreads have remained stable. Inflation rose above the 7-percent ceiling—due to the drought and the impact of the peso depreciation. The current budget postponed the achievement of the 2.5-percent of GDP deficit target by one year, to 2020, past the mandate of the current government. While an appropriate counter-cyclical response, additional measures will be needed to achieve the target.

Policy recommendations. With the worsening outlook and less friendly external environment, in the near term, policies should focus on maintaining resilience. In this context, additional efforts are needed to put debt on a firm downward trajectory and reduce inflation to within the target band. Given global trends, a flexible exchange rate is a key shock absorber and interventions should be limited to addressing disorderly market conditions. Facing low investment and declining employment, structural reforms are needed to ensure continued income convergence to advanced country levels. These reforms could include further measures to improve educational outcomes, strengthen the business environment and competitiveness, close infrastructure gaps, and address fiscal challenges from aging and already high social security spending, as well as measures to improve fiscal and monetary frameworks.

Past advice. The authorities and staff have remained in broad agreement on the macroeconomic policy objectives, including maintaining public debt on a sustainable trajectory, keeping inflation low, and allowing exchange rate to adjust in line with fundamentals. Fiscal adjustment, however, has not proceeded as quickly as had been originally expected, and inflation has proven difficult to contain within the authorities' target range.

Approved By
Patricia Alonso-Gamo (WHD) and Vikram Haksar (SPR)

Discussions took place in Montevideo during November 28–December 12, 2018. The staff team comprised S. Pelin Berkmen (head), Dmitry Gershenson, Carlos Goncalves, Jorge Restrepo, and Jose Torres (all WHD). Patricia Alonso-Gamo (WHD) joined the concluding meetings, and David Vogel (OED) participated in key meetings. Yehenew Endegnanew (SPR) contributed to the preparatory work, and Luis Omar Herrera Prada and Dan Pan (WHD) provided research assistance. Staff met with Minister of Finance Astori, Minister of Labor Murro, Minister of Transport Rossi, Director of Office of Planning and Budget García, Central Bank President Graña, other senior government officials, as well as representatives of public enterprises, the private sector, unions, civil society, and opposition.

CONTENTS

CONTEXT: RESILIENCE IN THE FACE OF MARKET TURMOIL 4

RECENT DEVELOPMENTS 4

OUTLOOK AND RISKS 8

POLICY DISCUSSIONS 10

A. Maintaining Fiscal Sustainability 10
B. Lowering Inflation 13
C. Maintaining Financial Sector Stability and Enhancing Intermediation 14
D. Enhancing Inclusive Growth and Competitiveness 15

STAFF APPRAISAL 19

BOXES

1. Cincuentones Transaction 6
2. Exchange Rate Intervention in Uruguay 7
3. Population Aging and Pensions in Uruguay 13
4. Pilot for Central Bank Digital Currency (E-Peso) 16
5. Real Exchange Rate and Sectoral Competitiveness 18

FIGURES

1. Real Activity 21
2. Inflation 22
3. External Accounts 23
4. Monetary Policy 24
5. Fiscal Developments 25

6. Global and Argentina Spillovers 26
7. Credit and Banking 27
8. Structural Issues 28

TABLES

1. Selected Financial Soundness Indicators 29
2. Selected Economic Indicators 30
3. Balance of Payments and External Sector Indicators 31
4. Main Fiscal Aggregates 32
5. Public Sector Debt and Assets 33
6. Statement of Operations of the Central Government 34
7. Central Government Stock Positions 35
8. Monetary Survey 36
9. Medium-Term Macroeconomic Framework 37

ANNEXES

I. External Sector Assessment 38
II. Public Sector Debt Sustainability Analysis (DSA) 41
III. External Debt Sustainability Analysis 49

CONTEXT: RESILIENCE IN THE FACE OF MARKET TURMOIL

1. **Uruguay's economy remains resilient, reflecting its strong institutions, prudent policies, and large buffers.** In a deteriorating external environment, Uruguay has successfully differentiated itself from its neighbors, thanks to progress in export market diversification, a prudent and coordinated public-sector asset-liability management, pre-financing of sizeable external financing needs, lower banking sector vulnerabilities, and ample reserves. As a result, public sector borrowing costs have remained subdued despite significant depreciation pressures, and, although growth has slowed, it remains positive.

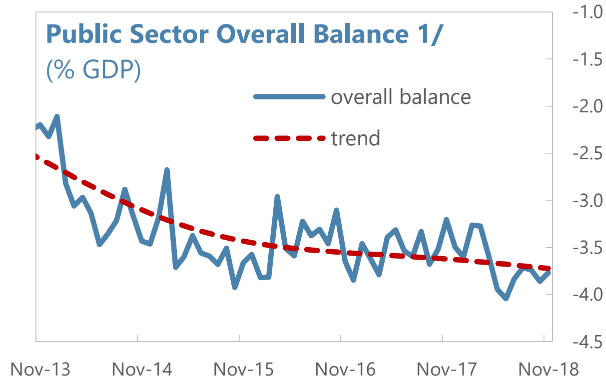
2. **Maintaining this resilience and differentiated status is a priority in the more turbulent regional and global context.** Uruguay is well positioned to weather the worsening external environment. Nevertheless, maintaining its resilience will hinge on the credibility of economic policies. This calls for actions to strengthen the fiscal and monetary anchors by putting debt on a firm downward trajectory and reducing inflation to within the target band. Over the medium term, the authorities should use Uruguay's institutional advantages to improve the fiscal and monetary policy frameworks and implement further structural reforms to support growth and safeguard the social gains of the past decade. Policies should be targeted to improve low investment, address declining employment, and strengthen educational outcomes.

RECENT DEVELOPMENTS

3. **After a strong 2017, growth has moderated.** Economic activity grew by 2.3 percent in the first three quarters of the year, after expanding by 2.7 percent in 2017 (Figure 1)**.** While consumption has continued to support domestic demand, private investment has remained sluggish and net exports turned negative. On the production side, manufacturing activity has remained weak, excluding the impact of the reopening of the oil refinery. Furthermore, a severe drought in the first quarter led to lower yields of summer crops (particularly soybeans). Labor market outcomes are weak, with unemployment fluctuating between 7 and 9 percent.

4. **Inflation has risen above the target range, partly reflecting temporary factors** (Figure 2)**.** In 2017, inflation fell to 6.6 percent, ending up within the central bank's 3-to-7-percent target range for the first time since 2010, due to earlier monetary policy tightening and peso appreciation. However, it has exceeded the target since May 2018 and currently stands at 8 percent reflecting the impact of drought and peso depreciation. With the reduction in monetary indicative references since July, short and medium-term rates have gradually increased but real rates remain lower than the guidance offered by neutral rates (while they can increase further as monetary policy works through its lags) (Figure 4). At the same time, medium-term inflation expectations are somewhat above the target range.

5. **Fiscal deficit reduction has stalled, and the time to reach the target of 2.5 percent of GDP has been extended to 2020** (Figure 5). In 2017, the overall public sector deficit (which includes the central bank interest payments) was 3.5 percent of GDP, an improvement of 0.3 percentage points relative to 2016. The current budget envisages a deficit of 3.3 percent of GDP in 2018 (up from a previous objective of 2.9 percent of GDP) and 2.8 percent of GDP in 2019 (up from 2.5 percent of GDP). If these objectives and the new 2020 target were met, public debt would decline gradually.[1] Although the 12-month rolling fiscal deficit stood at 2.7 percent of GDP in November 2018, it amounted to 3.8 percent of GDP excluding the effects of transactions related to *cincuentones* (see Box 1), suggesting that attainment of the 2018 objective, which does not include these transactions, is difficult.



1/ Excluding transfers from *cincuentones*.

Public Sector Overall Balance (percent of GDP) 1/

	2015	2016	2017	2018 prel. 2/
Public sector	**-3.6**	**-3.8**	**-3.5**	**-3.7**
central government	5.0	4.6	5.7	5.8
social security	-7.8	-8.3	-8.7	-8.8
non-financial public corporations	0.6	0.3	0.0	-0.1
local governments	0.1	0.1	0.1	0.2
public insurance company	-0.1	0.3	0.2	0.3
central bank	-1.4	-0.8	-0.8	-1.1
Memo items:				
spending non-financial public sector	28.8	29.9	30.0	30.1
of which: current spending	26.5	27.4	27.9	27.9

1/ Excluding transfers from *cincuentones*.
2/ Data through November 2018.

6. **The current account has weakened** (Figure 3). The current account has posted surpluses in 2016 and 2017—although recent revisions reduced them—reflecting the record tourism inflows from Argentina, a slowdown in imports associated with weak investment, and a lower oil import bill. The surplus has now turned to deficit (0.4 percent of GDP in the first three quarters of 2018 compared with a yearly surplus of 0.7 percent of GDP in 2017) because of negative investment income, higher oil prices, lower exports to neighboring countries facing difficulties (such as Argentina and Brazil), and lower agricultural exports due to the drought.

[1] The institutional coverage of public debt differs across countries, reflecting country-specific circumstances. Uruguay's public debt refers to the consolidated public sector (as presented in the authorities' budget documentation), which includes Banco Central del Uruguay, the nonfinancial public sector, local governments, and Banco de Seguros del Estado. Uruguay is one of the few countries for which public debt includes the debt of the central bank, which increases recorded public sector gross debt.

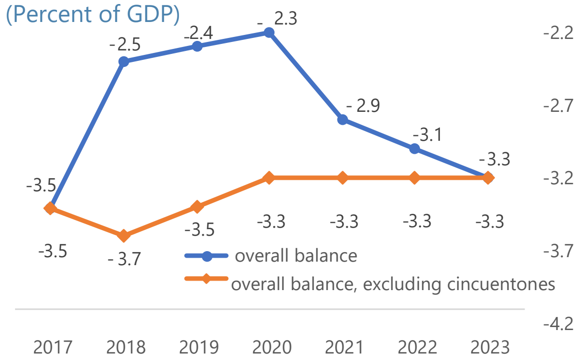
Box 1. *Cincuentones* Transactions

A new law compensates persons affected by the creation of the mixed pension system. Law 16.173 of 1996 required workers to continue paying a basic contribution to the public system, but persons younger than forty years old and with income beyond a certain threshold, were also required to contribute to the newly introduced individually-funded accounts. Past contributions of workers who were forced to affiliate to the new private pillar were not recognized (as this would have created a fiscal problem). These persons have started to retire and, due to the lower years of contributions, their replacement rates are significantly lower than of those who remained in the public system only. To redress the situation, Law 19.590 (approved at end-2017) allows affiliates (both workers and retirees older than 50 years in April 2016, the so-called "*cincuentones*") to revoke their participation and bring their accrued contributions to the public system.

Transactions related to *cincuentones* will improve the fiscal deficit in the near term but are estimated to weaken the government balance sheet after 5 years. In October 2018, the public pension system received a transfer of about 1 percent of GDP in the context of the aforementioned *cincuentones* transactions. These funds are recorded as revenue, consistent with IMF methodology, and thus lower the fiscal deficit. Moreover, this will also lower the stock of public debt but not significantly alter the public financing needs, as the additional revenues were placed in a trust fund ring-fenced for 6 years. Transfers will continue over the next three years, leading to further reductions in the fiscal deficit. These transactions were transparently recorded and communicated by the authorities in the relevant sections of fiscal accounts, and the authorities are presently calculating the resulting changes in the expected pension contributions and expenditures. Authorities estimate that after 5 years this operation will weaken the government's balance sheet since the additional pension liabilities will exceed the additional revenues and that the burden on the public pension system from this operation will be about 4 percent of GDP (in net present value terms over the next 30 years).

Public Sector's Overall Balance

(Percent of GDP)

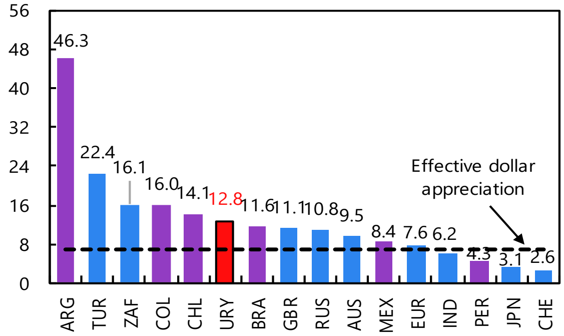


Source: Authorities and IMF staff estimates.

7. **Capital inflows, also affected by the inclusion of the merchanting activities, have been volatile.** More recently, the high-frequency data point to portfolio outflows as seen in many emerging markets. The authorities ably took advantage of favorable financing conditions through mid-2018 by issuing bonds in global markets at long maturities.

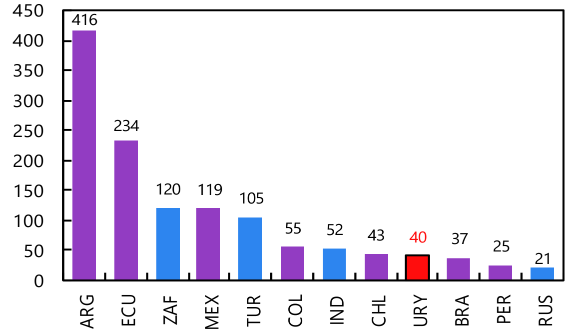
8. **The peso has depreciated by about 13 percent since April, and official foreign exchange reserves have declined.** In response to depreciation pressures, the central bank started to intervene in August. Overall, gross reserves declined from \$17.9 billion to \$15.6 billion, but at about 26 percent of GDP they remain substantially above prudential norms. About \$0.5 billion of this decline reflects repurchases of central bank paper to accommodate a portfolio reallocation by pension funds, in response to non-resident capital outflows, to avoid undue exchange rate volatility (Box 2).

Bilateral Exchange Rate Depreciation, 2018
(Percent depreciation since April 16, 2018; US$/NC)



Sources: Bloomberg Finance L.P.; Thomson Reuters Datastream; and IMF staff calculations.
Note: The US dollar index (BBDXY), which is a measure of the value of the US dollar relative to a basket of US trade partners' currencies, appreciated by 7.0 percent since April 16, 2018.

Increase in Sovereign EMBIG Spreads
(Basis points change since April 16, 2018)

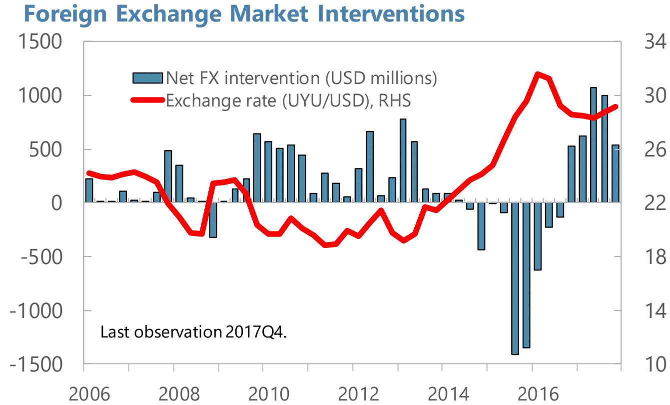


Sources: Thomson Reuters Datastream; and IMF staff

Box 2. Exchange Rate Intervention in Uruguay

Uruguay has intervened in the foreign exchange (FX) market actively since the country moved to a floating exchange rate regime in 2002. In addition to a small wholesale exchange rate market (about 12 percent of GDP), there is a small exchange forward market (about 3 percent of GDP). The central bank has been mainly intervening in the spot market, but it also performs operations in the forward market. In addition to direct market interventions, the central bank accommodates the foreign currency needs of the government (including large state-owned-enterprises) and portfolio shifts of large domestic institutional investors to avoid undue exchange rate volatility in a small FX market (with average daily turnover of about US$25 million). This leads to changes in reserves that overstate the size of direct interventions by the central bank, which is a common phenomenon in the region and in countries with small FX markets.[1]

Foreign Exchange Market Interventions



Sources: BCU and IMF staff estimates.

While the peso has moved broadly in line with global trends, the central bank has been intervening in response to recent large portfolio and capital flow shifts. In 2017, non-resident portfolio inflows and portfolio shifts by domestic pension funds led to upward pressure on the exchange rate. The central bank accommodated these shifts by buying foreign currency in return for central bank paper (sterilized intervention). As a result, both reserves and the volume of outstanding central bank paper increased. With the reversal of capital flows since May 2018, the peso came under depreciation pressure. While the central bank initially let the exchange rate adjust, it started to intervene in late August/early September (mostly in the spot market) as the pressures intensified—the disorderly market conditions index indicates heightened pressures for many countries in the region during that period. At the same time, pension funds decided to step in, in response to non-resident capital outflows, and shifted their portfolios to longer term local currency bonds. To accommodate this shift, the central bank performed a repurchase operation to buy back some of the outstanding central bank paper (with the option of settling in either local currency or U.S. dollars). This resulted in repurchase of the central bank paper (in return of foreign exchange) amounting US$0.5 billion. Overall, gross reserves declined from $17.2 billion in August to $15.6 billion in December.

1/ See Werner, A. Chamon, M., Hofman, D., Magud, N., "Foreign Exchange Interventions in Inflation Targeters in Latin America," *forthcoming*; and Endegnanew, Y., "Effectiveness of Foreign Exchange Intervention in Uruguay," Selected Issues Paper, *forthcoming*.

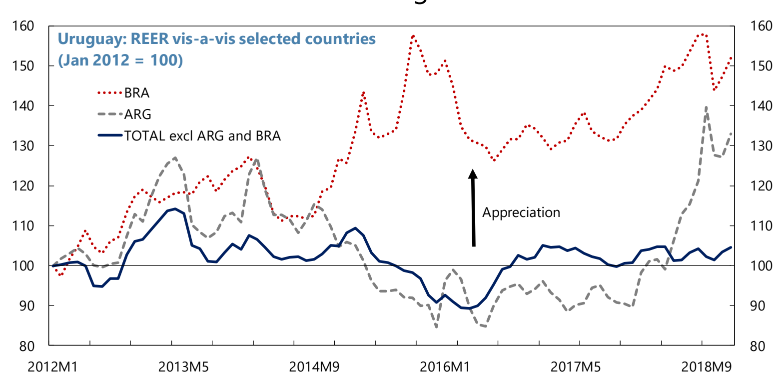
OUTLOOK AND RISKS

9. Uruguay's economy has been decoupling from regional trends (Figure 6). Uruguay's business cycle is less correlated with Argentina than in the past, with smaller direct financial sector linkages and China rising as a key trading partner. Nevertheless, both Argentina and Brazil remain important counterparts, and bilateral trade flows are sensitive to exchange rate movements.

10. The near-term outlook has worsened but remains stable relative to its neighbors. Growth is expected to moderate further to 2.1 percent in 2018 and 1.9 percent in 2019. This reflects (i) a slowdown in consumption due to peso depreciation against the U.S. dollar, and to lower confidence and real wages; and (ii) a weakening of tourism revenue and goods exports in the first half of 2019—due to the expected contraction in Argentina and to the appreciation of Uruguay's currency against its regional partners. At the same time, the expected rebound of agriculture from this year's drought will support growth and exports. Further, private investment, after contracting for four years in a row, is expected to gradually recover. In subsequent years, the economy is expected to grow slightly above potential, gradually closing the output gap. The current account is expected to register a deficit of 0.6 percent of GDP in 2018.

11. In 2019, inflation is expected to moderate but, at 7.5 percent, remain above the central bank's ceiling of the target range, established by the Macroeconomic Policy Coordination Committee. As the pass-through of the depreciation and the impact of the drought wear off, interest rates increase following the recent reductions in monetary indicative references, and the output gap widens, inflation is expected to gradually decline. Many of the ongoing multi-year wage negotiations are closing in line with the guidelines—which continue to eschew indexation and will put nominal wage increases on a declining path—thereby help anchor nontradable prices and temper inflation inertia. However, with medium-term inflation expectations above target, inflation beyond 2019 is projected to stay at 7 percent, the upper limit of the central bank's target range.

12. Staff assesses that the external position is broadly consistent with fundamentals and desirable policy settings (Annex I). Staff estimates that the projected 2018 current account balance—adjusted for the cyclical position and bilateral trade with Argentina—is at its estimated norm. The peso appreciated in real effective terms, by about 5 percent since December 2017, also reflecting about 40-percent appreciation against Argentina. In this context, the EBA-Lite REER model points to an 8 percent overvaluation.



Source: INS and Fund staff calculations

Risk Assessment Matrix			
Sources of Risk	**Likelihood**	**Impact if Realized**	**Policy Response**
Further slowdown in growth in neighboring economies.	**High**	**Medium (↓)** A further slowdown of growth in Argentina and Brazil would adversely affect exports, tourism, and FDI.	• Maintain flexible exchange rate. • Continue efforts to diversify trade.
Sharp tightening of global financial conditions.	**High**	**Medium/High (↓)** • Normalization of U.S. monetary policy could increase borrowing costs for Uruguayan public and private sectors. • A sustained decline in risk appetite for emerging market assets could potentially trigger capital outflows.	• Maintain flexible exchange rate. • Maintain solid macroeconomic fundamentals, including by maintaining monetary and fiscal anchors. • Use liquidity buffers if necessary.
Rising protectionism and retreat from multilateralism.	**High**	**Low/Medium (↓)** Further rounds of sustained trade actions could reduce cross-border trade flows, contribute to negative risks to investment and growth, and trigger market volatility.	• Maintain flexible exchange rate. • Continue efforts to diversify trade.
Significant slowdown in China.	**Low/Medium**	**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.	• Use exchange rate as a shock absorber. • Pass-through declines in oil import prices to households.
Insufficient public and private 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. • Continue efforts to further improve access to finance, business environment, human capital, and diversification.
Sizeable deviations from baseline energy prices.	**Medium**	**Low/Medium** Higher oil prices would raise import and fiscal costs.	• Use the oil price hedges. • Pass through oil price changes to households over the medium term.
Cyber-attacks.	**Medium**	**Medium (↓)** Given the current low level of Fintech activity, financial sector stability threats are limited, but confidence effects could be important.	• Continue efforts to increase cyber-security.
Large infrastructure projects.	**High**	**High (↑)** The realization of the planned paper pulp plant by UPM and other PPP projects, partly financed by FDI, could provide a major lift to investment.	• Save additional tax revenues to build fiscal buffers and finance the associated public investment. • Monitor fiscal risks stemming from PPPs.

13. There are both sizeable downside and upside risks to the outlook, given the more difficult external environment and large infrastructure projects (see the Risk Assessment Matrix). An abrupt tightening in global financial conditions, caused by a sharp increase in international risk premia coupled with a further strengthening of the U.S. dollar, could have negative repercussions for Uruguay's economy. A further slowdown in trading partners could also worsen the growth outlook. At the same time, prudent macroeconomic policies and strong institutions have improved Uruguay's ability to withstand regional shocks, and plans for the construction of a large cellulose plant, an associated railway system, and other infrastructure projects are a major upside risk. Over the medium-term, low investment and declining employment, if not reversed, could lower potential growth.

14. The authorities were broadly in agreement with staff's views. They expected the unfavorable external environment to moderate GDP growth in 2018 and 2019, with a pick-up in investment (also supported by tax incentives introduced in 2018) leading to a more robust recovery in the outer years. The authorities saw the inflation falling to within the target range in 2019, partly driven by a successful round of wage negotiations. Overall, they stressed that Uruguay—with a flexible exchange rate and ample financial buffers—was well positioned to manage external shocks.

POLICY DISCUSSIONS

A. Maintaining Fiscal Sustainability

15. Excluding the impact of the transfers related to *cincuentones*, the authorities' overall fiscal deficit target of 2.5 percent of GDP will be difficult to reach by 2020 without additional measures.[2] The current budget's relaxation is an appropriate counter-cyclical measure, and if these targets are met, debt would decline gradually. Staff projects, however, an overall public-sector deficit (without the *cincuentones* transfers) of 3.7 percent of GDP in 2018. In 2019 and 2020, the deficit is projected to decline by 0.2 percentage points per year due to a reduction in sterilization costs and lower current expenditures in line with the results of the ongoing wage negotiations. Thereafter, the deficit (without *cincuentones*) is projected to remain at 3.3 percent of GDP in the absence of additional measures.

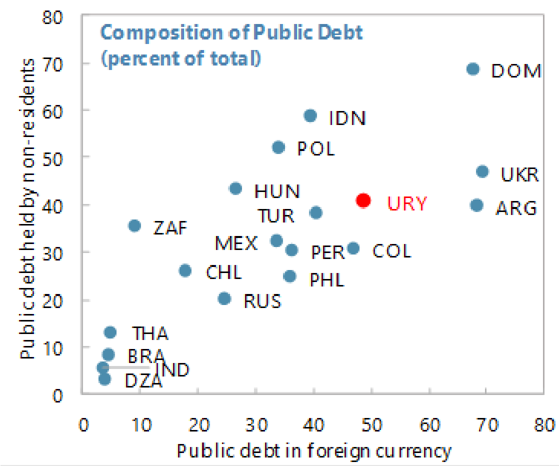
Public Sector Overall Balance (percent of GDP) 1/

	2017	2018	2019	2020
2017 Budget	-3.5	-2.9	-2.5	-2.5
2018 Budget	-3.5	-3.3	-2.8	-2.5
Staff Baseline	-3.5	-3.7	-3.5	-3.3
***with cincuentones**	-3.5	-2.5	-2.4	-2.3

1/ Excluding transfers from *cincuentones*.

[2] Overall fiscal balance includes the central bank interest payments.

16. While next year's gross financing needs are manageable, Uruguay should remain vigilant in the context of increasing global financial market volatility (Annex II)**.** Under the baseline scenario, debt of the non-financial public sector is projected to reach 54 percent of GDP in 2018 and to stabilize at 53 percent thereafter.[3] Large financing needs for 2019 are expected be to comfortably met in the context of coordinated public-sector asset-liability management, stable local currency funding from domestic institutional base (particularly after this year's introduction of wage-indexed bonds), the authorities' pre-financing policy, and sufficient buffers (in the form of nonfinancial-public-sector liquid assets and contingent credit lines).[4] The debt level are below the relevant benchmarks but remain elevated. Uruguay's sovereign risk spreads were not affected by the recent exchange rate volatility episodes, but the fiscal position has worsened since then and, historically, Uruguay has been sensitive to tightening global market conditions. In addition, despite recent improvements, the share of debt in foreign currency held by non-residents remains relatively high, leaving debt vulnerable to exchange rate pressures. As a result, Uruguay's fiscal space—the room for discretionary fiscal policy without endangering the debt sustainability—is at risk.



Source: IMF, *Global Financial Stability Report*, April 2018.

17. To maintain credibility and contain fiscal risks, the authorities need to introduce measures to put public debt on a firm downward path. Delivering on the budgetary targets would reduce debt of the non-financial public sector to 49 percent of GDP in 5 years and would lower it to the average level of 2012-14 (about 44 percent of GDP) in 10 years. However, this would require 0.8 percentage points of GDP in measures until 2020 (a total adjustment of 1.2 percent of GDP) during a period of an economic slowdown and elections, which could be hard to achieve. In this context, the authorities should introduce measures of at least 0.3 pe GDP in 2019 (amounting to a 0.5 percent-of-GDP of total adjustment in 2019), which would help put debt on a downward path, thereby reinforcing commitment to fiscal sustainability. Beyond 2019, bringing debt to 2012–14 levels in a 5-year period would require additional adjustments (of about 0.6 percent of GDP annually).

[3] This incorporates impact of the *cincuentones* transactions, which will reduce the debt for the next four years (as transferred assets are mostly government debt) but increase it thereafter. In addition, the IMF and the authorities use different methodologies to calculate debt-to-GDP ratios. The IMF uses local currency for both GDP and debt (the latter converted to pesos at end-period exchange rate), while the authorities use the GDP in U.S. dollars (converted at average exchange rate) and the stock of debt in U.S. dollars. The authorities project the nonfinancial public-sector debt at 51 percent of GDP in 2018.

[4] The nonfinancial-public-sector liquid assets (5 percent of GDP) and contingent credit lines (4 percent of GDP) are sufficient to cover the projected gross financing need of the nonfinancial public sector (6 percent of GDP) in 2019.

(continued)

18. Fiscal adjustment should come from reducing the elevated level of current expenditures. This would allow to contain the impact of fiscal adjustment on growth.[5] In addition, the utility tariffs should be adjusted in line with the cost structure and investment needs of public enterprises. In the medium term, further improvements in the efficiency of social spending will also be required to create space for the needed increase in capital spending.

19. Looking ahead, introducing a medium-term fiscal framework supported by a binding fiscal rule would help engrain fiscal anchor and sustainability. Under the current approach, each government outlines budgetary priorities for a fixed duration of its five-year term, leading to a lack of continuity and attendant uncertainty towards the end of the period, as the budgetary horizon shrinks. A medium-term fiscal framework would help strengthen multi-year fiscal discipline and achieve policy objectives with a more efficient use of limited resources. Even though the existing fiscal rule limits the annual increase in net debt, it has not been binding due to the use of escape clauses. An enhanced fiscal rule could include further safeguards that limit the frequent use of escape clauses, focus on the nonfinancial public-sector balance to avoid volatility associated with the liquidity management operations of the central bank, and be anchored on a medium-term debt objective.

20. Other medium-term fiscal priorities include addressing growing pension spending and maintaining the financial health of public enterprises. First, pension spending is high by regional standards, reflecting an aging society, the welcome almost universal coverage, and constitutionally mandated wage indexation. Reforms are needed to provide adequate pensions and maintain coverage for future generations, while ensuring the sustainability of the system (Box 3). Second, continued improvements in the management and profitability of public enterprises—an important component of the economy—are essential to strengthening the country's fiscal position. In this context, ongoing efforts to enhance the governance structure, risk-management practices, and the monitoring of their performance in a more consolidated manner are welcome.

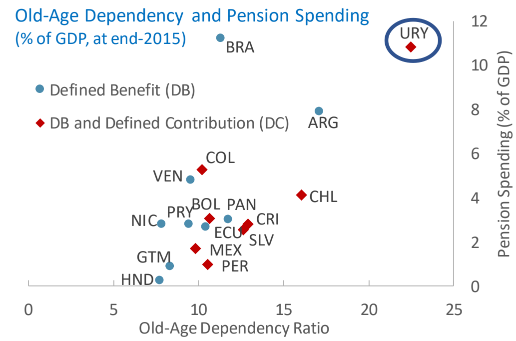
21. The authorities reaffirmed their commitment to fiscal sustainability and concurred with the need to enhance the governance of SOEs and improve the existing fiscal rule. They are working on possible measures to improve the fiscal outlook and achieve the 2.5-percent deficit (excluding *cincuentones*) targeted in 2020. The authorities were in agreement with staff's assessment on the need to improve the governance of SOEs and noted that they would propose legislation to professionalize the boards of public companies and limit the revolving door between SOEs and the private sector. The authorities emphasized the importance of flexibility for the fiscal rules but agreed that there was a need to establish tighter definitions of what constitutes an acceptable trigger for an escape clause. They also concurred with the need for a comprehensive reform of the social security system and highlighted the growing consensus on the need for such reforms.

---

[5] See *IMF Country Report 18/24*.

Box 3. Population Aging and Pensions in Uruguay[1]

Uruguay's public pension system has been a pillar of its modern welfare state. The system is one of the oldest in Latin America. The solidarity pillar evolved into a mixed system in 1996. In addition, there are separate special regimes, for banking employees, university professionals, public notaries, the military and the police. The system also includes a noncontributory elderly and disability pensions. Workers' contributions only partially finance the system. With almost universal coverage, the system has supported social cohesion.



Note: For Uruguay it includes special pension regimes.

At the same time, public pension expenditures are high compared to other countries. Uruguay has one of the oldest populations in Latin America. Together with the relatively high coverage, public pension expenditures as a share of GDP are higher (about 11 percent of GDP at end 2018) than in many other emerging and Latin American countries (of which about 3 corresponds to the special regimes). More broadly, Uruguay's social spending amounts to 25 percent of GDP—with 6.5 percent on health and 5 percent on education.

Population aging is expected to raise pension and more broadly age-related spending over the coming decades, weighing on fiscal sustainability in the long term. Focusing on solidarity and defined benefit pillars, Uruguay's pension spending (as a share of GDP) will exceed that of advanced economies by 2065. Spending increases of the special regimes and transactions related to "*cincuentones*" (Box 1) will further add to the medium-term spending pressures, which will limit critical spending in other areas (e.g. infrastructure) and weigh on fiscal sustainability in the absence of reforms.

Pension reform is needed to perpetuate achievements in living standards and ensure fiscal sustainability. In addition to the shift into a mixed system in 1996, reforms were undertaken for the police and military schemes in 2008 and 2018 respectively, but the fiscal impact of these reforms is limited. In the presence of population aging, additional reforms are needed to provide adequate pensions and maintain coverage for future generations, while ensuring the sustainability of the system. Such reform should encompass a comprehensive review of the entire system and an informed social dialogue. Early action will help smooth the transition to a revised system and reduce costs compared to a delayed response when aging pressures become more acute. Reforms will also be necessary to counter rising health care costs.

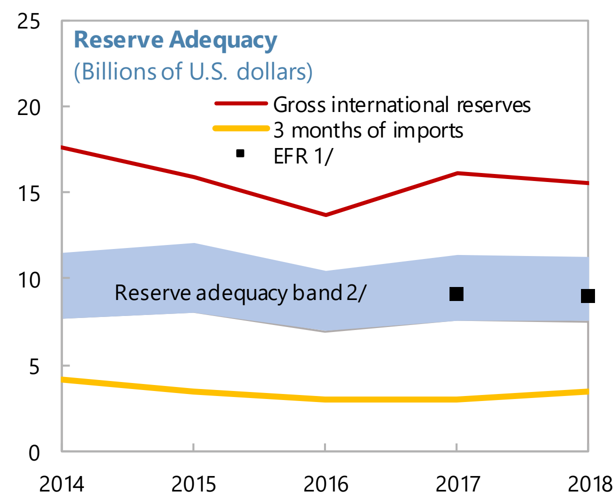
[1] This box is based on two earlier studies on pensions. For a detailed analysis of the pension system and regional comparison please see IMF Country Report No. 17/29 and SDN 18/05.

B. Lowering Inflation

22. Bringing inflation close to the middle of the central bank's 3-to-7 percent target range is important to anchor expectations. With medium-term inflation expectations above the target range, a further depreciation of the peso in the presence of remaining widespread indexation could render convergence to the target range more difficult. After the most recent reduction in the monetary indicative references at end-December, nominal interest rates have remained broadly constant at around 8 percent for the 1-month rate and at around 10 percent for the 1-year rate. As the monetary policy works through its lags, monetary indicative references should continue to be adjusted until the short- and medium-term real rates increase further to within the range of estimated real neutral rates (2-3 percent as of 2018Q4), and medium-term inflation expectations (currently at 7.5 percent) move towards the middle of the target range (5 percent).

23. In a longer-term perspective, the central bank is encouraged to further strengthen its monetary policy framework. Conducting monetary policy is challenging in the presence of a high dollarization, low credit-to-GDP ratios, and remaining wage indexation. Short-term interest rates remain volatile (due to movements in money demand), inflation expectations track actual inflation, and, in the past, inflation has persistently remained above the target range. In this context, further improvements could focus on strategies, instruments, and communication practices to enhance the commitment to achieve targets, thereby better anchoring inflation expectations. Ongoing discussions at the central bank on further enhancing communication strategies and reducing dollarization could be part of a review.

24. The exchange rate should remain the key shock absorber. Given global trends and potentially weaker capital flows to emerging markets, the peso should continue to adjust in line with fundamentals. Interventions should be reserved for addressing disorderly market conditions, and reserve buffers should be kept above or in line with prudential norms.[6]



Source: Banco Central de Uruguay (BCU), and Fund staff calculations.
1/ External Financing Requirement.
2/ The band spans 100 to 150 percent of the Fund's reserve adequacy metric.

25. The authorities reaffirmed their commitment to bringing inflation to within the central bank's target range. They noted an important role played by one-off factors (drought and peso depreciation) in pushing inflation outside the range and, looking forward, stressed the moderating influence of the new round of wage agreements on inflation and inflation expectations. Accordingly, the authorities considered the monetary policy stance to be adequate and the level of real interest rates– appropriate. In particular, they were mindful of the growth impact and excessive capital inflows in case interest rates become too high. Finally, the authorities confirmed the importance of maintaining a flexible exchange rate while avoiding its undue volatility.

C. Maintaining Financial Sector Stability and Enhancing Intermediation

26. The financial sector has fared well, but authorities should continue monitoring the quality of banks' assets closely (Figure 7). Despite the regional market turmoil, the financial sector has remained resilient, reflecting limited linkages to Argentina and enhanced supervision

[6] Gross reserves (26 percent of GDP) are substantially above the external financing requirement of about 16 percent in 2019. In addition, the ratio of gross reserves to the ARA metric is 180 percent.

since the 2002 crisis. With the improvements in regulatory capital to risk-weighted assets ratio and bank profits, the banking sector has comfortable buffers. Given exchange rate volatility and high dollarization, supervision should continue to closely monitor banks' exposures. In addition, the share of nonperforming loans has risen, and, while still manageable, needs to be monitored. In this regard, the recent adoption of the regulations on net stable funding ratio—requiring that the liquidity profiles of banks' assets and liabilities be aligned—is welcome.

27. The authorities are trying to boost financial inclusion, including by leveraging advances in financial sector technology (Fintech). Extensive dollarization and market segmentation limit bank credit and make it expensive, especially in the peso market (Figure 4). To improve financial inclusion, the authorities have been implementing measures that aim at promoting electronic transactions and competition in the banking sector (under the 2014 Financial Inclusion Law). Since the introduction of the Law, low-income households and small and micro enterprises have access to free bank accounts and debit cards. Even though peer-to-peer lending remains small, the authorities have introduced regulation in this area aimed at protecting consumers and guarding against money laundering. More broadly, the authorities' efforts to improve financial inclusion, innovation, and intermediation, while limiting risks—including a successful e-peso pilot—are welcome (Box 4).

28. The authorities stressed that the financial system is stable and profitable. While agreeing that NPLs call for monitoring, they noted that the increase in NPLs has largely been due to the drought and the economic slowdown and that the banks have right safeguards and sufficient buffers in place to address this issue. The authorities welcomed the development of Fintech as long as their concerns regarding consumer protection and preventing money laundering were addressed.

D. Enhancing Inclusive Growth and Competitiveness

29. Building on Uruguay's institutional strength, reaching the goal of continued income convergence to advanced economy levels needs further action. Uruguay has been one of the most stable countries in the region, with low income inequality and poverty (Figure 8). However, facing low investment and declining employment, there is consensus across the political spectrum that further efforts are needed to ensure continued income convergence. These could include creating fiscal space to close infrastructure gaps and reforming the education sector to enhance human capital. In addition, private investment can be supported by improving access to finance and the business environment. Furthermore, a more flexible labor market and real wage increases aligned with productivity increases would both ensure employment resilience to changes in business conditions and support private investment. These policies will also help enhance Uruguay's competitiveness.

Box 4. Pilot for Central Bank Digital Currency (E-Peso)

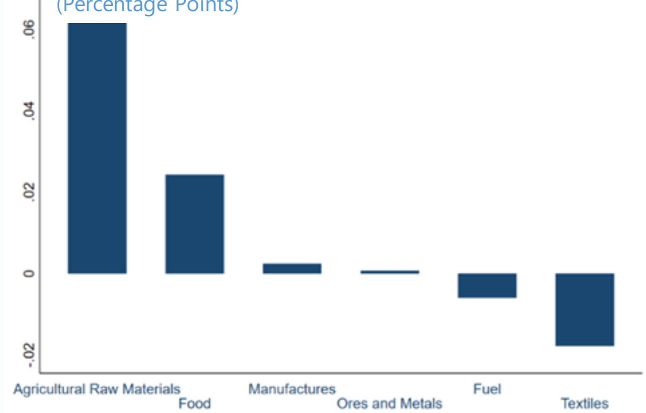
The Central Bank of Uruguay implemented a successful pilot program on Central Bank Digital Currency (CBDC). E-peso is a legal tender digital currency issued by the central bank. It is an electronic money and does not use distributed ledger technology. The pilot program was used to test the technical aspects and run for 6 months (November 2017-April 2018), with limited bill issuance ($20 million for 10000 mobile users) and size per person ($30,000 per wallet and $200,000 for registered businesses). E-peso was mainly used for payment transactions in registered stores and businesses, and peer-to-peer transfers. The system used instantaneous settlement and run through mobile line (no internet connection was needed). E-peso was anonyms but traceable, with unique bills preventing double spending and falsification.

E-peso is expected to reduce transaction costs, encourage financial innovation, and increase financial inclusion. The world is increasingly digitalized which provides both opportunities and challenges. The central bank of Uruguay is one of the pioneers in world in taking a proactive approach in evaluating the case for the CBDC (IMF SDN No. 18/08, 2018). In this context, the central bank aims at reducing transaction costs of cash (estimated at 0.6 percent of GDP), improve financial innovation by creating a supportive regulatory environment and infrastructure, and fostering financial inclusion by reaching out to nonbanked segments of the society through mobile networks.

Further analysis is needed to analyze the impact on monetary policy transmission, the banking system, and dollarization. The consequences of the introduction of the CBDC on payment systems, financial intermediation, the conduct of monetary policy, and financial integrity will hinge on its design and on country-specific characteristics. In this context, the central bank's research agenda will focus on analyzing implications of Fintech on payment systems and traditional banking systems. Broader considerations could include the following. First, e-peso has the potential to enhance the transmission mechanism as it provides a more systematic and transparent information on money demand in real time (given Uruguay's monetary targeting framework). Second, as the banks did not participate in the pilot, it is difficult to analyze the impact on the banking system. To the extent that e-Peso encourages innovation and competition, in the new equilibrium, interest rates could decline, improving financial intermediation and inclusion. At the same time, if e-peso becomes a substitute for bank deposits, it can lead to an increase in the funding costs of the banks, leading to an increase in the equilibrium interest rates. Third, improved information can help improve financial integrity by preventing tax evasion and money laundry. Finally, the impact on dollarization and exchange rate channels are likely to be minor as the demand for domestic and foreign assets are determined by other fundamental/external factors such as credibility and global financial conditions.

30. Uruguay has successfully diversified its export products and destinations and raised its global market share in many products. However, some manufacturing sectors lost market share and are sensitive to exchange rate movements (Box 5). Therefore, continued efforts are needed to improve competitiveness, to further diversify export products (including towards non-commodity sectors to limit exposure to commodity price swings and supply shocks), and to improve market access through multilateral and bilateral free trade agreements.

Difference in Global Market Shares Between 2004-2006 and 2013-2015, by Sector
(Percentage Points)



Sources: Comtrade and IMF staff estimates.

31. The authorities are continuing appropriate efforts to improve data. In 2017, the Banco Central de Uruguay released a new version of Balance of Payments and International Investment Position data, in line with the principles of the sixth edition of the Balance of Payments Manual. The authorities are also updating the base year of the national accounts series and aim to implement the 2008 System of National Accounts in 2020. The authorities could also consider updating the national account weights every 5 years or switching from a fixed-base year to chain-linking in line with international best practices.

32. The authorities agreed that infrastructure investment and structural reforms were needed to achieve their developmental objectives. They highlighted low investment and declining employment as key issues to tackle. In this context, they pointed to several projects, including the railway, being financed through public-private partnerships. They also noted the importance of ensuring that the education system produces graduates able to tackle the challenges of the technology-driven labor market. In addition, the authorities stressed the need for Uruguay to expand access to global markets by way of mutually beneficial trade agreements.

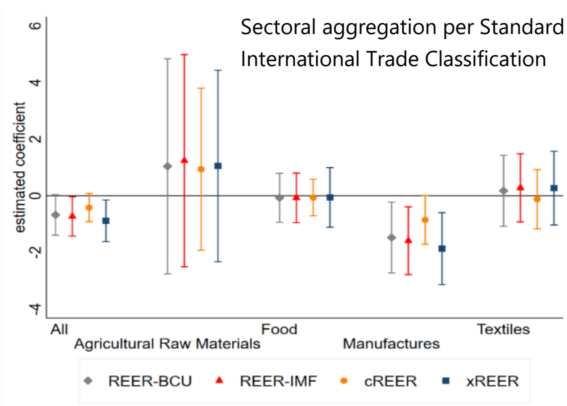
Box 5. Real Exchange Rate and Sectoral Competitiveness[1]

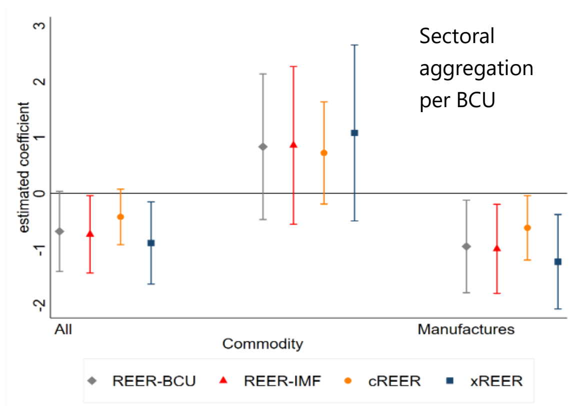
Maintaining sectoral competitiveness is important for supporting growth in the medium-term. In recent years, the share of exports in GDP remained broadly the same, and the country was able to export to new markets. At the same time, the real effective exchange rate has appreciated, and the composition of exports shifted towards primary sectors at the expense of manufacturing products. To better understand the sectoral trends and analyze the impact of the real exchange rate changes on sectoral exports, the detailed product data from the United Nations Commodity Trade Statistics Database (Comtrade) are used.

Across the product space, Uruguay both gained and lost global market shares. Aggregating the products by sectoral groups shows that while the market share of agricultural raw materials and food products has increased, textiles posted declines. Looking at the individual products that posted the largest market share gains and losses, while Uruguay has gained global market share in some primary sectors (such as soybeans), it has lost its share in sectors such as textile and leather products.

Uruguay's manufacturing exports are sensitive to the changes in REER, while exports of commodities and primary activities are not.[2] Additionally, textiles are not found to respond to changes in REER, suggesting that other factors might have been behind the significant loss of market share for that product group. The results are confirmed for four different measures of REER and for two different sectoral aggregations. These results suggest that, keeping other factors constant, a sustained real effective appreciation could reduce manufacturing exports more than exports by other sectors.

Global Market Share Elasticities: Point Estimates and 90-percent Confidence Intervals 1/





Sources: Comtrade, *Banco Central del Uruguay*, and IMF staff calculations.
1/ Estimated for four different measures of REER: (i) export-destination-weighted (xREER); (ii) competitor-weighted (cREER), (iii) combined (REER-IMF); and (iv) calculated by the *Banco Central del Uruguay* (REER-BCU).

---

[1] Based on Gershenson, D., Goncalves, C., and L. Herrera Prada, "Real Exchange Rate and Sectoral Competitiveness in Uruguay," Selected Issues Paper, *forthcoming*.
[2] To estimate relevant elasticities, we model the change in global market shares (a proxy for competitiveness) as a function of the change in REER.

STAFF APPRAISAL

33. Uruguay weathered the turbulence of 2018 well. Over the previous decade and a half, prudent macroeconomic policies combined with diversification of export markets, significant progress in improving banking sector stability, and astute management of assets and liabilities of the public sector allowed the country to reduce vulnerabilities and accumulate sizeable buffers. As a result, Uruguay emerged from the regional market turmoil relatively unscathed, with positive GDP growth and stable borrowing costs. Staff assesses that the external position is broadly consistent with fundamentals and desirable policy settings.

34. Maintaining Uruguay's differentiated status in the region will be key. While the postponement of the fiscal deficit target of 2.5 percent of GDP from 2019 to 2020 is appropriate in the face of the worsening outlook, the new target lies beyond the mandate of the current government and is not accompanied by adequate fiscal measures to achieve it, particularly given the optimistic growth assumptions based on the economic outlook in mid-2018.[7] Introducing additional measures of at least 0.3 percent of GDP in 2019 would be an important step in reinforcing Uruguay's commitment to fiscal sustainability. Over a longer horizon, developing a medium-term fiscal framework that focuses on the nonfinancial public sector and is supported by a binding fiscal rule will be a vital part of that effort. In this context, the new government (following the 2019 elections) will have the challenging task of reducing the elevated level of current expenditure while further improving its efficiency, continuing with the fiscal adjustment to put debt on firm downward path, and ensuring viability of the country's well-developed pension system.

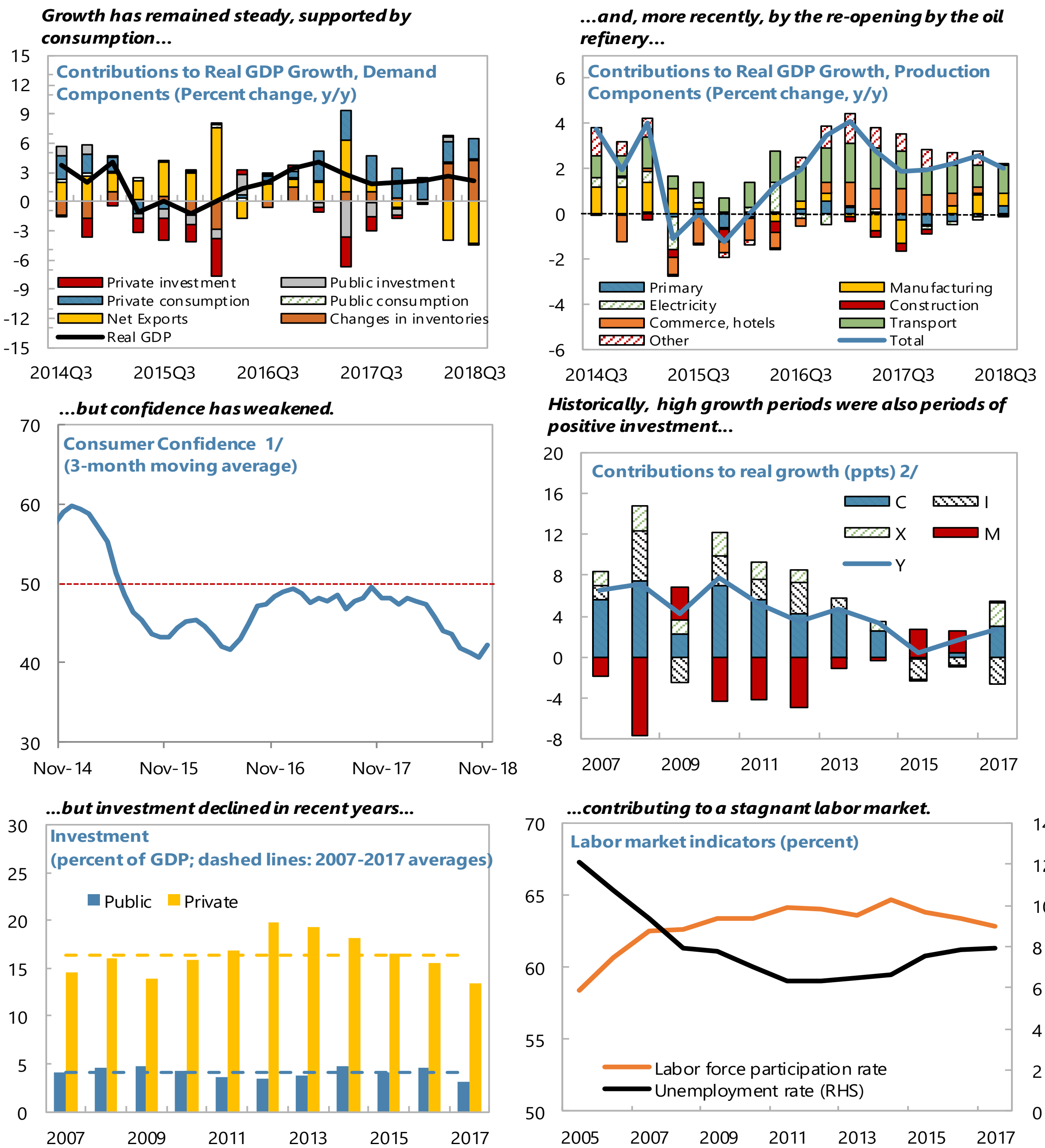
35. Keeping inflation close to the center of the target range is important to create buffers against temporary shocks and to anchor inflation expectations. In Uruguay, a high degree of dollarization, limited banking intermediation, and the remaining wage indexation render the monetary policy transmission mechanism weak. Still, monetary policy should ensure that inflation expectations (presently at around 7.5 percent) and inflation are at the center of the central bank's 3-to-7-percent target range. In a longer-term perspective, a better anchoring of inflation expectations will help create monetary policy space to implement counter-cyclical policies more effectively. In this context, the central bank can further strengthen the monetary policy framework with a view of enhancing its commitment to keeping inflation within the range. The authorities deserve full credit for their effort to expand the reach of the financial system while ensuring that it remains resilient in the face of regional shocks.

[7] The macroeconomic framework underpinning the current budget was prepared before the regional market turmoil was fully in effect (in May/June 2018) and therefore assumed the real GDP growth of 2.5 percent in 2018 and 3.3 percent in 2019, above the staff's current forecast of 2.1 and 1.9 percent, respectively.

36. Uruguay is well positioned to leverage its institutional strength to enhance inclusive growth and competitiveness. To ensure continued income convergence to advanced country levels, reforms are needed to increase investment, employment and labor force participation, and improve overall business environment and educational outcomes. Even though Uruguay's overall external position is assessed to be broadly consistent with fundamentals, further efforts are needed—in the context of moving the country to a higher growth trajectory—to maintain competitiveness and market access, particularly in the presence of sustained real appreciation.

37. Staff proposes that the next Article IV consultation with Uruguay take place on the standard 12-month cycle.

Figure 1. Uruguay: Real Activity

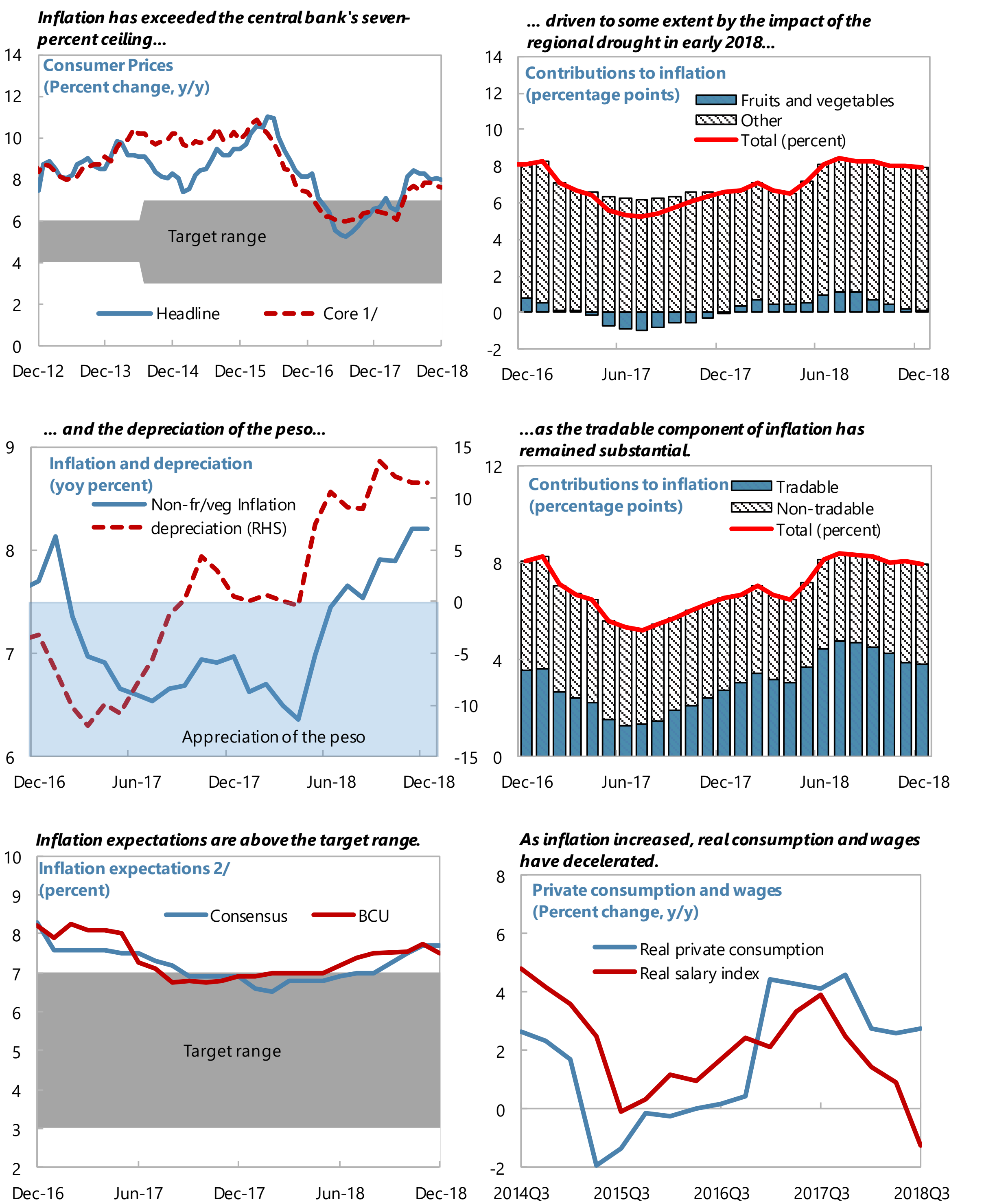


Source: World Economic Outlook, Haver Analytics, *Banco Central del Uruguay* (BCU), *Instituto Nacional de Estadística*, Bloomberg L.P., and Fund staff estimates and calculations.

1/ Values above 50 indicate that positive responses outnumber negative responses.

2/ Components of real growth (**Y**) are: **C**onsumption, **I**nvestment, e**X**ports, and i**M**ports.

Figure 2. Uruguay: Inflation



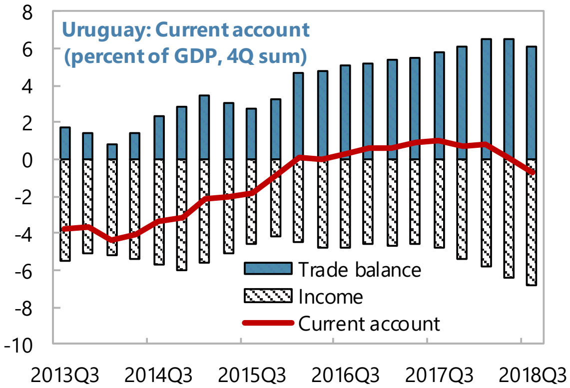
Source: World Economic Outlook, Haver Analytics *Banco Central del Uruguay* (BCU), *Instituto Nacional de Estadística*, Bloomberg L.P., and Fund staff estimates and calculations.

1/ The definition of core inflation follows BCU's definition and excludes administered prices, fruits and vegetables, and tobacco.

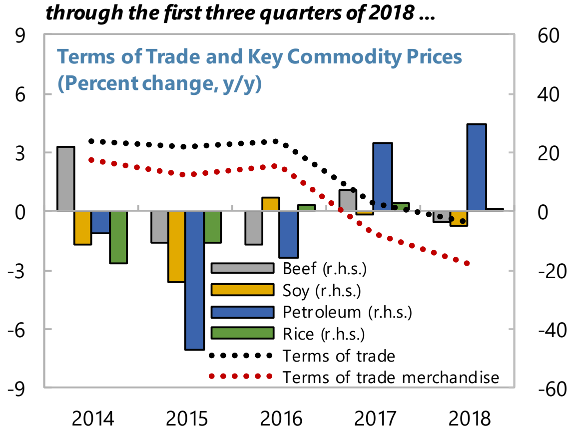
2/ Consensus:12 months ahead. BCU: median of expected inflation for the 24 months ahead.

Figure 3. Uruguay: External Accounts

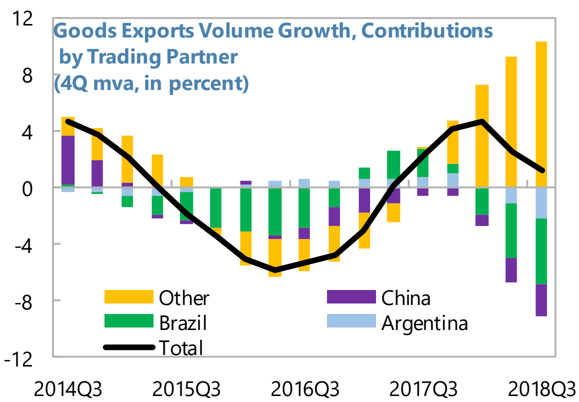
The current account surplus turned to a deficit due to a declining income balance...



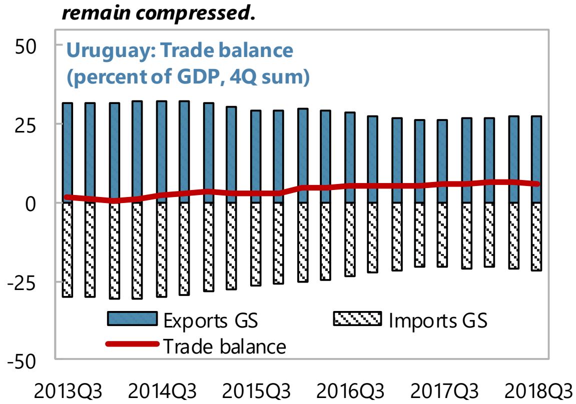
...worsening terms of trade, given higher oil prices through the first three quarters of 2018 ...



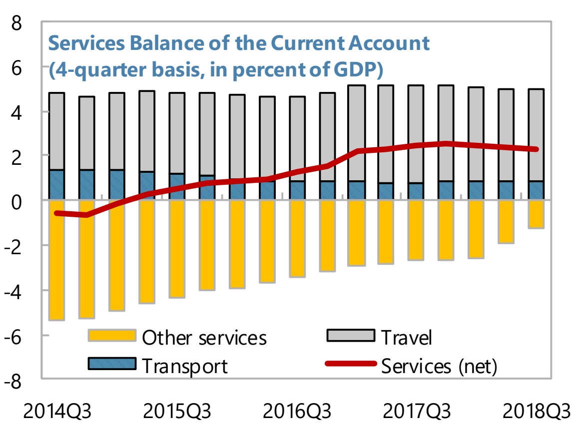
...and declining goods exports to Argentina, Brazil and China.



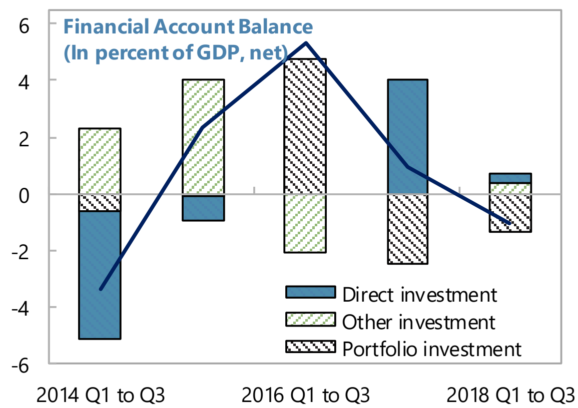
However, the trade balance has remained positive, since imports of capital and intermediate goods remain compressed.



The net services balance was also positive.

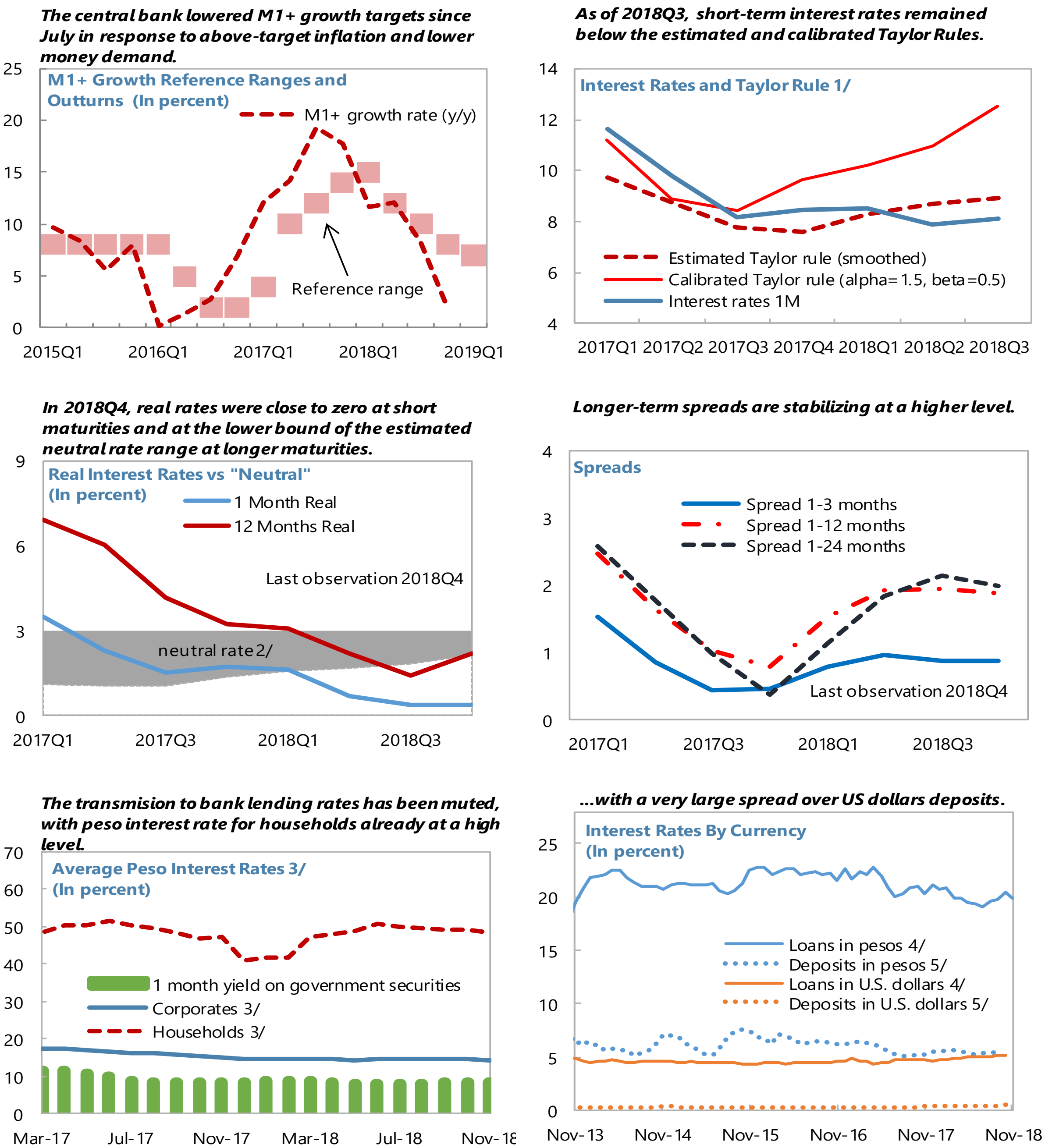


Capital flows have been volatile.



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

Figure 4. Uruguay: Monetary Policy



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

1/ The estimated Taylor Rule specification regresses short term interest rates on a measure of output gap (HP filter), inflation and lagged interest rates (hence the smoothing). Algebraically: $i_t=c+\rho i_t(t-1)+\beta\pi_t+\gamma h_t+\varepsilon_t$. We use data from 2007Q1 to 2018Q3. The calibrated model uses the mid-point of the inflation target of 5 percent.

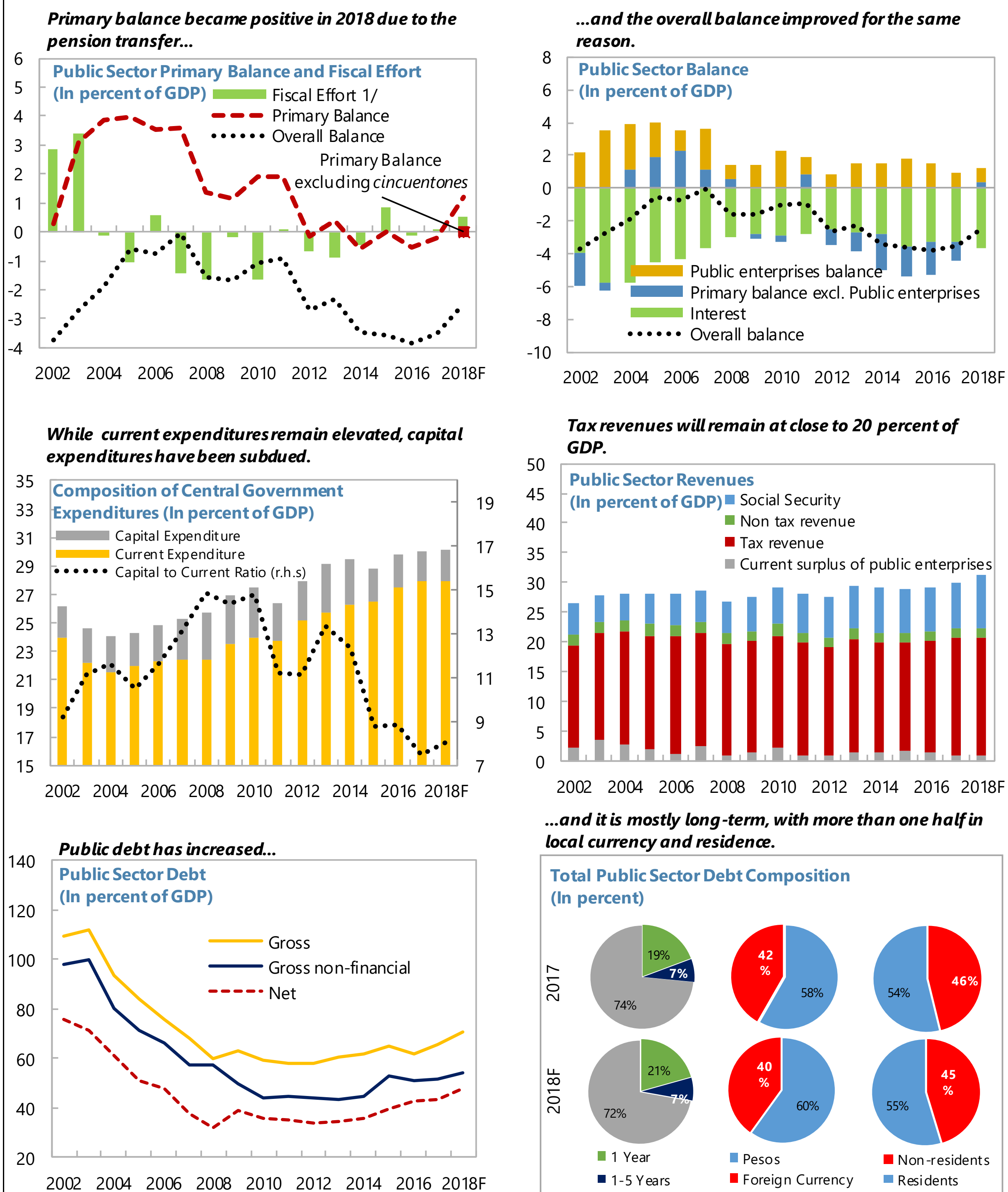
2/ Lower range of the neutral rate is the US interest rate plus the risk premium, upper range is the potential output. The estimated neutral range for the one-year horizon is around 3 percent.

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

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

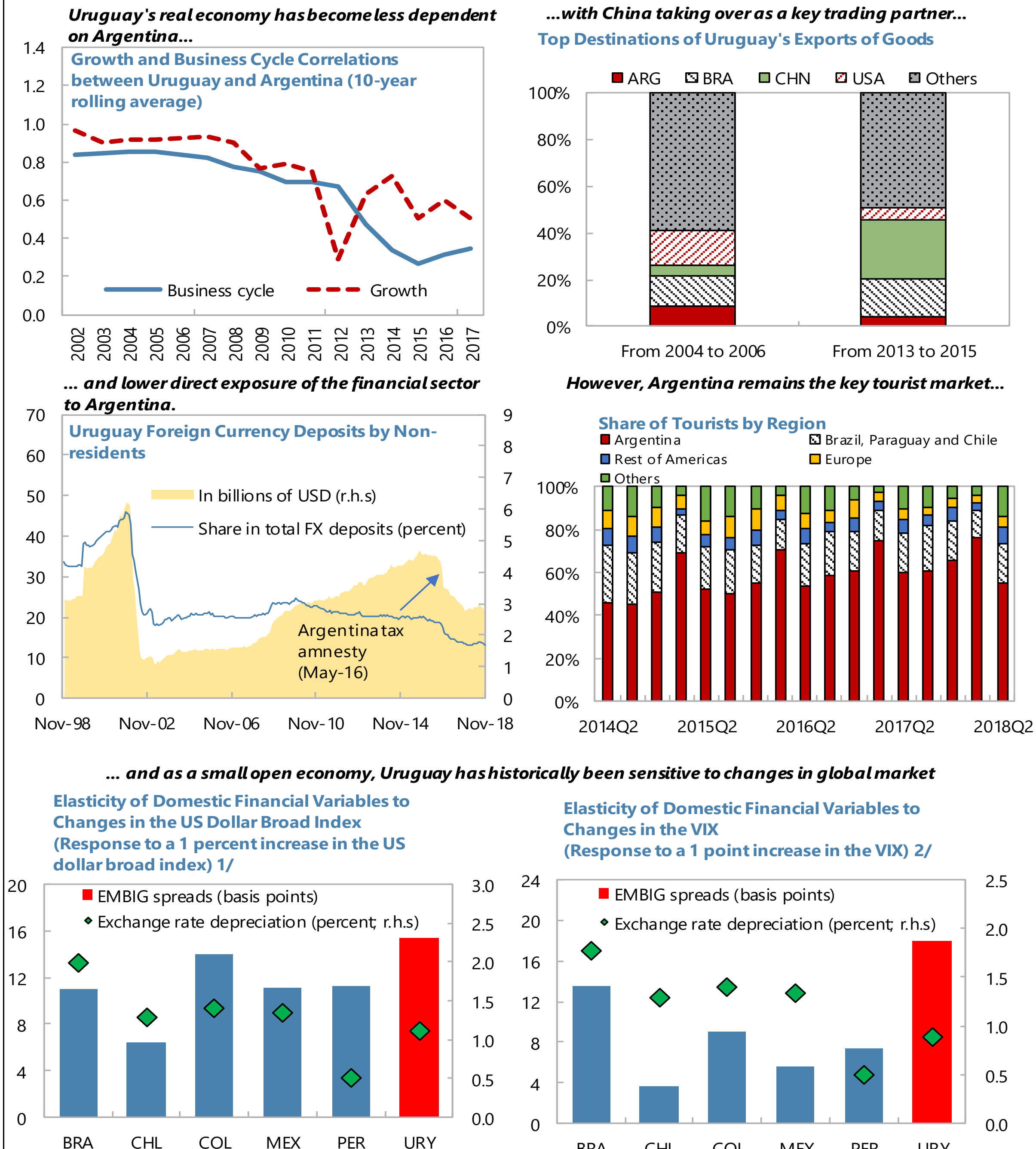
5/ Weighted average rate on totality of fixed term deposits.

Figure 5. Uruguay: Fiscal Developments



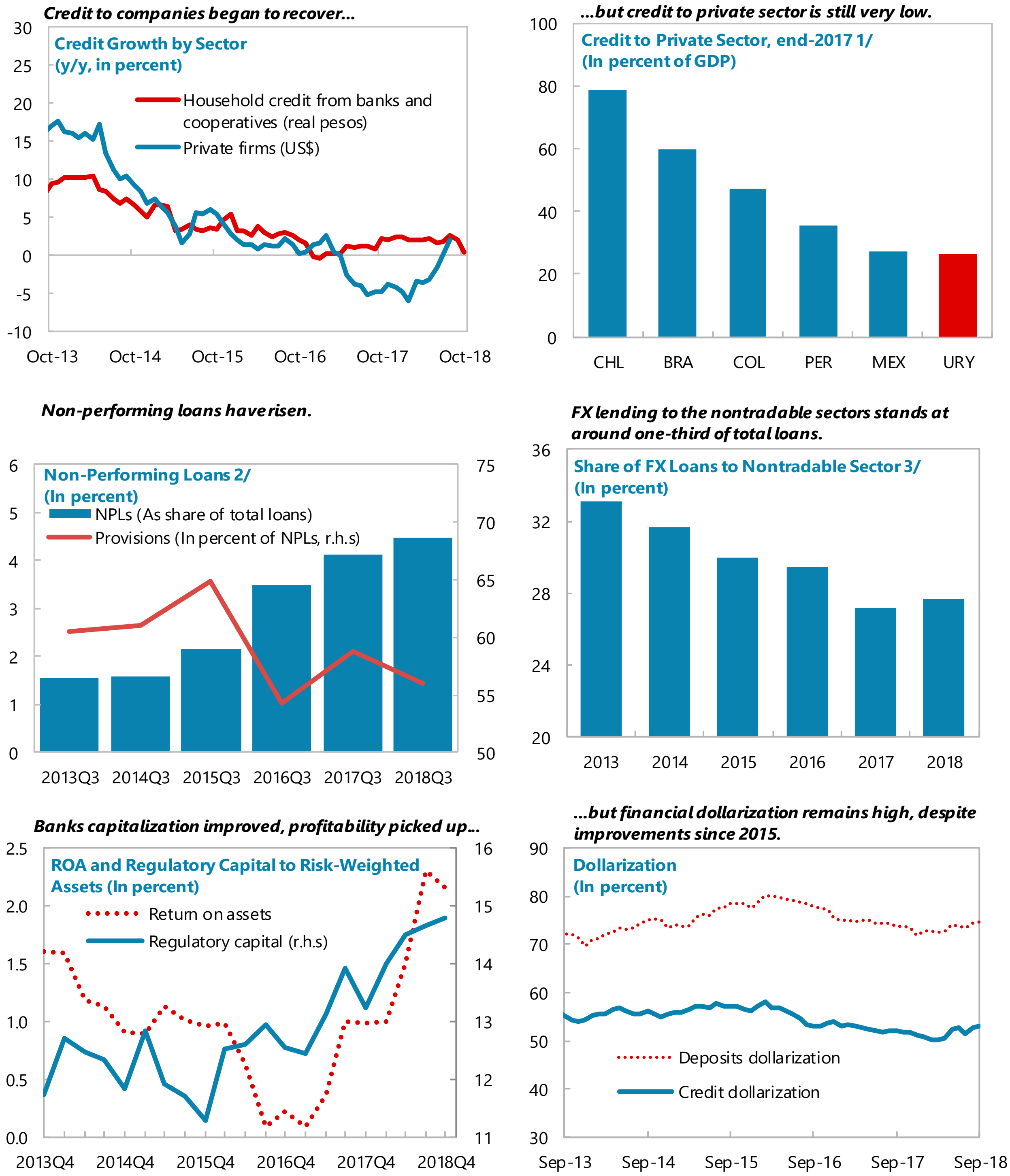
Sources: *World Economic Outlook, Banco Central del Uruguay*, Haver Analytics, and Fund staff calculations.
1 / Fiscal effort is defined as the change in the Structural Primary Balance.

Figure 6. Uruguay: Global and Argentina Spillovers



Sources: IMF, *World Economic Outlook*; *Banco Central del Uruguay*; Bloomberg; Thomson Reuters Datastream; and IMF staff estimates and calculations; October 2018 *Regional Economic Outlook* (REO): Western Hemisphere.
1/ Cumulative impulse response functions after three months to a 1 percent increase in the US dollar broad index. Data labels use International Organization for Standardization (ISO) country codes. EMBIG = J.P. Morgan Emerging Market Bond Index Global (US-dollar-denominated sovereign bonds). See the October 2018 WHD REO.
2/ Cumulative impulse response functions after three months to a 1 basis point increase in the VIX. Data labels use International Organization for Standardization (ISO) country codes. EMBIG = J.P. Morgan Emerging Market Bond Index Global (US-dollar-denominated sovereign bonds); VIX = Chicago Board Options Exchange Volatility Index. See the October 2018 WHD REO.

Figure 7. Uruguay: Credit and Banking



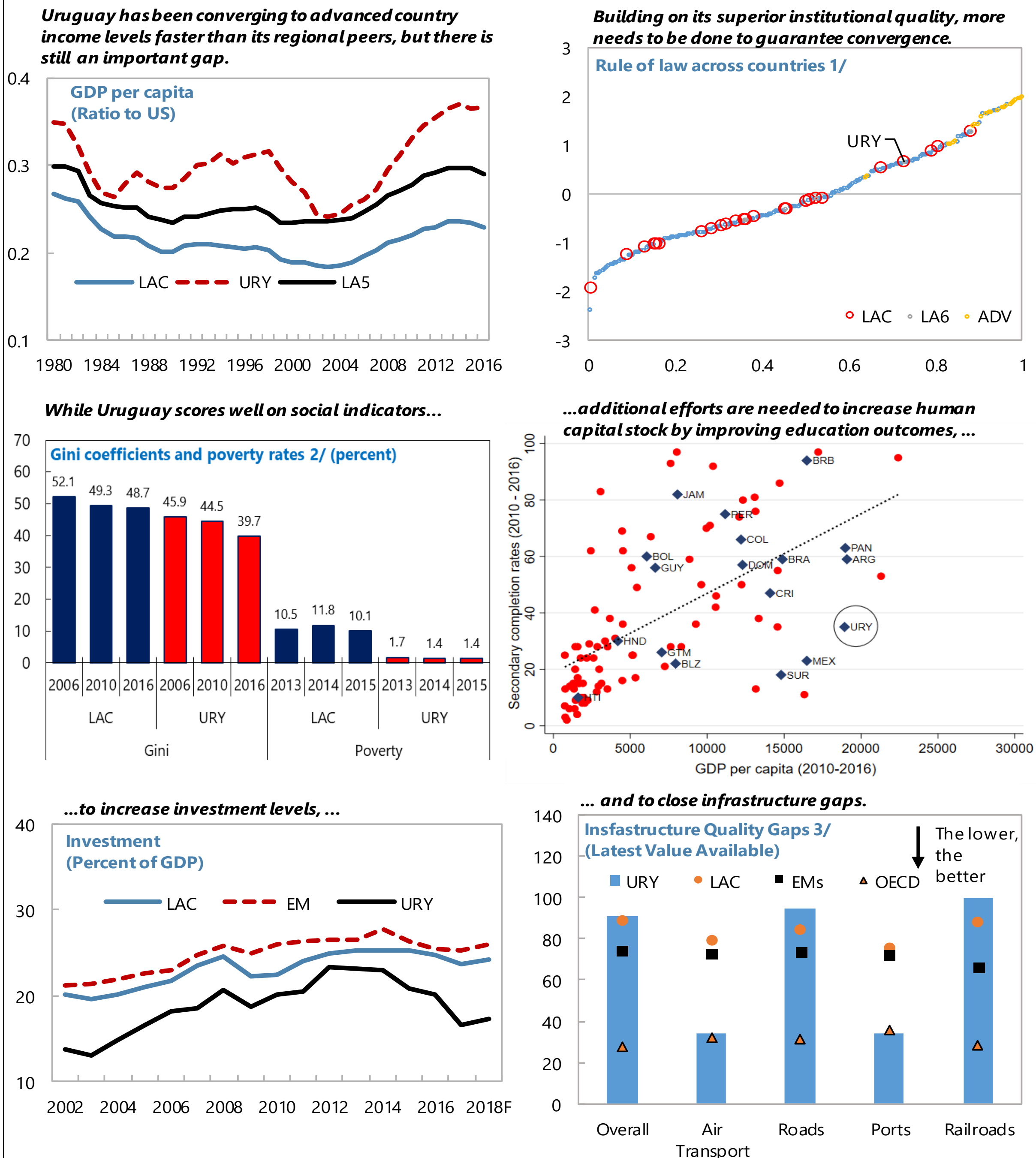
Sources: IMF, *World Economic Outlook*; *Banco Central del Uruguay* (BCU); and Fund staff estimates and calculations.

1/ Data for Colombia and Peru correspond to 2016.

2/ Data for 2018Q1 and 2018Q2 are not available.

3/ Share of FX Loans to borrowers in the nontradable sector; data is through 2018Q3.

Figure 8. Uruguay: Structural Issues



Source: IMF FAD Expenditure Assessment Tool (EAT), *World Economic Outlook*, *World Development Indicators*, IMF Investment and Capital Stock Dataset, World Economic Forum; World Bank, *Doing Business Indicators*; UNICEF; UNESCO; *World Governance Indicators* by Daniel Kaufmann (Natural Resource Governance Institute and Brookings Institution) and Aart Kraay (World Bank); and IMF staff calculations.

1/ Using other indicators of governance produces similar results. As with any perception indicators, point estimates as subject to uncernainty. ADV = Advanced Economies; LAC= Latin America and the Caribbean; LA6=Argentina, Brazil, Chile, Colombia, Mexico and Peru.

2/ Percentage of population living on US$ 3.20 or less per day at 2011 PPP.

3/ Ranking: 1=best, 144=worst.

Table 1. Uruguay: Selected Financial Soundness Indicators

	2011	2012	2013	2014	2015	2016	2017	2018 1/
Currency composition								
Dollar loans in percent of total loans	58.5	57.9	59.6	59.0	60.5	57.1	54.7	53.6
Loan dollarization (constant exchange rate, January 2013) 2/	52.9	52.3	51.4	49.6	44.9	43.3	40.9	40.6
Dollar deposits in percent of total deposits	71.9	71.9	73.5	76.8	80.0	76.4	72.6	74.5
Deposit dollarization (constant exchange rate, January 2013) 2/	67.2	67.4	67.2	68.4	68.6	66.7	62.9	53.2
Credit cycle								
Private sector credit in percent of GDP 3/	19.8	21.6	22.6	24.7	26.9	27.7	25.3	26.0
Private sector average credit growth in percent	24.0	16.3	17.3	8.8	1.5	1.9	2.7	0.6
Bank soundness								
Regulatory capital in percent of risk-weighted assets	13.7	12.8	11.7	11.8	11.3	12.5	13.2	14.9
Asset quality								
Non-performing loans in percent of total loans	1.3	1.5	1.3	1.5	2.1	3.6	4.0	4.0
Specific loan-loss provisions in percent of non-performing loans	71.1	69.0	56.2	65.2	63.1	56.6	59.4	54.1
Implicit exchange rate risk 4/	29.0	33.0	33.1	31.7	30.0	29.5	27.2	27.4
Profitability								
Return on assets	0.8	1.0	1.6	0.9	1.0	0.2	1.0	2.0
Return on equity	7.9	12.6	19.7	11.4	11.8	2.6	11.9	19.7
Operating costs in percent of gross income	83.4	81.0	83.1	86.0	86.0	80.5	68.3	79.7
Liquidity								
Liquidity ratio 5/	47.8	52.6	52.6	54.8	56.0	53.0	50.4	75.0
Non-resident deposits in percent of total deposits	14.6	15.2	15.0	14.7	15.8	12.0	9.7	9.7
Deposits/Loans ratio in national currency 2/	1.0	1.1	1.0	0.9	0.8	0.8	0.9	0.9
Deposits/Loans ratio in foreign currency 2/	2.2	2.3	2.0	2.0	2.0	2.4	2.4	2.5

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

1/ Latest available data November, unless otherwise specified.

2/ For 2018 data as of Feburary.

3/ For 2018 data as of the third quarter.

4/ Foreign currency bank credit to borrowers without natural hedges as a share of total bank loans to the private sector. For 2018, data as of the second quarter.

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

Table 2. Uruguay: Selected Economic Indicators

	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
						Projections					
Output, prices, and employment											
Real GDP (percent change)	4.6	3.2	0.4	1.7	2.7	2.1	1.9	3.0	3.0	3.0	3.0
GDP (US$ billions)	57.5	57.2	53.3	52.7	59.2	60.2	60.1	63.4	66.9	70.5	74.5
Unemployment (in percent, eop)	6.5	6.6	7.5	7.9	7.9	8.3	8.7	8.4	7.8	7.6	7.4
Output gap (percent of potential output)	3.3	2.7	0.2	-0.9	-0.8	-0.9	-1.5	-1.2	-0.8	-0.4	-0.1
CPI inflation (in percent, average)	8.6	8.9	8.7	9.6	6.2	7.6	7.5	7.2	7.2	7.0	7.0
CPI inflation (in percent, end of period))	8.5	8.3	9.4	8.1	6.6	7.8	7.5	7.0	7.0	7.0	7.0
Exchange rate (UY$/US$, average)	20.5	23.2	27.3	30.2	28.7	30.7	...	...	...	...	...
Real effective exchange rate (percent change, eop)	7.7	-2.9	1.0	-5.8	5.7	...	...	...	...	...	...
					(Percent change, unless otherwise specified)						
Monetary and banking indicators 1/											
Base money	12.9	1.4	7.2	9.7	3.6	...	...	...	...	...	...
Broader M1 (M1 plus savings deposits)	15.0	3.7	5.6	8.4	15.2	...	...	...	...	...	...
M2	13.7	6.4	9.0	14.4	13.4	...	...	...	...	...	...
Growth of credit to households (in real UY$)	9.9	4.7	6.3	-0.5	2.5	...	...	...	...	...	...
Growth of credit to firms (in US$)	16.2	6.8	2.8	1.5	-4.2	...	...	...	...	...	...
Bank assets (in percent of GDP)	60.8	63.6	72.5	65.5	61.6	...	...	...	...	...	...
Private credit (in percent of GDP) 2/	26.0	27.1	30.2	28.1	26.3	...	...	...	...	...	...
					(Percent of GDP, unless otherwise specified)						
Public sector indicators											
Revenue 3/	29.5	29.1	29.0	29.3	29.9	31.2	31.0	30.7	30.0	29.9	29.7
of which: *cincuentones* transactions	0.0	0.0	0.0	0.0	0.0	1.2	1.1	1.0	0.4	0.2	0.0
Non-interest expenditure 3/	29.1	29.5	28.8	29.9	30.0	30.1	29.9	29.7	29.7	29.7	29.7
Wage bill	4.9	5.0	5.0	5.1	5.2	5.2	5.1	5.1	5.1	5.1	5.1
Primary balance 4/	0.4	-0.6	0.0	-0.5	-0.2	1.2	1.1	0.9	0.2	0.1	-0.1
Primary balance excluding *cincuentones* transactions	0.4	-0.6	0.0	-0.5	-0.2	0.0	0.0	-0.1	-0.2	-0.1	-0.1
Structural primary balance 5/	-0.9	-1.4	-0.6	-0.7	-0.6	-0.1	0.4	0.2	0.0	0.2	-0.1
Interest 4/	2.7	2.8	3.6	3.3	3.3	3.7	3.5	3.2	3.1	3.2	3.2
Overall balance 4/	-2.3	-3.5	-3.6	-3.8	-3.5	-2.5	-2.4	-2.3	-2.9	-3.1	-3.3
Overall balance excluding *cincuentones* transactions	-2.3	-3.5	-3.6	-3.8	-3.5	-3.7	-3.5	-3.3	-3.3	-3.3	-3.3
Gross non-financial public sector debt	43.3	44.8	52.6	51.2	51.8	54.2	54.2	53.3	53.1	53.1	53.0
Gross public sector debt	60.2	61.4	64.6	61.6	65.8	69.6	70.6	70.0	70.2	70.4	70.4
Public sector debt net of liquid financial assets 6/	34.4	35.9	39.7	42.5	43.4	47.7	48.9	48.4	48.4	48.6	48.7
Public sector debt net of total assets	24.2	22.9	25.8	29.9	32.4	35.9	37.3	37.4	37.7	38.1	38.4
External indicators											
Merchandise exports, fob (US$ millions)	13,277	13,769	11,145	10,380	10,779	11,556	12,000	12,723	13,517	14,350	15,298
Merchandise imports, fob (US$ millions)	12,199	11,783	9,838	8,463	8,671	9,108	9,120	9,919	10,875	11,768	12,750
Terms of trade (percent change)	0.2	2.6	1.8	2.3	-1.1	-2.7	1.1	1.0	0.8	1.0	0.7
Current account balance	-3.6	-3.2	-0.9	0.6	0.7	-0.6	-0.6	-1.0	-1.3	-1.6	-1.8
Foreign direct investment	-4.8	-4.4	-1.6	2.1	3.7	0.3	-0.5	-0.6	-0.8	-1.0	-1.2
Total external debt + non-resident deposits	69.0	74.9	89.5	74.4	68.1	67.8	70.2	70.7	71.2	71.5	72.3
Of which: External public debt	31.9	33.7	37.1	31.6	30.4	32.3	32.4	32.8	33.4	33.8	34.6
External debt service (in percent of exports of g&s)	16.6	16.8	30.2	25.7	24.4	20.5	21.7	22.6	22.7	22.7	22.8
Gross official reserves (US$ millions)	16,279	17,574	15,637	13,473	15,939	15,551	15,891	16,521	17,455	18,405	19,355
In months of imports of goods and services	11	13	13	14	16	15	15	14	14	14	13
In percent of:											
Short-term external (STE) debt	181.8	187.2	173.2	194.6	245.6	234.5	240.2	237.5	238.8	239.8	239.7
STE debt plus banks' non-resident deposits	277.9	227.6	220.4	216.6	320.8	294.5	295.2	288.4	289.3	287.7	283.0

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/ Total public sector. Includes the non-financial public sector, local governments, Banco Central del Uruguay, and Banco de Seguros del Estado. Excludes *cincuentones* and transfers from the Energy Stabilization Fund.

6/ Gross debt of the public sector minus liquid financial assets of the public sector. Liquid financial assets arecalculated 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					
	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
						(In millions of U.S. dollars, unless otherwise indicated)					
Balance of Payments											
Current account	-2,089	-1,815	-488	324	423	-389	-359	-633	-838	-1,126	-1,308
Trade balance	1,077	1,986	1,306	1,916	2,108	2,448	2,880	2,804	2,642	2,582	2,548
Exports of goods	13,277	13,769	11,145	10,380	10,779	11,556	12,000	12,723	13,517	14,350	15,298
Imports of goods	12,199	11,783	9,838	8,463	8,671	9,108	9,120	9,919	10,875	11,768	12,750
Of which: Fuel products	2,055	1,722	1,031	736	1,036	1,460	1,349	1,438	1,531	1,639	1,758
Of which: Non-fuel products	10,145	10,061	8,808	7,727	7,635	7,648	7,771	8,481	9,344	10,129	10,992
Services balance	-266	-367	412	819	1,483	1,133	641	648	820	832	933
Exports, f.o.b.	4,823	4,617	4,486	4,156	5,080	4,879	4,218	4,511	4,827	5,073	5,428
Imports, f.o.b.	5,089	4,983	4,073	3,337	3,596	3,745	3,577	3,864	4,007	4,241	4,496
Income balance	-2,899	-3,431	-2,209	-2,412	-3,167	-3,970	-3,879	-4,085	-4,300	-4,540	-4,788
Financial and capital account balance	-987	-1,567	-576	-230	1,697	-379	-348	-622	-827	-1,114	-1,296
Foreign direct investment	-2,790	-2,512	-827	1,116	2,205	200	-300	-405	-527	-684	-890
Portfolio investment	-1,766	-347	987	2,036	-1,896	0	180	180	180	180	180
Financial derivatives and other investments (net)	383	-95	767	-1,210	-1,067	-484	-573	-1,032	-1,421	-1,566	-1,542
Change in reserve assets	2,981	1,372	-1,677	-2,189	2,449	-100	340	630	935	950	950
Net errors and omissions	692	219	-438	-588	1,263	-274	0	0	0	0	0
Reserve Adequacy and External Indicators											
Gross official reserves (stock)	16,279	17,574	15,637	13,473	15,939	15,839	16,179	16,809	17,743	18,693	19,643
In months of imports of goods and services	11.3	12.6	13.5	13.7	15.6	14.8	15.3	14.6	14.3	14.0	13.7
In percent of short-term debt	181.8	187.2	173.2	194.6	245.6	238.8	244.6	241.6	242.7	243.5	243.3
						(As percent of GDP)					
Balance of Payments											
Current account	-3.6	-3.2	-0.9	0.6	0.7	-0.6	-0.6	-1.0	-1.3	-1.6	-1.8
Trade balance	1.9	3.5	2.5	3.6	3.6	4.1	4.8	4.4	4.0	3.7	3.4
Exports of goods	23.1	24.1	20.9	19.7	18.2	19.2	20.0	20.1	20.2	20.4	20.5
Imports of goods	-21.2	-20.6	-18.5	-16.1	-14.7	-15.1	-15.2	-15.7	-16.3	-16.7	-17.1
Of which: Fuel products	3.6	3.0	1.9	1.4	1.8	2.4	2.2	2.3	2.3	2.3	2.4
Of which: Non-fuel products	17.6	17.6	16.5	14.7	12.9	12.7	12.9	13.4	14.0	14.4	14.8
Services balance	-0.5	-0.6	0.8	1.6	2.5	1.9	1.1	1.0	1.2	1.2	1.3
Exports	8.4	8.1	8.4	7.9	8.6	8.1	7.0	7.1	7.2	7.2	7.3
Imports	8.8	8.7	7.6	6.3	6.1	6.2	5.9	6.1	6.0	6.0	6.0
Income balance	-5.0	-6.0	-4.1	-4.6	-5.4	-6.6	-6.5	-6.4	-6.4	-6.4	-6.4
Financial and capital account balance	-1.7	-2.7	-1.1	-0.4	2.9	-0.6	-0.6	-1.0	-1.2	-1.6	-1.7
Foreign direct investment	-4.8	-4.4	-1.6	2.1	3.7	0.3	-0.5	-0.6	-0.8	-1.0	-1.2
Portfolio investment	-3.1	-0.6	1.9	3.9	-3.2	0.0	0.3	0.3	0.3	0.3	0.2
Financial derivatives and other investments (net)	0.7	-0.2	1.4	-2.3	-1.8	-0.8	-1.0	-1.6	-2.1	-2.2	-2.1
Reserve assets	5.2	2.4	-3.1	-4.2	4.1	-0.2	0.6	1.0	1.4	1.3	1.3
Total external debt	66.2	72.0	82.1	75.9	69.6	67.9	70.2	70.7	71.3	71.5	72.2
Of which: Short-term debt (residual maturity)	15.6	16.4	16.9	13.1	11.0	11.0	11.0	11.0	10.9	10.9	10.8
Of which: External public debt	31.9	33.7	37.1	31.6	30.4	32.4	32.4	32.8	33.5	33.8	34.6
						(As percent of annual exports of goods and services)					
External Debt											
Total external debt (including non-resident deposits)	210.5	224.0	279.8	275.0	259.5	248.5	260.3	259.9	259.9	259.6	259.6
Debt service	16.6	16.8	30.2	25.7	24.4	20.6	21.7	22.6	22.7	22.7	22.7
Of which: Interest payments	5.9	6.2	7.8	8.2	7.6	7.3	7.3	7.2	7.1	7.1	7.1
						(Annual percent changes)					
External Trade											
Exports of goods in US$	1.7	3.7	-19.1	-6.9	3.8	7.2	3.8	6.0	6.2	6.2	6.6
Imports of goods in US$	-4.3	-3.4	-16.5	-14.0	2.5	5.0	0.1	8.8	9.6	8.2	8.3
Export prices in US$	-2.0	0.6	-9.4	-4.2	3.4	3.2	1.6	0.8	1.3	0.8	0.7
Import prices in US$	-2.1	-2.0	-11.1	-6.4	4.6	6.1	0.6	-0.1	0.5	-0.1	0.0
Terms of trade for goods	0.2	2.6	1.8	2.3	-1.1	-2.7	1.1	1.0	0.8	1.0	0.7
Export volume (goods and non-factor services)	4.4	4.2	-10.6	-3.5	0.2	4.9	3.6	3.5	5.4	5.6	6.0
Import volume (goods and non-factor services)	-1.7	-0.5	-6.0	-8.7	-2.5	-0.7	1.9	8.5	9.6	8.4	8.5
Export volume (goods)	4.4	4.2	-10.6	-3.5	0.2	4.9	3.6	3.5	5.4	5.6	6.0
Import volume (goods)	-1.7	-0.5	-6.0	-8.7	-2.5	-0.7	1.9	8.5	9.6	8.4	8.5
Of which: Non-fuel products	15.2	2.8	-7.2	-8.2	3.2	-3.0	-5.9	8.8	10.1	8.6	8.7
Of which: Fuel products	-27.3	-9.4	13.4	-15.3	14.2	8.5	7.5	7.0	7.2	7.2	6.8

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

Table 4. Uruguay: Main Fiscal Aggregates

						Projections					
	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
	(In billions of pesos, unless otherwise indicated)										
I. Primary balance of the non-financial public sector (A+B+C)	5	-7.3	1.1	-7.1	-2.4	22.8	23.1	21.4	7.0	4.6	-0.8
A. Primary balance of central government, BPS and NFPE 1/ 2/	4	-4.7	3.2	-9.0	-1.7	19.3	21.7	20.3	6.3	3.8	-1.7
Revenues	347	387	422	465	508	576	623	681	736	809	889
Taxes	222	244	263	299	335	365	397	440	487	538	596
Non tax	21	22	23	24	26	32	35	39	43	47	52
Social security	86	101	109	118	131	162	174	191	197	212	229
of which: *cincuentones* transactions	0	0	0	0	0	22	22	22	10	5	0
NFPE operating balance 2/	18	20	27	24	16	16	16	11	9	12	12
Primary expenditures	343	392	419	474	509	556	601	660	730	805	890
Current	303	349	385	436	474	515	556	610	675	745	823
Capital	40	43	34	39	35	41	45	50	55	61	67
B. Primary balance of local governments	-0.8	-2.0	1.8	1.2	1.2	2.8	0.8	0.7	0.5	0.5	0.6
C. Primary balance of BSE 3/	1.8	-0.6	-4.0	0.6	-2.0	0.7	0.6	0.4	0.2	0.3	0.3
II. Primary balance of the BCU 4/	-0.8	-1.0	-1.4	-1.5	-1.3	-1.4	-2.0	-2.2	-2.5	-2.7	-3.0
III. Primary balance of the public sector (I+II)	4.6	-8.2	-0.3	-8.6	-3.7	21.4	21.1	19.2	4.6	1.9	-3.8
IV. Interest	32	38	52	52	56	68	69	70	76	86	95
of which: BCU 4/	4	7	18	10	12	19	16	13	13	17	19
V. Overall balance of the public sector (III+IV)	-27.4	-46.1	-52.1	-61.1	-59.5	-46.1	-48.3	-51.1	-71.1	-83.9	-98.7
overall balance excluding *cincuentones* transactions	-27.4	-46.1	-52.1	-61.1	-59.5	-68.1	-70.4	-73.4	-80.8	-89.0	-98.2
	(In percent of GDP, unless otherwise indicated)										
I. Primary balance of the non-financial public sector (A+B+C)	**0.5**	**-0.5**	**0.1**	**-0.4**	**-0.1**	**1.2**	**1.2**	**1.0**	**0.3**	**0.2**	**0.0**
A. Primary balance of central government, BPS and NFPE 1/ 2/	0.4	-0.3	0.2	-0.6	-0.1	1.0	1.1	0.9	0.3	0.1	-0.1
Revenues	29.5	29.1	29.0	29.3	29.9	31.2	31.0	30.7	30.0	29.9	29.7
Taxes	18.9	18.4	18.1	18.8	19.7	19.8	19.8	19.8	19.8	19.9	19.9
Non tax	1.8	1.6	1.6	1.5	1.5	1.7	1.7	1.7	1.7	1.7	1.7
Social security	7.3	7.6	7.5	7.5	7.7	8.8	8.7	8.6	8.0	7.8	7.6
of which: *cincuentones* transactions	0.0	0.0	0.0	0.0	0.0	1.2	1.1	1.0	0.4	0.2	0.0
NFPE operating balance 2/	1.5	1.5	1.8	1.5	0.9	0.9	0.8	0.5	0.4	0.4	0.4
Primary expenditures	29.1	29.5	28.8	29.9	30.0	30.1	29.9	29.7	29.7	29.7	29.7
Current	25.7	26.2	26.5	27.4	27.9	27.9	27.7	27.5	27.5	27.5	27.5
Capital	3.4	3.2	2.3	2.4	2.1	2.2	2.2	2.2	2.2	2.2	2.2
B. Primary balance of local governments	-0.1	-0.2	0.1	0.1	0.1	0.2	0.0	0.0	0.0	0.0	0.0
C. Primary balance of BSE 3/	0.2	0.0	-0.3	0.0	-0.1	0.0	0.0	0.0	0.0	0.0	0.0
II. Primary balance of BCU 4/	**-0.1**	**-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)	**0.4**	**-0.6**	**0.0**	**-0.5**	**-0.2**	**1.2**	**1.1**	**0.9**	**0.2**	**0.1**	**-0.1**
IV. Interest	**2.7**	**2.8**	**3.6**	**3.3**	**3.3**	**3.7**	**3.5**	**3.2**	**3.1**	**3.2**	**3.2**
Of which: BCU 4/	0.4	0.6	1.3	0.7	0.7	1.0	0.8	0.6	0.5	0.6	0.6
V. Overall balance of the public sector (III+IV)	**-2.3**	**-3.5**	**-3.6**	**-3.8**	**-3.5**	**-2.5**	**-2.4**	**-2.3**	**-2.9**	**-3.1**	**-3.3**
Overall balance excluding *cincuentones* transactions	-2.3	-3.5	-3.6	-3.8	-3.5	-3.7	-3.5	-3.3	-3.3	-3.3	-3.3
Memorandum Items:											
Real revenues growth (in percent)	11.3	1.9	0.1	2.7	4.8	6.4	1.4	1.8	0.8	2.6	2.3
Real primary spending growth (in percent)	6.1	5.7	1.1	1.3	3.9	0.8	0.6	2.4	3.1	3.2	3.4
GDP (in billions of pesos)	1,178	1,331	1,456	1,589	1,697	1,846	2,008	2,220	2,453	2,707	2,994

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/

	2013	2014	2015	2016	2017	Projections 2018	2019	2020	2021	2022	2023
	(In billions of U.S. dollars, unless otherwise indicated)										
Public Sector Debt											
Gross debt of the public sector	33.1	33.5	31.4	33.3	38.7	39.5	41.4	43.4	45.9	48.5	51.3
of which:											
Non-financial public sector debt	23.8	24.5	25.6	27.7	30.5	30.7	31.8	33.0	34.7	36.6	38.5
Central bank debt	9.3	9.1	5.8	5.6	8.2	8.7	9.6	10.4	11.2	11.9	12.7
External debt of the public sector	17.6	18.4	18.1	17.1	17.9	18.3	19.0	20.3	21.9	23.3	25.2
Domestic debt of the public sector	15.5	15.1	13.3	16.2	20.9	21.1	22.4	23.1	24.0	25.2	26.0
Public Sector Assets											
Gross assets of the public sector	19.8	21.0	18.9	17.1	19.7	19.1	19.5	20.2	21.2	22.3	23.3
of which:											
Financial assets of the non-financial public sector	2.7	2.5	2.3	2.7	2.8	2.6	2.6	2.7	2.8	2.9	3.0
Reserve assets of the central bank	17.1	18.5	16.6	14.4	16.9	16.5	16.9	17.5	18.4	19.4	20.3
Liquid reserve assets of the central bank	11.5	11.4	9.8	7.6	10.4	9.8	10.1	10.7	11.4	12.1	12.8
Liquid assets of the public sector 2/	14.2	13.9	12.1	10.3	13.2	12.4	12.7	13.4	14.2	15.0	15.8
Net Public Sector Debt											
Gross debt minus liquid financial assets 2/	18.9	19.6	19.3	23.0	25.6	27.1	28.7	30.0	31.6	33.5	35.5
Authorities' definition 3/	13.3	12.5	12.5	16.2	19.1	20.3	21.9	23.2	24.7	26.3	28.0
	(In percent of GDP, unless otherwise indicated) 1/										
Public Sector Debt											
Gross debt of the public sector	60.2	61.4	64.6	61.6	65.8	69.6	70.6	70.0	70.2	70.4	70.4
of which:											
Non-financial public sector debt	43.3	44.8	52.6	51.2	51.8	54.2	54.2	53.3	53.1	53.1	53.0
Central bank debt	16.9	16.6	12.0	10.4	13.9	15.4	16.4	16.7	17.1	17.3	17.5
External debt of the public sector	31.9	33.7	37.1	31.6	30.4	32.3	32.4	32.8	33.4	33.8	34.6
Domestic debt of the public sector	28.3	27.7	27.4	30.0	35.4	37.3	38.2	37.2	36.7	36.6	35.8
Public Sector Assets											
Gross financial assets of the public sector	36.0	38.5	38.8	31.6	33.4	33.7	33.2	32.6	32.5	32.3	32.0
of which:											
Financial assets of the non-financial public sector	4.8	4.7	4.7	5.0	4.7	4.6	4.5	4.4	4.3	4.2	4.1
Reserve assets of the central bank	31.2	33.8	34.1	26.6	28.7	29.1	28.8	28.2	28.2	28.1	27.9
Liquid reserve assets of the central bank 2/	20.9	20.8	20.1	14.0	17.7	17.3	17.2	17.2	17.5	17.6	17.6
Liquid assets of the public sector 2/	25.7	25.5	24.9	19.0	22.4	21.9	21.6	21.6	21.8	21.8	21.7
Net Public Sector Debt											
Gross debt minus liquid financial assets 2/	34.4	35.9	39.7	42.5	43.4	47.7	48.9	48.4	48.4	48.6	48.7
Authorities' definition 3/	24.2	22.9	25.8	29.9	32.4	35.9	37.3	37.4	37.7	38.1	38.4
Memorandum Items											
GDP (in billions of pesos)	1,178	1,331	1,456	1,589	1,697	1,846	2,008	2,220	2,453	2,707	2,994

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/

	2012	2013	2014	2015	2016	2017
	(In percent of GDP, based on the 2001 GFS Manual)					
Revenue	30.0	31.1	28.9	30.4	41.3	38.3
Taxes	18.8	19.0	18.6	18.5	23.7	19.9
Social contributions	9.7	10.1	8.5	10.4	10.5	10.8
Grants	0.0	0.0	0.0	0.0	5.2	5.6
Other revenue	1.5	2.0	1.8	1.5	1.9	1.9
Expense	30.5	31.2	29.8	31.9	43.6	40.0
Compensation of employees	7.1	7.2	7.4	7.4	12.5	8.8
Use of goods and services	3.5	3.7	3.7	3.4	3.9	3.7
Consumption of fixed capital 2/	....	0	0	0	0	0
Interest	2.3	2.4	2.3	2.2	2.7	2.7
Subsidies	0.3	0.2	0.2	0.3	0.4	0.2
Grants	0.0	0.0	0.0	0.0	5.2	5.6
Social benefits	14.2	14.5	13.3	15.3	15.8	15.7
Other expenses	3.1	3.2	2.9	3.3	3.2	3.2
Net acquisition of nonfinancial assets	1.4	1.4	1.4	1.2	1.4	1.3
Gross operating balance	-0.6	-0.1	-0.9	-1.5	-2.3	-1.7
Net operating balance 2/	....	-0.1	-0.9	-1.5	-2.3	-1.7
Net lending (+) borrowing (-)	-2.0	-1.5	-2.3	-2.7	-3.7	-3.0
Net acquisition of financial assets	0.7	-0.3	0.2	2.1	-1.8	-0.4
By instrument						
Monetary gold and SDRs	0.0	0.0	0.0	0.0	0.0	0.0
Currency and deposits	0.2	-0.9	0.7	1.8	-1.0	-0.4
Debt securities	0.0	-0.1	0.0	-0.1	-0.1	-0.1
Loans	0.4	0.8	-0.4	0.4	-0.7	0.1
Equity and shares	0.0	0.0	0.0	0.0	0.0	0.0
By residency						
Domestic	0.2	-0.3	0.2	2.1	-1.8	-0.4
External	0.0	0.0	0.0	0.0	0.0	0.0
Net incurrence of liabilities	2.7	1.3	2.5	5.1	3.1	2.6
By instrument						
SDRs	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
Debt securities	2.2	2.1	2.3	4.9	2.3	2.6
Loans	0.5	-0.8	0.2	0.2	0.8	0.0
Equity and shares	0.0	0.0	0.0	0.0	0.0	0.0
By residency						
Domestic	0.6	-1.4	0.1	3.0	4.3	1.8
External	2.1	2.7	2.5	2.1	-1.3	0.8
Memorandum items:						
Public sector net lending (+) borrowing (-)	-2.7	-2.3	-3.5	-3.6	-3.8	-3.5
Public sector primary balance	-0.2	0.4	-0.6	0.0	-0.5	-0.2

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 2013-17 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	2017
	(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	-41.3	-40.6
Financial assets	8.6	10.4	9.9	8.9	9.1	9.5	9.4	8.9
By instrument								
Monetary gold and SDRs	0.0	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	5.7
Debt securities	2.0	2.5	2.5	2.2	2.2	2.1	2.1	2.1
Loans	1.6	0.6	0.5	1.7	1.2	1.3	0.5	0.9
Equity and shares	0.6	0.5	0.4	0.3	0.3	0.3	0.2	0.2
By residency								
Domestic	8.6	10.3	9.9	8.9	9.1	9.5	9.3	8.9
External	0.0	0.0	0.0	0.0	0.0	0.0	0.1	0.0
Liabilities	44.2	45.4	43.4	42.7	44.4	51.2	50.7	49.5
By instrument								
SDRs	0.0	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	0.0
Debt securities	32.5	34.6	34.3	35.1	37.0	44.2	43.7	44.3
Loans	11.7	10.7	9.1	7.6	7.4	7.0	7.0	5.2
Equity and shares	0.0	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	22.9	22.8
External	26.3	24.3	24.0	25.9	27.5	31.8	27.8	26.7

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

1/ Central government and Social Security Bank. Data for 2013 - 17 are not consolidated.

Table 8. Uruguay: Monetary Survey

	2012	2013	2014	2015	2016	2017
	(End of period, in billions of pesos)					
Banco Central del Uruguay (BCU)						
Net foreign assets	254	331	408	458	399	461
Gross international reserves	264	348	428	467	394	459
Net domestic assets	-153	-210	-286	-353	-285	-330
Net credit to the public sector	43	76	71	31	60	104
Net credit to the financial system	-83	-129	-192	-250	-202	-176
Credit to the private sector	0	0	0	1	1	1
Securities issued by the BCU	-155	-202	-202	-126	-125	-250
Other	38	30	11	-49	-55	-56
Peso monetary liabilities 1/	101	121	121	105	113	131
Public and Private Banks 2/						
Net foreign assets	71	65	74	144	177	168
Net domestic assets	346	438	531	615	611	633
Net credit to the public sector	25	20	33	38	39	36
Net credit to the financial system	149	190	232	251	250	285
Credit to the private sector	244	306	359	438	445	445
Other	-71	-78	-94	-112	-123	-133
Liabilities to the private sector (residents)	417	503	605	760	788	801
Banking System (Central, Private, and Public Banks)						
Net foreign assets	325	395	482	603	575	629
Net domestic assets	115	134	148	177	236	197
Credit to the public sector	68	96	104	69	98	140
Credit to the rest of financial system	-9	-18	-31	-44	-6	50
Credit to the private sector	244	307	360	440	447	446
Other	440	529	630	780	811	826
Broad money (M-3)	440	529	630	780	811	826
	(In percent of total private credit)					
Composition of Credit						
Credit to firms	56.8	57.4	59.3	61.3	60.9	57.3
Credit to households	43.2	42.6	40.7	38.7	39.1	42.7
Consumption	63.7	63.1	61.8	61.2	60.3	59.5
Car loans	0.7	1.0	1.3	1.4	1.7	2.1
Mortgages	35.6	35.9	36.9	37.5	38.0	38.4
	(Percentage change)					
Memorandum Items:						
Base money	26.7	12.9	1.4	7.2	9.7	3.6
M-1	9.2	13.1	1.0	5.2	6.6	10.6
Broader M1 (M1 plus savings deposits)	11.2	15.0	3.7	5.6	8.4	15.2
M-2	10.3	13.7	6.4	9.0	14.4	13.4
M-3	10.0	19.2	19.3	23.7	3.9	1.9
Credit to firms (in US$)	17.5	16.2	6.8	2.8	1.5	-4.2
Credit to households (in real UY$) 3/	7.3	9.9	4.7	6.3	-0.5	2.5

Source: Banco Central del Uruguay.

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

2/ The Banco de la Republica Oriental de Uruguay (BROU), Banco Hipotecario de Uruguay (BHU; mortgage institution), private banks, financial houses and cooperatives.

3/ Includes credit to households from banks and credit cooperatives.

Table 9. Uruguay: Medium-Term Macroeconomic Framework

						Projections					
	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
	(Annual percent change, unless otherwise indicated)										
National Accounts											
Real GDP	4.6	3.2	0.4	1.7	2.7	2.1	1.9	3.0	3.0	3.0	3.0
Total domestic demand	5.3	2.3	-2.0	-0.4	0.3	2.2	2.8	4.5	4.1	4.1	4.0
Final consumption expenditure	5.5	2.9	-0.2	0.4	3.6	2.9	2.3	4.5	4.3	4.3	4.1
Private final consumption expenditure	5.5	3.0	-0.5	0.1	4.4	3.2	2.5	4.4	4.3	4.3	4.1
Public final consumption expenditure	4.9	2.5	2.2	2.9	-1.3	0.7	0.8	5.4	3.9	4.0	4.2
Gross capital formation	4.8	0.0	-9.0	-3.9	-13.8	-1.6	5.2	4.3	3.0	3.4	3.5
Gross fixed capital formation	3.8	2.4	-9.2	-1.6	-15.5	-1.6	5.2	4.3	3.0	3.4	3.5
Private fixed capital formation	2.1	-2.8	-8.5	-4.8	-11.3	-3.3	6.2	5.6	3.8	4.3	4.3
Public fixed capital formation	13.6	28.7	-12.2	10.9	-29.6	5.8	1.2	-1.2	-0.7	-0.6	-0.5
Change in inventories (contribution to growth)	0.2	-0.6	0.1	-0.5	0.4	0.0	0.0	0.0	0.0	0.0	0.0
Net exports (contribution to growth)	-1.1	0.7	2.6	2.1	2.3	-0.1	-0.9	-1.6	-1.2	0.0	-2.6
Consumer Prices											
CPI inflation (average)	8.6	8.9	8.7	9.6	6.2	7.6	7.5	7.2	7.2	7.0	7.0
CPI inflation (end of period)	8.5	8.3	9.4	8.1	6.6	7.8	7.5	7.0	7.0	7.0	7.0
Balance of Payments											
Current account balance (percent of GDP)	-3.6	-3.2	-0.9	0.6	0.7	-0.6	-0.6	-1.0	-1.3	-1.6	-1.8
Exports of goods and services (volume)	-0.1	3.5	-0.6	-0.2	7.6	-0.3	-3.7	2.7	3.9	3.5	4.4
Export of goods (volume)	4.4	4.2	-10.6	-3.5	0.2	4.9	3.6	3.5	5.4	5.6	6.0
Imports of goods and services (volume)	-1.7	-0.5	-6.0	-8.7	-2.5	-0.7	1.9	8.5	9.6	8.4	8.5
Imports of goods (volume)	-1.7	-0.5	-6.0	-8.7	-2.5	-0.7	1.9	8.5	9.6	8.4	8.5
Terms of trade (goods)	100.0	102.6	104.5	107.1	105.6	102.0	104.1	106.4	107.2	108.0	108.8
	(In percent of GDP, unless otherwise indicated)										
Public Sector Finance											
Primary balance 1/	0.4	-0.6	0.0	-0.5	-0.2	1.2	1.1	0.9	0.2	0.1	-0.1
Primary balance excluding *cincuentones* transactions	0.4	-0.6	0.0	-0.5	-0.2	0.0	0.0	-0.1	-0.2	-0.1	-0.1
Revenue 2/	29.5	29.1	29.0	29.3	29.9	31.2	31.0	30.7	30.0	29.9	29.7
of which: *cincuentones* transactions	0.0	0.0	0.0	0.0	0.0	1.2	1.1	1.0	0.4	0.2	0.0
Primary expenditure 2/	29.1	29.5	28.8	29.9	30.0	30.1	29.9	29.7	29.7	29.7	29.7
Structural primary balance 3/	-0.9	-1.4	-0.6	-0.7	-0.6	-0.1	0.4	0.2	0.0	0.2	-0.1
Overall balance	-2.3	-3.5	-3.6	-3.8	-3.5	-2.5	-2.4	-2.3	-2.9	-3.1	-3.3
Overall balance excluding *cincuentones* transactions	-2.3	-3.5	-3.6	-3.8	-3.5	-3.7	-3.5	-3.3	-3.3	-3.3	-3.3
Gross non-financial public sector debt	43.3	44.8	52.6	51.2	51.8	54.2	54.2	53.3	53.1	53.1	53.0
Gross public sector debt	60.2	61.4	64.6	61.6	65.8	69.6	70.6	70.0	70.2	70.4	70.4
Assets of the public sector	36.0	38.5	38.8	31.6	33.4	33.7	33.2	32.6	32.5	32.3	32.0
Non-financial public sector	4.8	4.7	4.7	5.0	4.7	4.6	4.5	4.4	4.3	4.2	4.1
Banco Central del Uruguay	31.2	33.8	34.1	26.6	28.7	29.1	28.8	28.2	28.2	28.1	27.9
Liquid assets of the public sector 4/	25.7	25.5	24.9	19.0	22.4	21.9	21.6	21.6	21.8	21.8	21.7
Net public sector debt (gross debt minus liquid assets)	34.4	35.9	39.7	42.5	43.4	47.7	48.9	48.4	48.4	48.6	48.7
External Debt											
Gross external debt	66.2	72.0	82.1	75.9	69.6	67.8	70.2	70.7	71.2	71.5	72.3
Public sector gross external debt	31.9	33.7	37.1	31.6	30.4	32.3	32.4	32.8	33.4	33.8	34.6
Gross international reserves (US$ billions)	16.3	17.6	15.6	13.5	15.9	15.6	15.9	16.5	17.5	18.4	19.4
Saving and Investment											
Gross domestic investment	22.5	21.2	19.7	17.8	15.7	15.9	16.6	17.7	18.3	19.0	19.8
Public sector gross investment	4.2	4.9	4.6	4.8	3.9	4.2	4.2	4.2	4.2	4.2	4.2
Private sector gross investment	18.3	16.3	15.1	13.0	11.9	11.7	12.4	13.5	14.2	14.9	15.6
Gross national saving	18.9	18.0	18.8	18.4	16.4	15.2	16.0	16.7	17.1	17.4	18.1
Public sector gross saving	1.1	-0.2	-1.3	-1.4	-1.4	-0.3	-0.2	-0.1	-0.7	-0.9	-1.1
Private sector gross saving	17.7	18.3	20.1	19.8	17.9	15.5	16.1	16.7	17.7	18.3	19.1
Unemployment and Output Gap											
Population (Mil)	3.4	3.5	3.5	3.5	3.5	3.5	3.5	3.5	3.5	3.6	3.6
Labor force participation (percent)	63.6	64.7	63.8	63.4	62.9	62.9	62.9	62.9	62.9	62.9	62.9
Employment growth (percent)	2.5	2.3	-0.4	-0.2	0.4	0.4	0.4	0.4	0.3	0.3	0.3
Unemployment rate (percent)	6.5	6.6	7.5	7.9	7.9	8.3	8.7	8.4	7.8	7.6	7.4
Output gap (percent of potential output)	3.3	2.7	0.2	-0.9	-0.8	-0.9	-1.5	-1.2	-0.8	-0.4	-0.1

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/ Total public sector. Includes the non-financial public sector, local governments, Banco Central del Uruguay, and Banco de Seguros del Estado. Excludes cincuentones and transfers from the Energy Stabilization Fund.

4/ 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

Staff assesses that the external position is broadly consistent with fundamentals according to the External Balance Assessment (EBA) current account model. At the same time, according to both the EBA-Lite real effective exchange rate (REER) model and the EBA external sustainability approach, Uruguay is overvalued. External stability risks remain contained given that the level of reserves is larger than the external financing requirements.

1. **After achieving a historic surplus in 2016–17, the current account weakened substantially in 2018.** The current account improved steadily between 2014 and 2017, due to low oil prices (with imports of fuel declining from 5.6 percent of GDP in 2012 to 1¾ percent of GDP in 2017), weak investment spending, and the sharp improvement in the bilateral trade balance with Argentina on the back of overvalued Argentinean real exchange rate. However, the current account weakened substantially in 2018 (first 3 quarters) due to a more negative primary income; the worsening terms of trade (primarily, higher oil prices); a drought that affected primary exports (with soybeans exports declining some 60 percent in volume during the first seven months of 2018 compared to the same period in 2017), and weaker demand from Argentina and Brazil.

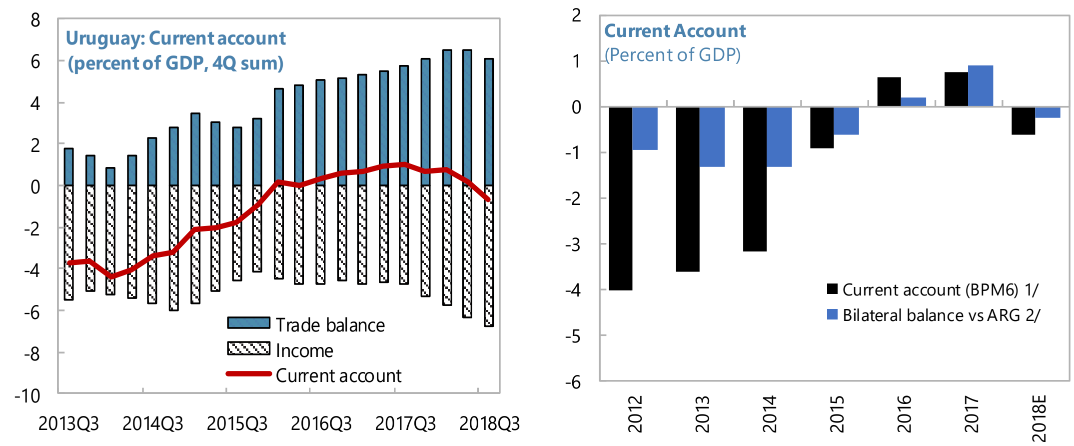
2. **The current account is expected to deteriorate further.** As the market turmoil in Argentina began after the end of the 2018 tourism season, the correction in the Argentinean real effective exchange rate and the decline in demand will start to affect Uruguay's tourism and goods exports at the end of 2018 and in early 2019. The bilateral trade balance with Argentina is expected to be slightly below zero in 2018, after posting a record surplus of 0.9 percent of GDP in 2017 and to converge to its 2005-17 average of -1.5 percent thereafter. In 2019, the negative impact of the decline in tourism revenues is expected to be somewhat offset by the rebound in the exports of primary goods. In the medium term, the current account is projected to weaken further as imports of capital and intermediate goods grow along with the expected recovery in investment and the trade balance (goods and tourism) with Argentina reverts to its historical levels.

Uruguay: Merchandise Trade Balance

(In percent of GDP)

	2012	2013	2014	2015	2016	2017	Proj. 2018
Trade balance	0.6	1.9	3.5	2.5	3.6	3.6	4.1
Exports	25.5	23.1	24.1	20.9	19.7	18.2	19.2
Imports	24.9	21.2	20.6	18.5	16.1	14.7	15.1
Fuel	5.6	3.6	3.0	1.9	1.4	1.8	2.4
Non-fuel	19.3	17.6	17.6	16.5	14.7	12.9	12.7
Capital	3.0	3.4	3.7	3.4	3.0	1.9	1.9
Consumption	5.2	4.9	5.1	5.0	4.7	4.8	4.7
Intermediary	8.6	8.4	8.2	7.4	6.3	6.0	5.9

Sources: *Banco Central del Uruguay*; and Fund staff calculations.



1/ The current account balance for 2018 reflects data through 2018Q3.
2/ The bilateral balance against Argentina for 2018 reflects merchandise trade through 2018Q3, tourism through 2018Q2, and staff estimation for the remainder of the year.

3. **Staff assesses that the external position is broadly consistent with fundamentals and desirable policy settings.** This assessment is based, primarily, on an almost zero current account gap according to the EBA current account model. At the same time, the EBA-Lite REER model, and the EBA External Sustainability approach show that Uruguay is overvalued.

- *EBA current account model.* The external position is broadly in line with fundamentals. This assessment is based primarily on an adjusted current account balance that is at the model's current account norm (-2.5 percent of GDP). The cyclically adjusted current account in 2018 is larger by 1.3 percent of GDP than the norm according to the External Balance Assessment (EBA) current account model. However, given that the unusually high trade and tourism revenues from Argentina in 2017 is expected to revert to the historical average (from the estimated 0.3 percent of GDP deficit in 2018 to 1.5-percent-of-GDP deficit), the adjusted current account gap is almost zero (0.04 percent of GDP).
- EBA-*Lite REER model* shows that Uruguay is 7.7 percent overvalued, driven largely by its actual appreciation, relative to the level that is consistent with fundamentals and desirable policies.
- *The EBA external sustainability (ES) approach* assesses the REER to be overvalued (about 2 percent), given that the projected current account deficit for 2023 (1.8 percent of GDP) is below the level required to stabilize the stock of NFA at its current level (a deficit of 1.3 percent of GDP).

4. These varying results might reflect i) quantities adjusting slower than prices, and ii) the impact of lower FDI in recent years, which reduces imports on impact, on export capacity in the long run.

Uruguay: Exchange Rate Assessment

	Deviation from equilibrium (in percent) 1/	CA norm 5/	CA projection 6/	Difference
I. EBA - Current Account model 2/ 4/	-5.8	-2.5	-1.2	1.3
Adjusted for bilateral trade with Argentina	-0.2	-2.5	-2.5	0.0
II. External Sustainability (ES) approach 3/ 4/	1.9	-1.3 7/	-1.8 8/	-0.4
III. EBA-lite REER model	7.7			

Source: Fund staff calculations
1/ Positive values indicate overvaluation.
2/ Based on the October 2018 EBA results.
3/ RES calculations based on the EBA ES approach, but using team's latest CA forecast.
4/ Using a CA elasticity of 0.22 (see RES EBA CA and EBA ES results for Uruguay).
5/ Cyclically-adjusted in 2018.
6/ Cyclically adjusted in 2018.
7/ CA balance required to stabilize NFA in the medium-term.
8/ 2023 CA balance projection.

5. Capital flows have been volatile, fluctuating between 9 percent of GDP to -3 percent of GDP. The first three quarters of 2018 showed foreign direct investment outflows of 0.3 percent of GDP (after declining 3.7 percentage points in 2017), but at the same time there was an inflow of portfolio investment of 1 percent of GDP. High frequency data shows continued nonresident portfolio outflows for the fourth quarter, following 1.7-percent-of-GDP portfolio outflows in the third quarter.

6. External stability risks for Uruguay remain contained. As of December, gross reserves are at slightly lower level than last year. Reserves remain above the upper bound of the IMF reserve adequacy metric range, and other prudential indicators. This is considered appropriate given the high degree of dollarization of the economy and commercial banks' foreign currency requirements. Net reserves appear more than adequate to offset possible disorderly conditions in the foreign exchange market, if needed. Given the level of reserves, external stability risks are contained.

Uruguay: Gross International Reserves

In billions of U.S. dollars (December 28, 2018)	15.6
In months of imports (2017)	15.2
In percent of:	
GDP (2017) 1/	25.9
Short-term external (STE) debt (2017)	179.4
STE debt and foreign currency deposits (2017)	51.7
STE debt and nonresident deposits (2017)	135.7
M2 (latest) 2/	173.8
M3 (latest)	55.3
Memo items:	
IMF's new reserve adequacy metric range in US$, billions (2018 Q2) 3/	8.6 to 12.9
Banks' gross foreign assets (US$, billions, 2017)	9.7
Ratio of gross reserves plus banks' foreign assets to STE debt and foreign currency deposits (percent)	83.9

Sources: Banco Central del Uruguay and Fund staff calculations.
1/ Reserves-to-GDP ratio calculated after converting GDP to U.S. dollars.
2/ STE debt includes debt both by original and by remaining maturity.
3/ Reserve adequacy metric range is the minimum reserve adequacy to 1.5 times the minimum.

Annex II. Public Sector Debt Sustainability Analysis (DSA)

Uruguay is one of few countries that report debt figures on a consolidated basis for the whole public sector, including the central bank. This results in higher debt ratios and financing needs than in countries that only report the central government's or the non-financial public-sector's debt. Under the baseline scenario, the public sector gross debt ratio is projected to stabilize at around 70 percent of GDP (53 percent of GDP for the non-financial public sector), but its long average maturity (13 years) and substantial liquid assets (22 percent of GDP at end-2017) mitigate short-term risks.

1. At end-2017 the public sector (PS) gross debt was 66 percent of GDP, which includes:[1]

- *Central government's debt:* 48 percent of GDP, with 13-year average maturity, and about one half denominated in local currency and ⅓ indexed to CPI.
- *Central bank's debt*: 14 percent of GDP, mostly short-term securities used for liquidity management (about 90 percent denominated in local currency), its stock varies with BCU's (sterilized) foreign exchange interventions.
- *Debt from other public corporations*: 4 percent of GDP.
- *Debt from local governments and other public-sector entities:* 0.4 percent of GDP.

2. The PS holds sizeable financial assets (including international reserves), amounting to 33 percent of GDP, and has access to contingent credit lines from multilateral institutions of about 4 percent of GDP.

- *Central bank's financial* assets: 29 percent of GDP (of which 27 percent of GDP correspond to international reserves). About 11 percent of GDP in reserves are the counterpart to reserve requirements on foreign currency deposits.
- *Financial assets from the non-financial public sector:* 5 percent of GDP, mostly held in liquid instruments (e.g., securities and deposits), in line with the government's prefunding policy of holding sufficient liquid assets to cover at least 12 months of debt service.

3. The PS net debt (gross debt minus liquid assets) was 43 percent of GDP in 2017. Liquid assets were 22 percent of GDP, computed as the difference between gross assets and reserve requirements on foreign currency deposits.

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

Scenarios

4. The PS gross debt ratio is expected to increase in 2018 and stabilize thereafter. The negative impact of the depreciation of the peso and the accumulation of foreign reserves are offset by the debt-reducing impact of the *cincuentones* transaction, and going forward, by the expected recovery in economic growth and low real interest rates.

5. If real GDP growth, real interest rates, and other debt-creating flows remain at their projected level for 2023, the debt-stabilizing primary balance is estimated at 0.1 percent of GDP (close to the projected primary balance which explains why the debt remains broadly stable at the end of the projection period).

6. Baseline assumptions seem plausible, as staff's forecasts are not systematically biased (based on historical projection errors). Furthermore, fan charts show limited uncertainty around the baseline (the symmetric fan chart has a width of about 20 percent of GDP).

7. A historical scenario yields a downward-sloping PS debt ratio, since it assumes key macroeconomic variables will behave as in the previous decade where Uruguay experienced high growth and exchange rate appreciation as it recovered from the 2002 financial crisis.

Risks

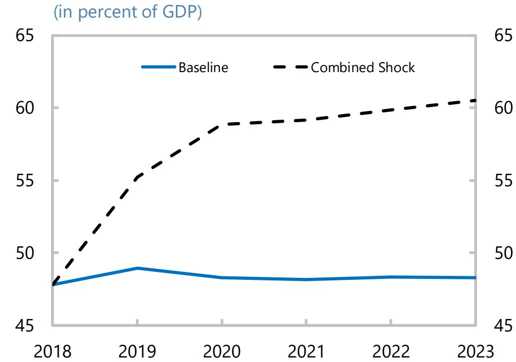
8. Staff's risk analysis was conducted for the non-financial public sector (NFPS), to make the risk benchmarks (estimated from a cross-country sample) more applicable to Uruguay where indebtedness is biased upwards by the inclusion of central bank's debt (since many countries do not include this debt in their statistics). For example, although the PS gross financing needs are about 23 percent of GDP (which exceed the estimated risk benchmark) about 2/3 of this amount corresponds to the central bank liabilities (short-term instruments used for liquidity management). Thus, the gross financing needs of the NFPS (7 percent of GDP) are well below the risk benchmark.

9. The share of NFPS debt held by non-residents is above its risk benchmark, but refinancing risks are limited given the sizable liquid financial assets and contingent credit lines of the NFPS (5 and 4 percent of GDP, respectively). Short-term debt of the NFPS is negligible (0.5 percent of GDP), reflecting the authorities' long-standing emphasis on extending maturities and minimizing roll-over risk. For the PS, the share of short-term debt increased in 2017 to about 13 percent of GDP due to an increase in central bank's debt (needed to sterilize an accumulation of reserves). This was somewhat reversed in 2018 as the central bank had to sell some reserves due to market pressures from developments in Argentina.

Stress Tests

10. Debt dynamics are moderately sensitive to shocks. In a stylized downside scenario which combines a permanent 20 percent exchange rate depreciation (relative to the baseline) with a temporary drop in growth and primary balances, and a permanent and a permanent increase in real interest rates, PS net debt would only increase 12 percentage points as the valuation effects on foreign-currency assets partially offset the impact on debt. Fan charts of the projected debt distribution confirm that debt dynamics are generally manageable under statistical distributions of combined shocks, although they have deteriorated from last year. Gross NFPS debt would remain below 70 percent of GDP in 95 percent of the cases.

Dynamics of Net Public Debt
(in percent of GDP)



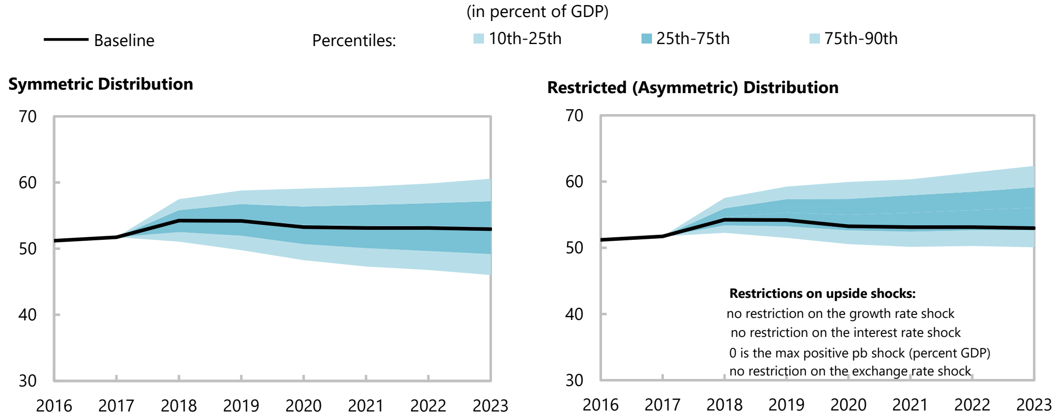
Source: Fund staff calculations.
Note: Combined shock as described in the text.

Figure 1. Uruguay: Public DSA Risk Assessment
(Nonfinancial Public Sector Debt)

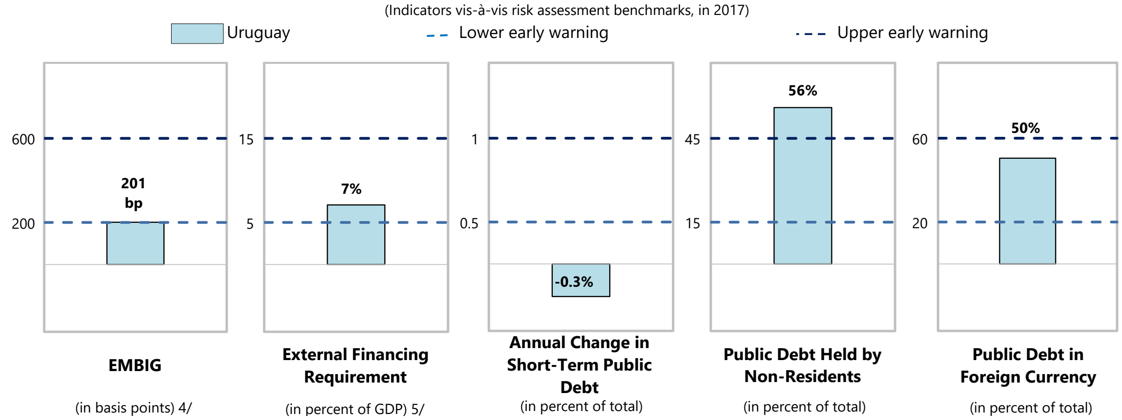
Heat Map

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/	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 Debt NFPS
(in percent of GDP)



Debt Profile Vulnerabilities
(Indicators vis-à-vis risk assessment benchmarks, in 2017)



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.

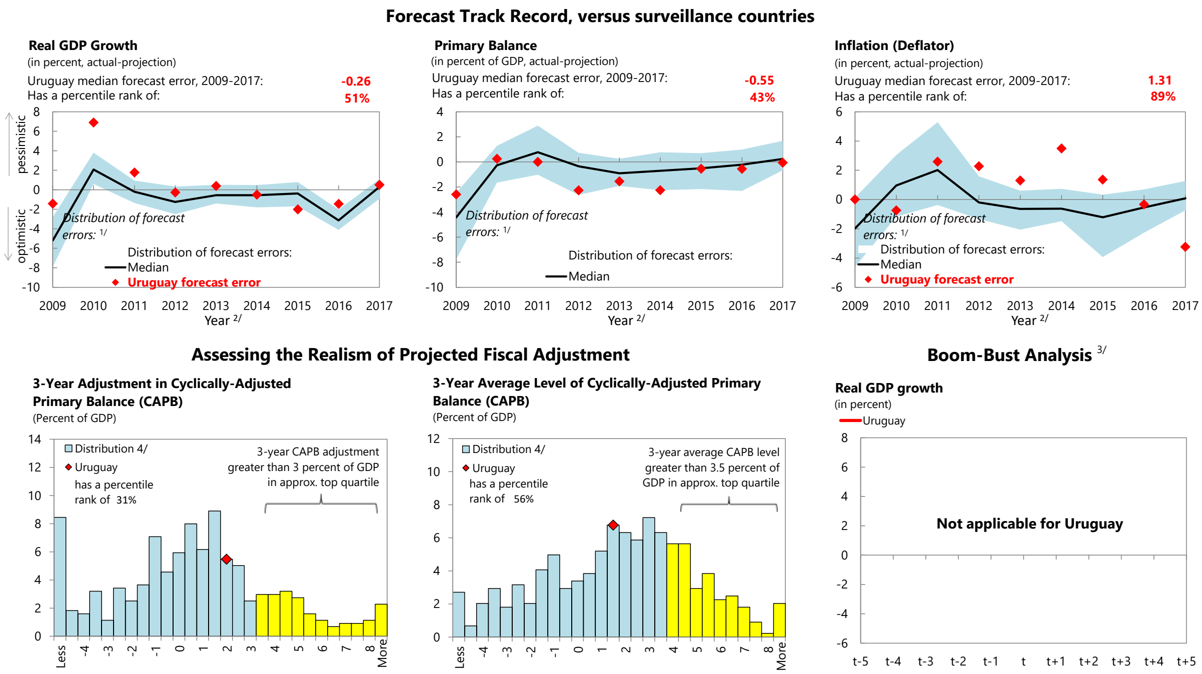
3/ The cell is highlighted in green if country value is less than the lower risk-assessment benchmark, red if country value exceeds the upper risk-assessment benchmark, yellow if country value is between the lower and upper risk-assessment benchmarks. If data are unavailable or indicator is not relevant,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

4/ EMBIG, an average over the last 3 months, 13-Oct-18 through 11-Jan-19.

5/ 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.

Figure 2. 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.

Figure 3. Uruguay: Public Sector DSA—Baseline Scenario

(Public Sector Debt)

(in percent of GDP unless otherwise indicated)

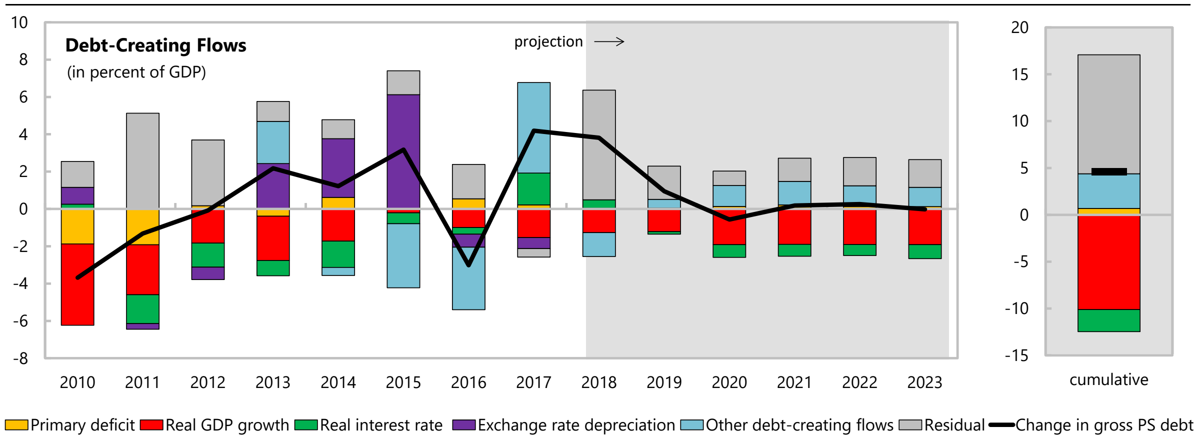
Debt, Economic and Market Indicators [1]

	Actual			Projections					
	2007-2015 [2]	2016	2017	2018	2019	2020	2021	2022	2023
Nominal gross debt NFPS	54.8	51.2	51.7	54.2	54.2	53.3	53.1	53.1	53.0
Nominal gross debt PS [4]	61.4	61.6	65.8	69.6	70.5	70.0	70.1	70.4	70.4
Gross financing needs NFPS	8.6	8.3	8.5	7.0	5.9	5.7	6.4	8.0	7.0
Gross financing needs PS	11.6	14.1	14.4	23.4	17.3	17.5	18.1	19.9	19.1
Real GDP growth (in percent)	4.7	1.7	2.7	2.1	1.9	3.0	3.0	3.0	3.0
Inflation (GDP deflator, in percent)	8.2	7.3	4.0	6.5	6.8	7.3	7.3	7.2	7.4
Nominal GDP growth (in percent)	13.4	9.2	6.8	8.8	8.8	10.5	10.5	10.4	10.6
Effective interest rate (in percent) [5]	6.3	6.9	7.1	7.4	6.7	6.5	6.5	6.4	6.4

As of January 11, 2019		
Sovereign Spreads		
EMBIG (bp) 3/		191
5Y CDS (bp)		119
Ratings	Foreign	Local
Moody's	Baa2	Baa2
S&Ps	BBB	BBB
Fitch	BBB-	BBB-

Contribution to Changes in Public Sector Debt

	Actual			Projections							
	2007-2015	2016	2017	2018	2019	2020	2021	2022	2023	cumulative	debt-stabilizing primary balance [10]
Change in gross debt PS	-1.2	-3.0	4.2	3.8	0.9	-0.6	0.2	0.3	0.0	4.6	
Identified debt-creating flows	-4.8	-4.9	4.6	-2.1	-0.8	-1.3	-1.1	-1.3	-1.5	-8.1	
Primary deficit (headline)	-1.1	0.5	0.2	1.2	1.1	1.1	0.6	0.3	0.1	4.6	0.1
Primary deficit (excluding cincuentones)	-1.1	0.5	0.2	0.0	0.0	0.1	0.2	0.1	0.1	0.7	
Primary (noninterest) revenue and grants	28.4	29.3	29.9	30.0	29.9	29.7	29.6	29.7	29.7	178.5	
excluding cincuentones	28.4	29.3	29.9	28.8	28.8	28.7	29.2	29.5	29.7	174.6	
Primary (noninterest) expenditure	27.4	29.8	30.1	30.0	30.0	29.8	29.8	29.8	29.8	179.2	
Automatic debt dynamics [6]	-3.6	-2.0	-0.4	-0.8	-1.4	-2.6	-2.5	-2.5	-2.7	-12.5	
Interest rate/growth differential [7]	-3.9	-1.4	0.2	-0.8	-1.4	-2.6	-2.5	-2.5	-2.7	-12.5	
Of which: real interest rate	-1.3	-0.4	1.7	0.4	-0.1	-0.7	-0.6	-0.6	-0.8	-2.3	
Of which: real GDP growth	-2.7	-1.0	-1.5	-1.3	-1.2	-1.9	-1.9	-1.9	-1.9	-10.1	
Exchange rate depreciation [8]	0.4	-0.7	-0.6	…	…	…	…	…	…	…	
Other identified debt-creating flows	-0.2	-3.4	4.8	-1.3	0.5	1.1	1.3	1.1	1.0	3.7	
Net privatization proceeds (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)	-0.2	-3.4	4.8	-1.3	0.5	1.1	1.3	1.1	1.0	3.7	
Residual, including asset changes [9]	3.6	1.8	-0.5	5.9	1.8	0.8	1.2	1.5	1.5	12.7	



Source: IMF staff.

1/ Public sector is defined as consolidated public sector.

2/ Based on available data.

3/ EMBIG.

4/ Debt coverage used in the authorities' budget documentation, consistent with the GFSM.

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

6/ Derived as [(r - π(1+g) - g + ae(1+r)]/(1+g+π+gπ)) 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).

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

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

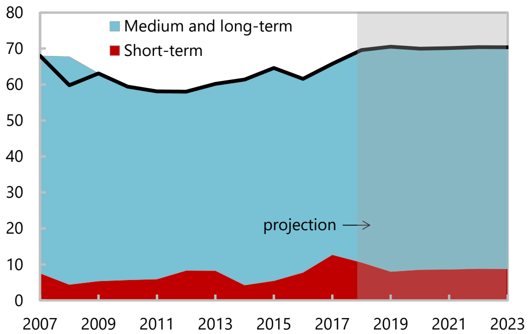
9/ Includes asset changes and interest revenues (if any). For projections, includes exchange rate changes during the projection period.

10/ 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.

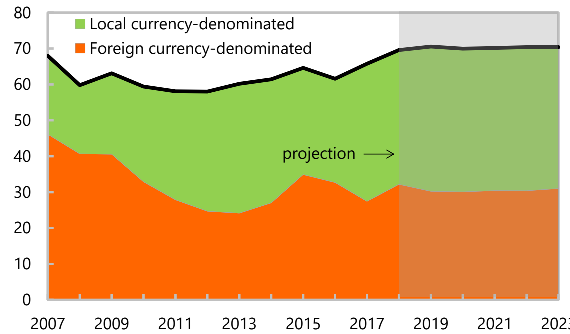
Figure 4. Uruguay: Public DSA—Composition of Public Debt and Alternative Scenarios
(Public Sector Debt)

Composition of PS Debt

By Maturity
(in percent of GDP)



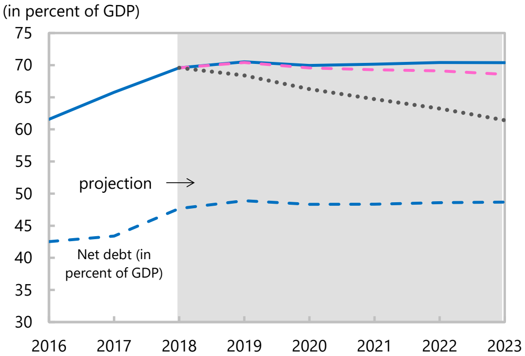
By Currency
(in percent of GDP)



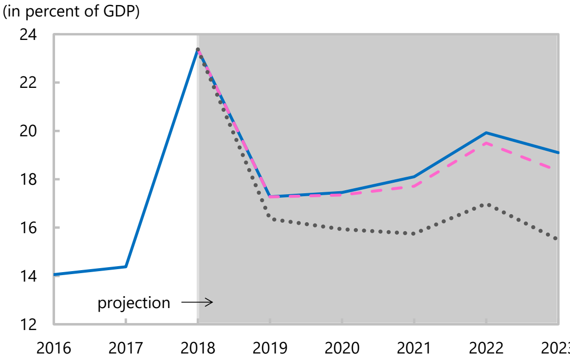
Alternative Scenarios

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	2018	2019	2020	2021	2022	2023
Real GDP growth	2.1	1.9	3.0	3.0	3.0	3.0
Inflation	6.5	6.8	7.3	7.3	7.2	7.4
Primary Balance	0.0	0.0	-0.1	-0.2	-0.1	-0.1
Effective interest rate	7.4	6.7	6.5	6.5	6.4	6.4
Constant Primary Balance Scenario						
Real GDP growth	2.1	1.9	3.0	3.0	3.0	3.0
Inflation	6.5	6.8	7.3	7.3	7.2	7.4
Primary Balance	0.0	0.0	0.0	0.0	0.0	0.0
Effective interest rate	7.4	6.7	6.5	6.5	6.5	6.4

Historical Scenario	2018	2019	2020	2021	2022	2023
Real GDP growth	2.1	4.1	4.1	4.1	4.1	4.1
Inflation	6.5	6.8	7.3	7.3	7.2	7.4
Primary Balance	0.0	0.5	0.5	0.5	0.5	0.5
Effective interest rate	7.4	6.7	6.4	6.3	6.2	6.2

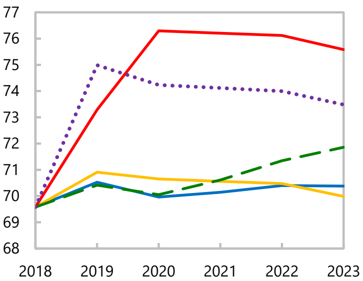
Source: IMF staff.

Figure 5. Uruguay: Public DSA—Stress Tests
(Public Sector Debt)

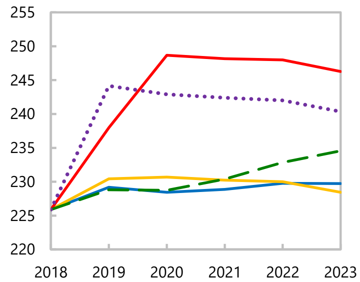
Macro-Fiscal Stress Tests

Baseline
Real GDP Growth Shock
Primary Balance Shock
Real Exchange Rate Shock
Real Interest Rate Shock

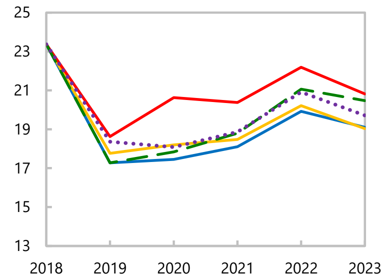
Gross Nominal Public Debt
(in percent of GDP)



Gross Nominal Public Debt
(in percent of Revenue)



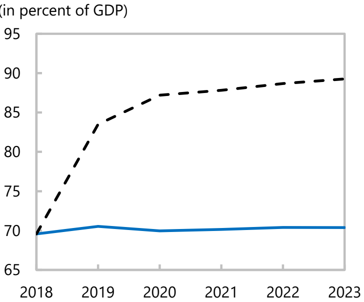
Public Gross Financing Needs
(in percent of GDP)



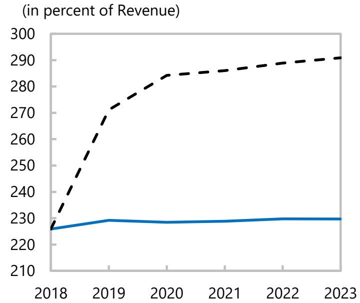
Additional Stress Tests

Baseline
Combined Macro-Fiscal Shock

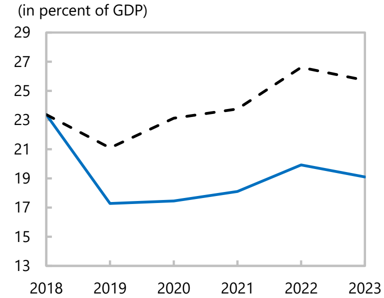
Gross Nominal Public Debt
(in percent of GDP)



Gross Nominal Public Debt
(in percent of Revenue)



Public Gross Financing Needs
(in percent of GDP)



Underlying Assumptions
(in percent)

Primary Balance Shock	2018	2019	2020	2021	2022	2023
Real GDP growth	2.1	1.9	3.0	3.0	3.0	3.0
Inflation	6.5	6.8	7.3	7.3	7.2	7.4
Primary balance	0.0	-0.5	-0.6	-0.2	-0.1	-0.1
Effective interest rate	7.4	6.7	6.5	6.6	6.5	6.4
Real Interest Rate Shock						
Real GDP growth	2.1	1.9	3.0	3.0	3.0	3.0
Inflation	6.5	6.8	7.3	7.3	7.2	7.4
Primary balance	0.0	0.0	-0.1	-0.2	-0.1	-0.1
Effective interest rate	7.4	6.7	7.1	7.5	7.8	8.0
Combined Shock						
Real GDP growth	2.1	-0.4	0.7	3.0	3.0	3.0
Inflation	6.5	6.2	6.7	7.3	7.2	7.4
Primary balance	0.0	-0.9	-1.9	-0.2	-0.1	-0.1
Effective interest rate	7.4	7.4	7.0	7.6	7.8	8.0

Real GDP Growth Shock	2018	2019	2020	2021	2022	2023
Real GDP growth	2.1	-0.4	0.7	3.0	3.0	3.0
Inflation	6.5	6.2	6.7	7.3	7.2	7.4
Primary balance	0.0	-0.9	-1.9	-0.2	-0.1	-0.1
Effective interest rate	7.4	6.7	6.5	6.6	6.5	6.5
Real Exchange Rate Shock						
Real GDP growth	2.1	1.9	3.0	3.0	3.0	3.0
Inflation	6.5	14.4	7.3	7.3	7.2	7.4
Primary balance	0.0	0.0	-0.1	-0.2	-0.1	-0.1
Effective interest rate	7.4	7.4	6.4	6.5	6.4	6.4

Source: IMF staff.

Annex III. External Debt Sustainability Analysis

1. **External debt in Uruguay peaked in 2015 at 82 percent of GDP but fell to 70 percent of GDP in 2017 (see Table)**. A strong current account has contributed to this downward movement. About 45 percent of the external debt is owed by the public sector.

2. **Gross external debt is estimated to decline slightly to 68 percent of GDP in 2018, and projected to gradually rise afterwards, where favorable automatic debt dynamics are offset by the projected current account deficits**.

3. **Gross external financing requirements are expected to increase gradually over the medium term with a normalization of the non-interest current account and amortization of longer-term debt.** Non-debt creating capital inflows are expected to support a slowly increasing long-term ratio of external debt to GDP.

4. **Stress tests indicate that the standard growth and interest rate shocks would have a minimal impact on external debt**. Shocks to the non-interest current account and a combined shock (to the real interest rate, growth and current account) would have a greater, but still moderate, impact.

5. **The main risk to Uruguay's external debt sustainability is an exchange rate depreciation**. A counterfactual 30 percent exchange rate depreciation would increase the external debt-to-GDP ratio by nearly 40 percentage points, other things being equal (see Figure). Nonetheless, given Uruguay's sizeable gross international reserves and liquidity buffers, risks to external debt sustainability remain limited.

Table 1. Uruguay: External Debt Sustainability Framework, 2013–2023

(In percent of GDP, unless otherwise indicated)

	Actual							Projections						
	2013	2014	2015	2016	2017			2018	2019	2020	2021	2022	2023	**Debt-stabilizing non-interest current account 7/**
Baseline: External debt 1/	66.2	72.0	82.1	75.9	69.6			**67.9**	**70.2**	**70.7**	**71.3**	**71.5**	**72.2**	**-0.6**
Change in external debt	-4.8	5.8	10.1	-6.2	-6.3			-1.7	2.3	0.5	0.6	0.3	0.7	
Identified external debt-creating flows (4+8+9)	-1.0	-1.3	3.6	-0.8	3.5			3.0	-1.6	-2.1	-1.6	-1.2	-0.8	
Current account deficit, excluding interest payments	1.8	1.2	-1.4	-2.9	-2.7			-1.3	-1.4	-1.0	-0.7	-0.4	-0.2	
Deficit in balance of goods and services	-1.4	-2.8	-3.2	-5.2	-6.1			6.0	5.9	5.4	5.2	4.8	4.7	
Exports	31.5	32.1	29.3	27.6	26.8			27.3	27.0	27.2	27.4	27.5	27.8	
Imports	-30.1	-29.3	-26.1	-22.4	-20.7			-21.4	-21.1	-21.8	-22.2	-22.7	-23.2	
Net non-debt creating capital inflows (negative)	4.8	4.4	1.6	-2.1	-3.7			-0.3	0.5	0.7	0.8	1.0	1.2	
Automatic debt dynamics 2/	-7.7	-6.9	3.4	4.1	9.9			4.6	-0.7	-1.8	-1.7	-1.9	-1.8	
Contribution from nominal interest rate	1.7	1.7	2.2	2.3	2.5			2.1	1.9	1.9	1.9	2.0	2.0	
Contribution from real GDP growth	-2.9	-1.9	-0.3	-1.4	-2.2			-1.5	-1.2	-2.0	-2.0	-2.0	-2.0	
Contribution from price and exchange rate changes 3/	-6.5	-6.8	1.5	3.3	9.6			4.0	-1.4	-1.8	-1.6	-1.8	-1.8	
Residual, incl. change in gross foreign assets (2-3) 4/	-3.8	7.1	6.5	-5.4	-9.8			-4.8	3.5	2.6	2.2	1.4	1.6	
External debt-to-exports ratio (in percent)	210.5	224.0	279.8	275.0	259.5			248.5	260.3	259.9	259.9	259.6	259.6	
Gross external financing need (in billions of US dollars) 5/	11.8	12.7	13.4	11.2	9.2			9.1	9.3	9.9	10.7	11.5	12.2	
in percent of GDP	20.4	22.2	25.1	21.3	15.5			15.1	15.5	15.6	15.9	16.3	16.4	
Scenario with key variables at their historical averages 6/						6-Year Historical Average	6-Year Standard Deviation	**67.9**	**71.0**	**73.2**	**74.9**	**75.7**	**76.7**	**-0.3**
Key Macroeconomic Assumptions Underlying Baseline														
Real GDP growth (in percent)	4.6	3.2	0.4	1.7	2.7	3.0	1.5	2.1	1.9	3.0	3.0	3.0	3.0	
GDP deflator in US dollars (change in percent)	10.1	11.4	-2.1	-3.8	-11.3	2.8	8.8	-5.5	2.0	2.5	2.3	2.5	2.5	
Nominal external interest rate (in percent)	2.8	3.0	3.0	2.7	3.0	3.5	0.9	2.9	2.9	2.9	2.9	2.9	2.9	
Growth of exports (US dollar terms, in percent)	0.0	1.6	-15.0	-7.0	9.1	-2.1	9.1	3.6	-1.3	6.3	6.4	5.9	6.7	
Growth of imports (US dollar terms, in percent)	4.2	-3.0	-17.0	-15.2	4.0	-5.4	10.2	4.8	-1.2	8.6	8.0	7.6	7.7	
Current account balance, excluding interest payments	-1.8	-1.2	1.4	2.9	2.7	0.3	2.3	1.3	1.4	1.0	0.7	0.4	0.2	
Net non-debt creating capital inflows	-4.8	-4.4	-1.6	2.1	3.7	-1.5	3.7	0.3	-0.5	-0.7	-0.8	-1.0	-1.2	

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.

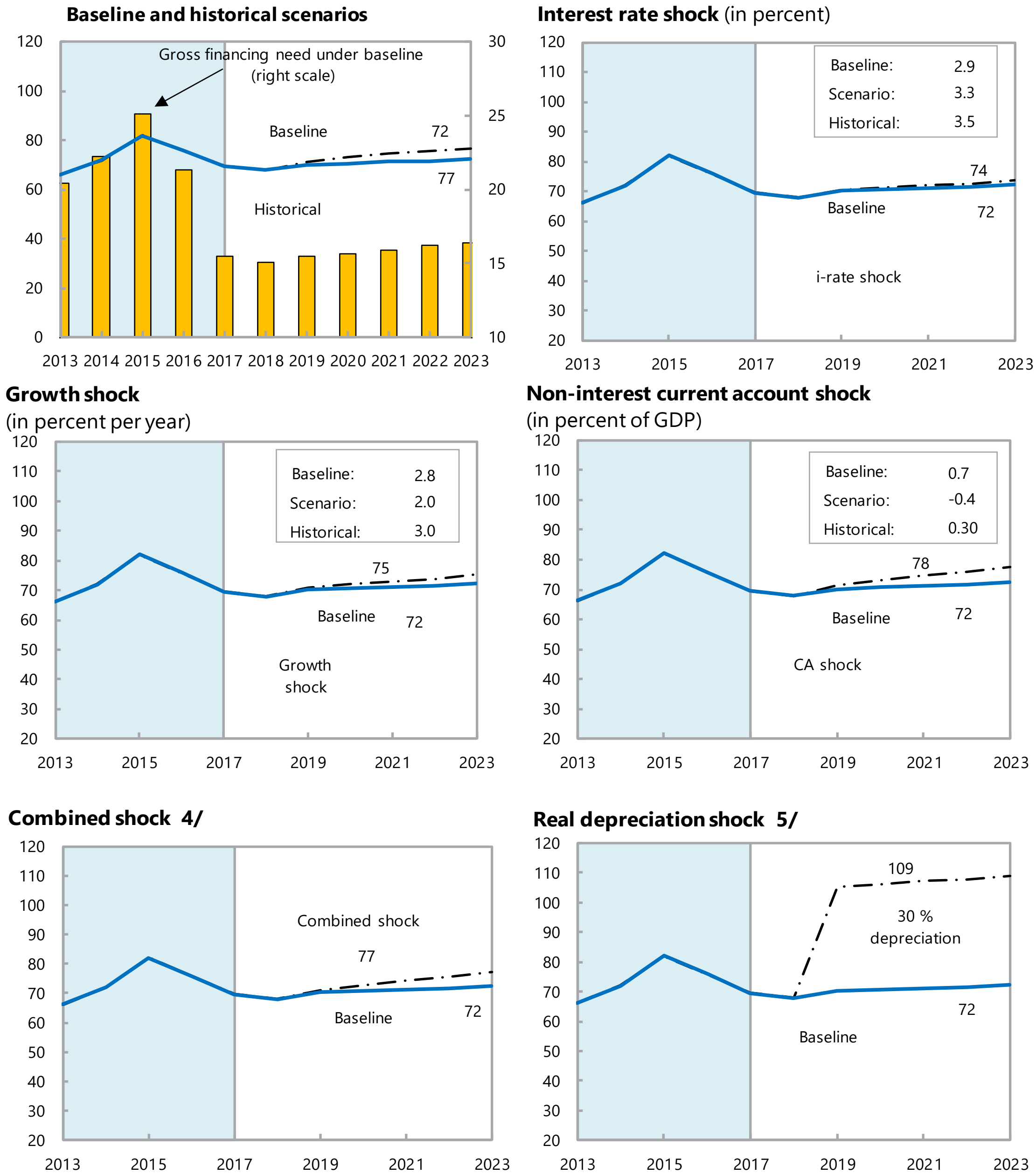
5/ Defined as current account deficit, plus amortization on medium- and long-term debt, plus short-term debt at end of previous period.

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.

Figure 1. 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. Six-year historical average for the variable is also shown.
2/ For historical scenarios, the historical averages are calculated over the six-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 2018.

INTERNATIONAL MONETARY FUND

URUGUAY

January 29, 2019

STAFF REPORT FOR THE 2018 ARTICLE IV CONSULTATION—INFORMATIONAL ANNEX

Prepared By	Western Hemisphere Department (in consultation with other departments)

CONTENTS

FUND RELATIONS 2

RELATIONS WITH OTHER INTERNATIONAL INSTITUTIONS 5

STATISTICAL ISSUES 6

FUND RELATIONS

(As of November 30, 2018)

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

General Resources Account:	**SDR Million**	**%Quota**
Quota	429.10	100.00
IMF's Holdings of Currency (Holdings Rate)	366.89	85.50
Reserve Tranche Position	62.21	14.50
SDR Department:	**SDR Million**	**%Allocation**
Net cumulative allocation	293.26	100.00
Holdings	214.70	73.21

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	Jun 24, 2003	128.70	128.70
Stand-By	May 31, 2000	Mar 31, 2002	150.00	150.00

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

		Forthcoming			
	2018	2019	2020	2021	2022
Principal					
Charges/Interest		0.85	0.85	0.85	0.85
Total		0.85	0.85	0.85	0.85

Implementation of HIPC Initiative: Not Applicable

Implementation of Multilateral Debt Relief Initiative (MDRI): Not Applicable

Implementation of Catastrophe Containment and Relief (CCR): Not Applicable

As of February 4, 2015, the Post-Catastrophe Debt Relief Trust has been transformed to the Catastrophe Containment and Relief (CCR) Trust.

[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.

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$). Uruguay's de jure and de facto exchange rate arrangements are classified as floating. Since June 2013, monetary policy targets the growth rate of M1 plus saving deposits as the intermediate instrument. On January 4, 2019, the exchange rate in the official market was UY$ 32.46 per U.S. dollar. Uruguay has accepted the 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 2008–18.

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 OTHER INTERNATIONAL INSTITUTIONS

- World Bank: https://www.worldbank.org/en/country/uruguay
- Inter-American Development Bank: https://www.iadb.org/en/countries/uruguay/overview

STATISTICAL ISSUES

(As of January 8, 2019)

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), set the reference period for the volume estimates in 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.
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
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 January 16, 2019)

	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	01/14/19	01/15/19	D	D	D		
International Reserve Assets and Reserve Liabilities of the Monetary Authorities 1/	01/14/19	01/15/19	D	D	D		
Reserve/Base Money	Dec 2018	Jan 2019	M	M	M		
Broad Money	Dec 2018	Jan 2019	M	M	M		
Central Bank Balance Sheet	Dec 2018	Jan 2019	M	M	M		
Consolidated Balance Sheet of the Banking System	Dec 2018	Jan 2019	M	M	M		
Interest Rates 2/	01/14/19	01/15/19	D	D	D		
Consumer Price Index	Dec 2018	Jan 2019	M	M	M	O, LO, O, O	LO, O, O, LNO, NO
Revenue, Expenditure, Balance and Composition of Financing 3/– Central Government 4/	Nov 2018	Dec 2018	M	M	M		
Stocks of Central Government and Central Government-Guaranteed Debt 4/ 5/	Q3/2018	Dec 2018	Q	Q	Q		
External Current Account Balance	Q3/2018	Dec 2018	Q	Q	Q		
Exports and Imports of Goods and Services	Nov 2018	Dec 2018	M	M	M		
GDP/GNP	Q3/2018	Dec 2018	Q	Q	Q	LO, LO, LO, LO	LNO, LNO, LO, O, LO
Gross External Debt	Q3/2018	Dec 2018	Q	Q	Q		
International Investment Position 6/	Q3/2018	Dec 2018	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 Mr. Lopetegui and Mr. Vogel on Uruguay

February 13, 2019

I. An Unprecedented Period of Growth

Uruguay has posted positive economic growth each year since 2003, which constitutes its longest uninterrupted period of expansion in modern times.

II. What Decoupling Means

Uruguay managed to sustain growth despite economic recessions in Argentina and Brazil. This is a stark departure from past episodes of regional volatility, when Uruguay systematically suffered economic contractions, often even deeper than its neighbors. In the past, this was due to its domestic financial vulnerabilities, low levels of export diversification, and the lack of instruments or policies that prevented Uruguay from appropriately absorbing external shocks.

During this period of growth, Uruguay has managed to smoothly transit an extremely bumpy road. This included, among others, the 2008 global crisis, Brazil's deepest recession in its history during 2015-16, and three years of recession over the past five years in Argentina, which comprised a sudden and sharp depreciation of its local currency in 2018, especially during the third quarter.

Evidently, economic and financial decoupling is an appropriate concept to illustrate the critical reduction of Uruguay's exposure to its two big neighbors, and its significant policy buffers. Of course, decoupling does not mean that the country does not suffer the impact of regional shocks; indeed, the robustness of Uruguay's growth is not the same as was until 2013, while fiscal and external accounts, as well as labor market indicators, have been clearly impacted by regional episodes.

Hence, decoupling means that Uruguay has been able to continue growing amidst negative external shocks, keeping macroeconomic and financial indicators fully under control, sustaining the process of social improvements, and enjoying the confidence of investors and rating agencies, all of which constitute a testament of the country's sound economic policies, a long process of structural reforms, and the quality of its institutions.

III. The Fundamental Objective of Inclusive Growth

One essential development to underscore is that this period of economic expansion has been simultaneously accompanied with a substantial improvement in social conditions, especially for society's most vulnerable sectors. Poverty rates have systematically declined, for instance, from 32.5 percent in 2006 to 7.9 percent in 2017 (the latest available figure), without recording a single year of increase. Furthermore, extreme poverty decreased from 2.5 percent to 0.1 percent in the same period of comparison, while the Gini Index, declining from 0.455 to 0.38, reflects significant progress towards reducing inequality.

As previously noted, even in years in which growth rates, although positive, have been more tepid, the process of social improvements has continued unabated, in line with one of the key objectives of the authorities' economic policies, which is inclusive growth. As others worldwide, Uruguay's case demonstrates that growth and social progress can, and should, go hand-in-hand.

The authorities would like to express their satisfaction with the IMF's strong emphasis on the need to reduce inequalities, which, for instance, is highlighted in the last World Economic Outlook (WEO) update as one of the potential triggers of downside risks for the global economy.

IV. Orientations, Policies, and Reforms

- Diversification

An increasing integration of the country into the global economy has constituted another key objective of the Uruguayan authorities. The evolution of merchandise exports reflects, to a good extent, the process of diversification carried out by the country. While twenty years ago merchandise exports to Brazil and Argentina represented about 50 percent of Uruguay's exports, currently the figure is half of what it used to be. Diversification has happened not only in terms of markets and origins of foreign direct investment, but also with regards to products, where non-traditional exports of goods, and especially services, have been substantially spread; service exports, which include software, financial consultancy, audiovisual products, and logistics, among others, have significantly increased with a consequent impact on skilled-labor demand and wages. That said, Uruguay does remain heavily dependent on Argentine demand within the country's borders, representing around two thirds of total tourism revenue.

- Prudence

The Uruguayan authorities are fully aware of the need to intensify efforts in the fiscal area and continue to be absolutely committed to fiscal consolidation, a key priority for the government, with the objective of reducing debt levels relative to GDP. Admittedly, fiscal figures and targets are different from those projected in the budget under very different realities. As stressed before, decoupling does not mean being impervious to regional shocks. When the current budget was prepared, the IMF's April 2018 WEO projected growth rates of 2 percent for 2018 and 3.2 percent for 2019 for Argentina; and 3.9 percent for the world economy for this year (instead of the current 3.5 percent). Amidst this adjustment in global growth and in the region, and in line with what has been mentioned regarding growth developments, the fiscal situation continues to be under control, but, as may have been expected, it has not been (and will not be) immune. Among other things, private investment reacted to the less benign circumstances, leading the authorities to introduce tax incentives aimed at reactivating it, which is starting to bear fruit.

- Consistency

It is impossible to have a sustainable economic expansion and social progress without macroeconomic stability. In that vein, as underlined by the authorities, consistency among policies (which refers to fiscal, monetary, exchange rate, debt-management, and income policies) is crucial.

After reaching two-digit inflation rates in the first quarter of 2016, the Central Bank adopted a tighter stance of its monetary policy, which led to a reduction of inflation and inflation expectations. Inflation was within the target range (and close to its middle point) from March 2017 to April 2018 (with the exception of February 2018, when inflation stayed a little above the band). As noted in the staff report, the impact of a drought and peso depreciation were relevant factors to understand inflationary developments thereafter. Nonetheless, once the above-referred factors dissipated, inflation restarted a declining trend, with the latest figure (7.4 percent accumulated during a 12-month period until January 2019) approaching even closer to the target range. The Central Bank has announced that it will maintain a contractionary policy bias to help contain inflationary pressures.

The authorities' disinflation efforts also center on reducing inertial price pressures. Many of the ongoing multi-year wage negotiations are closing in line with the guidelines—which continue to eschew indexation—, thereby anchoring non-tradable prices and tempering inflation inertia.

Meanwhile, the authorities reaffirm their full adherence to a flexible exchange rate regime, a key element to cushion external shocks. Interventions will continue to be reserved to limit excessive volatility. Amidst a period of volatility during the third quarter of 2018, which evidently was not consistent with fundamentals but a clear over-reaction following regional developments, interventions in the foreign exchange market were more frequent.

The Central Bank has maintained high levels of international reserves, which are well above prudential international norms. By end-December 2018, international reserves totaled USD15.6 billion (approximately 25.4 percent of GDP). More importantly, these levels have remained largely stable over the last few years, with reserves-to-GDP ratios consistently surpassing 25 percent since 2012.

The authorities take note of the staff's assessment that the external position is broadly consistent with fundamentals and desirable policy settings.

- Financial Buffers

Over the past decade and a half, the Uruguayan authorities have worked toward strengthening macroeconomic and financial stability. Active debt management has played an important role in mitigating financial vulnerabilities associated with currency and maturity mismatches. Debt management strategy has limited refinancing risk by lengthening the maturity of the debt and smoothing the redemption profile. Debt in foreign currency is currently 54 percent of total debt (it was 89 percent in 2005); average time to maturity has been extended to 14.5 years (compared to 8 years); and debt at fixed-rate is 94 percent (vs. 78 percent).

Regarding the latest developments, it is noteworthy that at the beginning of 2019, Uruguay was the first Latin American sovereign to tap international debt markets, issuing a new dollar-denominated global bond with maturity 2031 at 175 bps over US Treasuries.

As noted in the most recent IMF Fiscal Monitor, the country has made substantial progress in measuring and managing sovereign risk exposures across the consolidated public sector. The authorities have implemented transactions across public-sector institutions designed to offset risks, attain hedging gains, reduce borrowing costs, and increase asset returns within the entire public sector.

Rating agencies' assessments also reflect confidence in the country. In their latest releases, Moody's reaffirmed Uruguay's Baa2 rating with stable outlook, while R&I and DBRS also confirmed the country's ratings.

- Soundness

Uruguay's substantial efforts and reforms in the financial system, in terms of governance of public banks, as well as regulation and supervision of the system, are perfectly mirrored in the system's developments over the years.

Macro-prudential measures anchored in the implementation of the Basel regulatory framework have played an important role for ensuring financial stability; the banking sector continues to present sound financial indicators, including high capital levels and adequate liquidity buffers.

Local effects on regional shocks have been negligible in the financial sector, which was once a major transmission channel of crises. Figure 6 of the staff report exhibits the drastic reduction of the financial system linkages to Argentina. Although increasing due to transitory factors, non-performing loans, at about 4 percent, remain at low levels, not only at regional but also global levels.

Developments at the Banco República Oriental del Uruguay (BROU), Uruguay's public bank, constitute an excellent example of the benefits entailed by reforms. Once a critical source of vulnerabilities (largely stressed in IMF reports before the 2002 crisis), good governance and professional management have led to excellent results. Therefore, in 2018, BROU presented a record in its profits and a further improvement in capital indicators.

V. Institutions

It would not be possible to fully understand Uruguay's economic and social developments without considering the fundamental role of its strong institutions as the pillars of the country. In order to mention just a few indicators that reflect the above-referred robustness, we underline that Uruguay is within the group of 20 countries—out of 167 around the world—characterized as full democracies by the Democracy Index 2018 of The Economist Intelligence Unit, with an overall score of 8.38 (scores are between 0 and 10), recording 10 or about 10 in the sub-indexes of Civil Liberties and Electoral Process and Pluralism.

Moreover, the latest report on Corruption Perception Index from Transparency International ranked Uruguay 23rd out of 180 countries, with a score of 70 (0-100), occupying the first place among all emerging economies, and above many advanced economies.

VI. Looking Forward

A number of developments, at global, regional and domestic levels, entail substantial challenges for the country. As noted before, fiscal consolidation is a key priority for the authorities. The staff report stresses the impact on fiscal accounts that population aging, which is especially relevant in Uruguay, is going to have, noting that "early action will help smooth the transition to a revised system and reduce costs compared to a delayed response when aging pressures become more acute”. Growing consensus among Uruguay’s political spectrum and society in general will be key in this regard. Attaining more vigorous private investment will be essential for growth and employment creation; significantly more efforts are needed in this area. Improvements in education will be essential for Uruguay to successfully face the future and the continuation of the country’s insertion in the global economy. Inclusiveness is always a work in progress, and sustained efforts are essential; financial inclusion is one of the multiple dimensions of inclusiveness, in which the authorities have attained important achievements, such as those underlined in the staff report, when noting that “low-income households and small and micro enterprises have access to free bank accounts and debit cards”.

On-going infrastructure planning is key to establish the foundation for long-term economic growth. Infrastructure investments will become a sustainable pillar of GDP growth moving forward. Along with the potential construction of a new pulp mill by Finland’s UPM, the government’s 2015-19 infrastructure plan actively targets new investments in transportation, energy, communications, and social infrastructure under PPP schemes. The flagship project in the country infrastructure’s program will be a new railway line in the corridor of the country.

In sum, positive results, as well as the recognition of the international community, markets, multilateral institutions, and rating agencies, do not by any means constitute reasons for complacency, but further stimulus to keep working along the lines of robust policies and institutions.