INTERNATIONAL MONETARY FUND

IMF Country Report No. 24/215

URUGUAY

July 2024

2024 ARTICLE IV CONSULTATION—PRESS RELEASE; AND STAFF REPORT

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 2024 Article IV consultation with Uruguay, the following documents have been released and are included in this package:

- A **Press Release**
- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on a lapse-of-time basis, following discussions that ended on May 3, 2024, 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 June 14, 2024.
- An **Informational Annex** prepared by the IMF staff.

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.

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International Monetary Fund
Washington, D.C.

PRESS RELEASE

PR24/265

IMF Executive Board Concludes 2024 Article IV Consultation with Uruguay

FOR IMMEDIATE RELEASE

Washington, DC – July 11, 2024: The Executive Board of the International Monetary Fund (IMF) concluded the Article IV Consultation[1] with Uruguay and endorsed the staff appraisal without a meeting on a lapse-of-time basis.

The 2024 Article IV Consultation for Uruguay met the established Executive Board criteria for lapse-of-time consideration, including the following conditions: (i) there are no acute or significant risks, or general policy issues requiring Board discussion; (ii) policies or circumstances are unlikely to have a significant regional or global impact in the near term; and (iii) the use of Fund resources is not under discussion or anticipated.

Recent Developments

In 2023, Uruguay confronted the impact of a once-in-a-century severe drought and external headwinds, but the economy remained resilient, owing to the authorities' sound macroeconomic policies, the country's political stability, and strong institutions. From October 2022 to April 2023, rainfall was about 47 percent below historical averages, affecting key agricultural areas. Real GDP growth slowed to 0.4 percent in 2023. Employment rose by 37,000 to 1.7 million in 2023, while the unemployment rate continued to hover around 8 percent. Inflation fell within the target range in mid-2023, reaching its lowest level in the last eighteen years. The financial sector remained resilient, and the banking system is well capitalized, highly liquid, and profitable.

As inflationary pressures cooled off, the Banco Central del Uruguay (BCU) started its easing cycle in April 2023. The Monetary Policy Committee of the BCU gradually lowered the monetary policy rate from 11.5 percent at the start of 2023 to 8.5 percent in April 2024 as headline inflation reverted within the target range and inflation expectations gradually declined. At the end of 2023, the authorities reaffirmed that the BCU inflation target is the center of the target band (4.5 percent).

The deficit and debt outcomes were consistent with the targets of the fiscal rule in 2023. Adherence to the fiscal rule for four consecutive years has helped stabilize the debt-to-GDP ratio under a sequence of negative shocks. The pension system reform, that was approved in May 2023, is expected to stabilize spending over the medium-term. The improved fiscal outlook is being reflected in historically low sovereign spreads, including the lowest EMBI (emerging markets bond index) spread in Latin America.

The economy is expected to strongly rebound in 2024, while macroeconomic risks are broadly balanced. The recovery of agricultural exports, increased cellulose production, easing of

[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.

financial conditions and robust private consumption, as real wages recover and the price differential with Argentina normalizes, are expected to support a growth rate of 3.4 percent in 2024 and 3 percent in 2025. Inflation is projected to pick up in the second half of 2024, but stay within the target range, following a gradual easing of monetary policy and robust wage growth. Downside risks are derived from a worsening of external financial conditions, deterioration of international geopolitical tensions and the potential for further extreme climate events. Upside risks draw from events that could bring higher-than-expected agricultural export prices or lower fuel import prices.

Executive Board Assessment[2]

In concluding the 2024 Article IV Consultation with Uruguay, Executive Directors endorsed staff's appraisal, as follows:

In 2023, Uruguay confronted the impact of a once-in-a-century severe drought and external headwinds, but the economy remained resilient, owing to the authorities' sound macroeconomic policies, the country's political stability, and strong institutions. Despite the challenging environment, Uruguay maintained favorable market access with improved sovereign debt ratings and sovereign spreads at historically low levels, including the lowest spreads in the region. The current administration, in office since 2020, has implemented a significant upgrade of the fiscal and monetary policy frameworks and has advanced decisive structural reforms. In 2023, the authorities approved a key pension reform, placing medium-term public finances on a more sustainable path, and started implementing an education reform. Consolidating these gains should be the most important priority, as they provide the necessary macroeconomic policy space to confront domestic and external risks and support long-term growth.

While the 2024 revised budget is aligned with the net indebtedness target of the fiscal rule and social protection objectives, further efforts are needed to ensure a sustained downward path for the debt-to-GDP ratio over the medium term. The projected NFPS deficit, excluding *cincuentones*, of 3.1 percent of GDP in 2024 balances deficit reduction with safeguarding social spending, a sizeable share of total expenditures. While the current fiscal rule has been successful at stabilizing the debt-to-GDP ratio under challenging circumstances, further efforts are needed to ensure a sustained downward path for the debt-to-GDP ratio and rebuild fiscal buffers over the medium term, requiring lower targets for the structural balance and net indebtedness pillars of the fiscal rule. Refinements to the fiscal framework would help consolidate recent credibility gains.

Monetary policy should remain contractionary to ensure that inflation and inflation expectations stay within the target range in a sustained manner. Sustained monetary policy vigilance is crucial for continuing to build credibility and supporting de-dollarization efforts by delivering low and stable inflation rates. The authorities should continue emphasizing that the inflation target is the mid-point of the target band (4.5 percent) in their public communications, to help anchor expectations. Enhancing de jure central bank independence would further improve credibility and support policy continuity.

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[2] The Executive Board takes decisions under its lapse-of-time procedure when the Board agrees that a proposal can be considered without convening formal discussions.

The financial sector remained resilient. The banking system is well capitalized, highly liquid, and profitable. Amid higher international interest rates and a more stable exchange rate, profitability increased. Despite last year's economic slowdown and losses in the agricultural sector, non-performing loans remained low with adequate loan loss provisions. In line with past FSAP recommendations, the SSF should continue pursuing efforts to upgrade its risk-based supervision framework, by enhancing its stress-testing framework and closing data gaps. Operationalizing the Pillar II capital add-ons will create an opportunity to address the adverse effect on capital buffers from the bank wealth tax.

Efforts to continue implementing structural reforms are key to unlock potential growth, while climate adaptation efforts need to be intensified. The implementation of the education reform is critical to provide the human capital Uruguay needs in the medium-term to foster the adoption of innovative technologies and increase productivity. The deepening of Uruguay's global integration should focus on pursuing efforts for trade facilitation, addressing non-tariff barriers and red tape, and reducing logistics costs. Reducing backward-looking indexation and introducing more sectoral differentiation in wage negotiations would support the disinflation process and competitiveness. Uruguay has been at the forefront of climate finance innovation. Droughts are becoming particularly relevant considering the output losses to the agricultural sector and the required recurrent fiscal interventions. Against this backdrop, it is critical to enhance water resource management, promote sustainability, and increase resilience to droughts.

Table 1. Uruguay: Selected Economic Indicators, 2021-25

				Projections	
	2021	2022	2023	2024	2025
Output, prices, and employment					
Real GDP (percent change)	5.6	4.7	0.4	3.4	3.0
GDP (US$ billions)	60.8	70.2	77.2	82.8	87.0
Unemployment (in percent, pa)	9.4	7.9	8.3	8.2	8.0
Output gap (percent of potential output)	-2.0	-0.5	-1.7	-0.9	-0.4
CPI inflation (in percent, end of period)	8.0	8.3	5.1	5.5	5.4
	(Percent change, unless otherwise indicated)				
Monetary and banking indicators 1/					
Base money	9.1	1.7	9.0	...	...
M2	16.2	7.2	11.3	...	...
Growth of credit to households (in real pesos)	4.4	6.4	7.0	...	...
Growth of credit to firms (in US$)	7.0	19.1	11.2	...	...
Bank assets (in percent of GDP)	75.0	68.0	63.8	...	...
Private credit (in percent of GDP) 2/	26.7	26.8	28.8	...	...
Monetary policy rate (end of period)	5.8	11.3	9.0	...	...
	(In percent of GDP, unless otherwise indicated)				
Fiscal sector indicators 3/					
Revenue CG-BPS (A)	27.3	27.5	27.7	27.7	27.8
excluding *cincuentones*	27.0	27.4	27.7	27.7	27.8
Primary expenditure CG-BPS (B)	28.2	28.2	28.6	28.6	28.6
Primary balance of local governments (C)	0.1	0.1	0.0	0.0	0.0
Primary balance of BSE (D)	0.1	0.0	-0.1	0.2	0.2
Primary balance NFPS (A-B+C+D)	-0.6	-0.5	-0.9	-0.7	-0.6
excluding *cincuentones* 4/	-0.9	-0.6	-0.9	-0.7	-0.6
Interest NFPS	2.0	2.0	2.1	2.3	2.1
Overall balance CG-BPS	-3.7	-2.9	-3.0	-3.3	-3.0
excluding *cincuentones* 4/	-4.1	-3.1	-3.1	-3.4	-3.1
Overall balance NFPS	-2.6	-2.5	-3.1	-3.0	-2.6
excluding *cincuentones* 4/	-3.1	-2.7	-3.2	-3.1	-2.7
Gross debt NFPS	64.1	60.3	64.5	64.6	64.9
Gross debt CG-BPS (authorities' definition)	60.0	56.7	58.6	58.7	59.0
External indicators					
Merchandise exports, fob (US$ billions)	15.8	17.0	15.1	16.6	17.9
Merchandise imports, fob (US$ billions)	11.2	13.5	13.0	14.1	15.0
Terms of trade (percent change)	2.0	-1.8	0.3	0.3	2.5
Current account balance	-2.4	-3.9	-3.6	-3.1	-2.8
Total external debt + non-resident deposits	79.7	76.0	67.2	69.4	68.4
Of which: External public debt	35.1	29.6	29.9	34.0	33.4
External debt service (in percent of exports of g&s)	56.9	53.7	58.0	51.9	45.6
Gross official reserves (US$ billions)	17.0	15.1	16.2	16.4	16.6
In months of imports of goods and services	13.4	9.6	10.3	9.9	9.5
In percent of:					
Short-term external (STE) debt	646	636	690	576	563
STE debt plus banks' non-resident deposits	300	272	288	261	254

Sources: Banco Central del Uruguay, Ministerio de Economia y Finanzas, Instituto Nacional de Estadistica, and IMF staff calculations.
1/ Percent change of end-of-year data.
2/ Includes bank and non-bank credit.
3/ Non-financial public sector (NFPS) includes the Central Government (CG), Banco de Prevision Social (BPS), Banco de Seguros del Estado (BSE), and Non-Financial Public Enterprises (NFPE).
4/ Temporary proceeds resulting from the pension reform that allowed workers above 50 years old (and with certain income level) to voluntarily move back to the public pension system. Proceeds are projected to end in 2022.

INTERNATIONAL MONETARY FUND

URUGUAY

STAFF REPORT FOR THE 2024 ARTICLE IV CONSULTATION

June 14, 2024

KEY ISSUES

Context. In 2023, Uruguay confronted the impact of a once-in-a-century drought, causing significant direct losses to the primary sector. The economic situation in Argentina created further headwinds for Uruguay, although with no signs of financial spillovers. The economy remained resilient, owing to the authorities' sound macroeconomic policies, the country's political stability, and strong institutions. The current administration, in office since 2020, has implemented a significant upgrade of the fiscal and monetary policy frameworks and has advanced decisive structural reforms. Consolidating these gains should be the most important priority.

Recent Developments. While economic growth decelerated in 2023, employment rose, and inflation fell within the target range. As inflationary pressures cooled off, the Banco Central del Uruguay started lowering its monetary policy rate in April 2023, while maintaining a contractionary stance. The authorities reaffirmed that the BCU inflation target is the center of the target band (4.5 percent). Amid external headwinds and severe weather shocks, the fiscal deficit increased during 2023. Uruguay's fiscal rule played a notable role in strengthening fiscal discipline, while the pension reform approval improved longer-term debt dynamics, amid historically low sovereign spreads.

Outlook and Risks. The economy is expected to strongly rebound in 2024, underpinned by the recovery of agricultural exports, increased cellulose production, easing of financial conditions and robust private consumption. Main risks are broadly balanced. Overall fiscal and external risks are low. Staff assesses there is some fiscal space to address adverse shocks without impacting market access. The financial sector is well-positioned to sustain severe funding pressure and severe macro-financial shocks.

Policy Issues. The post-drought growth momentum creates opportunities for reinvigorating fiscal consolidation efforts. The crafting of the next five-year budget law opens an opportunity to recalibrate the fiscal rule targets to place debt on a downward path. Refinements to the fiscal rule would help consolidate recent credibility gains. Monetary policy should remain contractionary to ensure that inflation and inflation expectations stay within the target range in a sustained manner. Structural reforms are key to unlock potential growth, create policy space to preserve the country's safety net and social cohesion, and support favorable sovereign debt ratings.

Approved By
Patricia Alonso-Gamo (WHD) and S. Jay Peiris (SPR)

Discussions took place in Montevideo from April 23 to May 3, 2024. The staff team comprised of Pau Rabanal (head), Jean Francois Clevy, Christopher Evans (all WHD) and Marie Pierre Aquino (ICD). Roberta Guarnieri, Diego Gutierrez, Mariana Bravo Coello and Nicolas Landeta (WHD) assisted the team through research assistance and editorial support. Inés Bustillo (OED) attended key meetings with the authorities. The team met with Minister of Economy and Finance Arbeleche, Central Bank President Labat, Minister of Labor Mieres, Minister of Agriculture Mattos, Director of the Office of Planning and Budget Blanco, other senior government officials, as well as representatives of state-owned enterprises, labor unions, the private sector, and academia.

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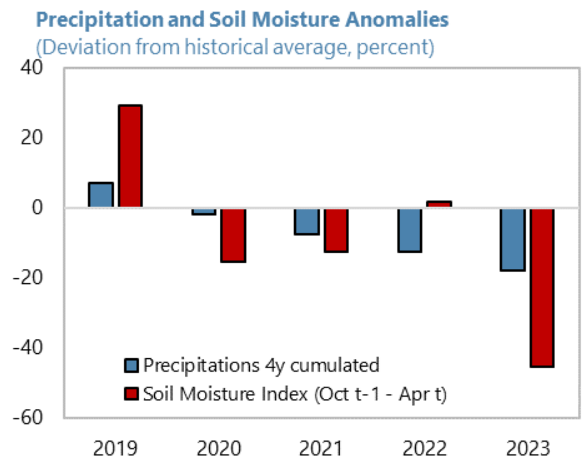
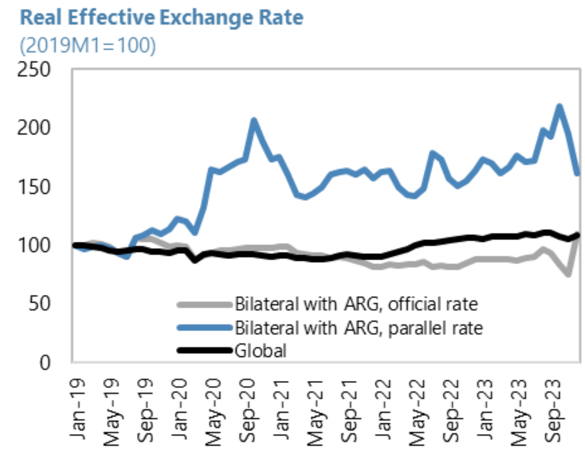
CONTEXT

1. In 2023, Uruguay confronted the impact of a once-in-a-century severe drought. From October 2022 to April 2023, rainfall was about 47 percent below historical averages, affecting key agricultural areas, and causing significant direct losses to the primary sector, especially for soybean production and cattle farming. Agricultural output was mostly affected between the last quarter of 2022 and the second quarter of 2023 when it declined by 25 percent on a year-on-year basis, although it quickly recovered in the second half of the year as rainfall normalized. The authorities declared an agricultural emergency between October 2022 and December 2023 to support affected sectors.



Sources: IMF staff calculations, INE, INUMET, INIA.



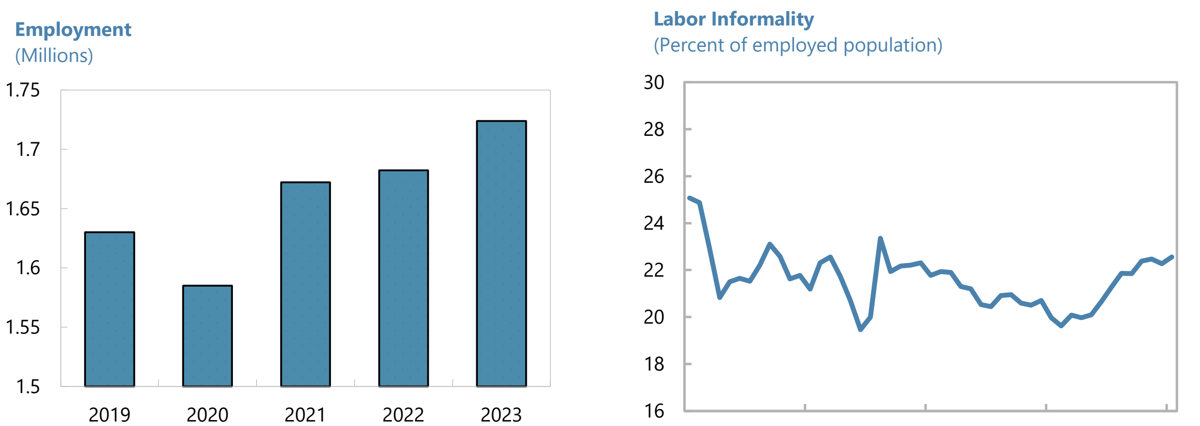
Sources: IMF staff calculations, BCU, IMF INS.

2. The economic situation in Argentina created further headwinds for Uruguay. Amid a strong Uruguayan peso, the substantial depreciation of Argentina's currency, particularly in the parallel market, motivated important cross-border consumption flows taking advantage of relatively cheaper Argentinian goods and services, doubling the number of Uruguayans visiting Argentina in 2023. This situation depressed commercial activity in Uruguay, particularly in border cities, and weighed on domestic consumption and tax collection. Meanwhile, there were no financial sector spillovers.

3. Against this backdrop, the economy remained resilient, owing to the authorities' sound macroeconomic policies, the country's political stability, and strong institutions. Despite the challenging environment, Uruguay maintained favorable market access with improved sovereign debt ratings and sovereign spreads at historically low levels, including the lowest spreads in the region. The current administration, in office since 2020, has implemented a significant upgrade of the fiscal and monetary policy frameworks and has advanced decisive structural reforms. In 2023, the authorities approved a key pension reform, placing medium-term public finances on a more sustainable path, and started implementing an education reform. Consolidating these gains should be the most important priority, as they provide the necessary macroeconomic policy space to confront domestic and external risks and support long-term growth.

RECENT DEVELOPMENTS

4. **Economic growth decelerated in 2023.** Real GDP growth slowed to 0.4 percent in 2023, owing to the effects of the drought on agricultural production and electricity generation. IMF staff estimates that the impact of the drought on growth was about 1 percent in 2023 (Annex I). Moreover, the temporary closure of the country's oil refinery since September and a slowdown in construction as works associated with the UPM-II pulp mill were completed also weighed on growth. Imports of goods and services rose as fuel imports increased to cover the oil refinery stoppage and the drought led to higher imports of foods and intermediate inputs for agricultural production, applying further downward pressure on growth. Employment rose by 37,000 to 1.7 million in 2023, while the unemployment rate continued to hover around 8 percent, and the share of labor informality increased moderately relative to 2022 while remaining amongst the lowest in the region.



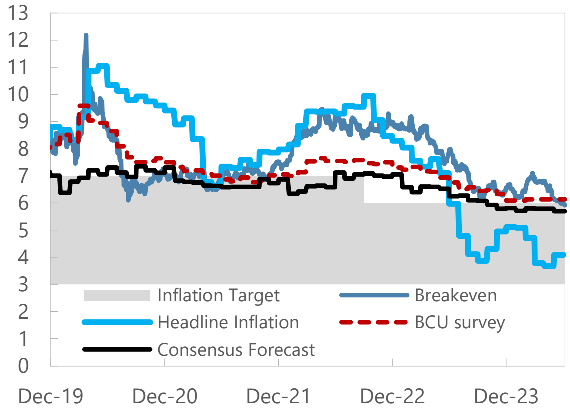
Sources: INE and IMF staff calculations

5. **Inflation fell within the target range in mid-2023, reaching its lowest level in the last eighteen years.** CPI inflation fell from 8.3 percent in December 2022 to 5.1 percent in December 2023, the lowest end-of-year value since 2005, owing to a strong contractionary monetary policy response in 2022, the appreciation of the Uruguayan peso, and falling import prices. Inflation expectations have recently converged to the central bank target range, reflecting gains in policy credibility, enhanced central bank communication and the continued easing of price pressures in the first quarter of 2024. CPI inflation reached 4.1 percent in May, achieving one year within the target range. The decline in inflation has been driven by lower goods inflation, while non-tradables core inflation, that includes services, has proved stickier (currently at 6.7 percent).

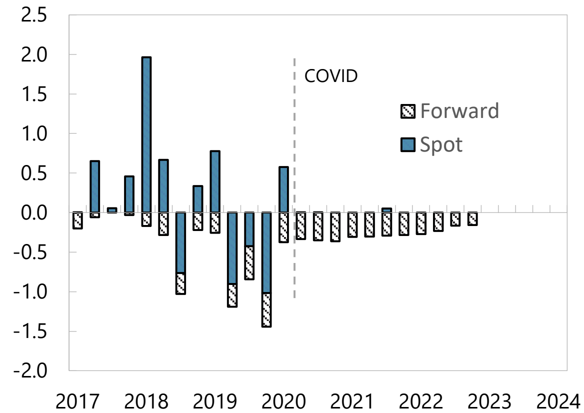
6. **As inflationary pressures cooled off, the Banco Central del Uruguay (BCU) started its easing cycle in April 2023.** The Monetary Policy Committee of the BCU gradually lowered the monetary policy rate from 11.5 percent at the start of 2023 to 8.5 percent in April 2024 as headline inflation reverted within the target range and inflation expectations gradually declined. While cutting nominal interest rates, the BCU kept a contractionary stance by keeping ex-ante real rates above the neutral rate throughout 2023. At the end of 2023, the authorities reaffirmed that the BCU inflation target is the center of the target band (4.5 percent) in a Macroeconomic Coordination

Committee meeting. The authorities have continued to not intervene in the foreign exchange market, providing clarity and consistency on the main objectives of monetary policy.

Inflation and Inflation Expectations
(12-month ahead)



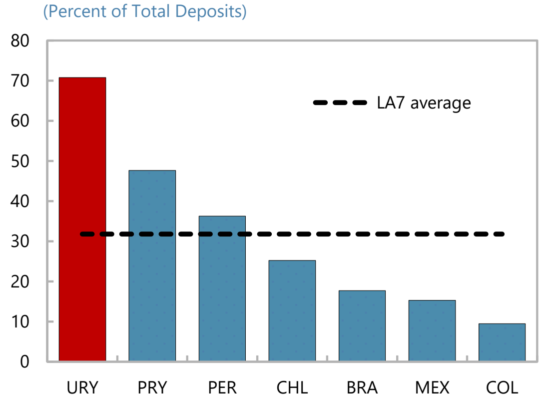
Net FX Purchases
(Percent of GDP)



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

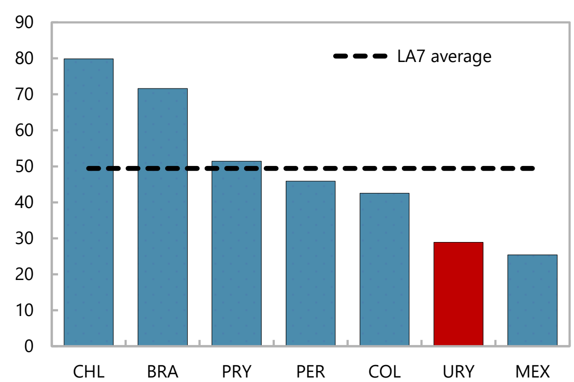
7. The financial sector remained resilient. The banking system is well capitalized, highly liquid, and profitable. With capital requirements for credit, market, operational and market risks, the Uruguayan banking sector maintains almost twice the minimum regulatory requirement. Amid higher international interest rates and a more stable exchange rate, profitability increased to about 3 percent of assets (from 1.8 percent by end 2022). Despite last year's economic slowdown and losses in the agricultural sector, non-performing loans remained low (1.7 percent of total loans) with adequate loan loss provisions (NPL coverage ratio of 256 percent). Financial intermediation remains low with the private credit-to-GDP ratio at 29 percent while dollarization remains high at 69 percent for liabilities and around 51 percent for loans, compared to other countries in the region.

Foreign Currency Deposits 1/
(Percent of Total Deposits)



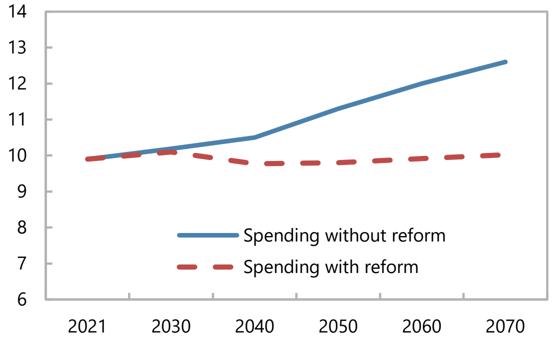
Sources: IMF Financial Soundness Indicators (FSI) and staff calculations.
1/ Latest observation is for 2023Q3, for Mexico latest available is 2021Q1.

Credit to Private Sector: 2023 1/
(Percent of GDP)



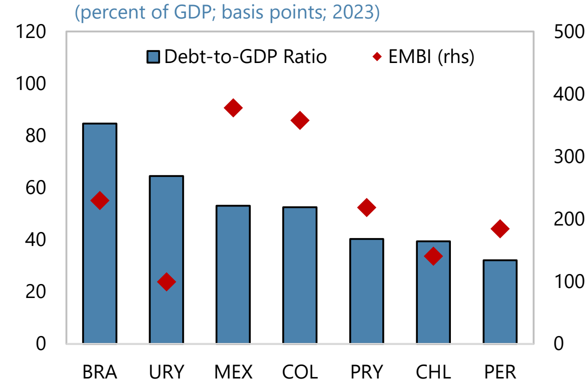
1/ Latest observation available for PER is 2022.
Sources: IMF staff calculations.

Pension System Reform Projection 1/
(Percent of GDP)



1/ Only earnings-related pensions shown.
Sources: Uruguayan authorities and Senate presentation: *Proyecto de Ley Reforma de la Seguridad Social: Principales Resultados.*

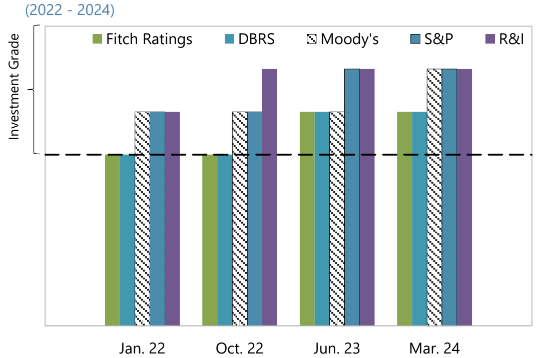
Public Debt and EMBI Spreads
(percent of GDP; basis points; 2023)



Sources: MEF, Bloomberg, staff calculations

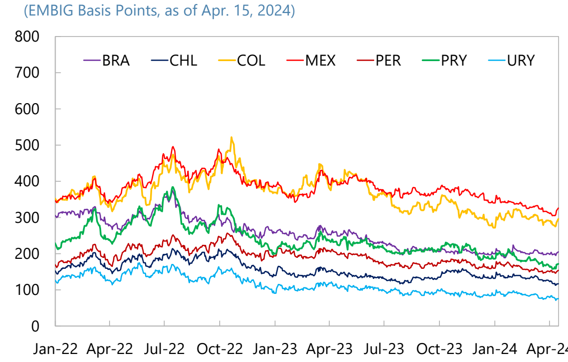
8. Uruguay's fiscal rule played a notable role in strengthening fiscal discipline, while the pension reform approval improved longer-term debt dynamics. The deficit and debt outcomes were consistent with the targets of the fiscal rule in 2023, which are defined at the Central Government (including the *Banco de Previsión Social*) level. Adherence to the fiscal rule for four consecutive years has bolstered fiscal credibility, helping stabilize the debt-to-GDP ratio under a sequence of negative shocks and curb its upward trend (the debt-to-GDP ratio had increased by about 20 percentage points between 2010 and 2019). The pension system reform, that was approved in May 2023, is expected to stabilize spending over the medium term, by including a gradual increase in the retirement age, a restructuring of pension contributions, and a revision of the pension calculation basis towards OECD norms.[1] The improved fiscal outlook is being reflected in historically low sovereign spreads, including the lowest EMBI spread in Latin America.

Credit Rating Evolution
(2022 - 2024)



Sources: Bloomberg.

Sovereign Spreads
(EMBIG Basis Points, as of Apr. 15, 2024)



Sources: Bloomberg Finance LP, and IMF staff calculations.

9. Amid external headwinds and the severe drought, the fiscal deficit increased during 2023. The deficit for the non-financial public sector (NFPS), excluding *cincuentones*[2], widened to 3.2 percent of GDP in 2023, driven by the smaller balance of the rest of the NFPS (state-owned

[1] See IMF Country Reports 23/178 (Annex VIII) and 22/16 (Annex VII) for more details on the pension reform.

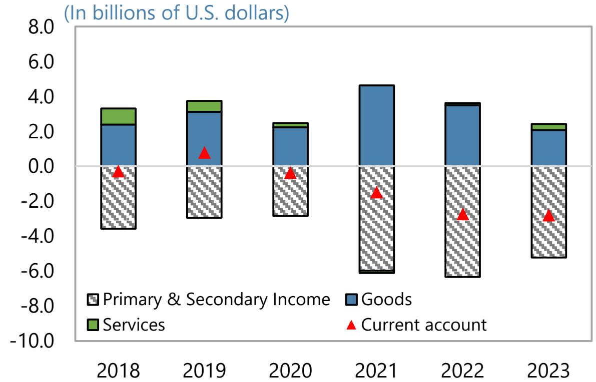
[2] Temporary proceeds from the pension reform that allowed certain workers to voluntarily move back to the public pension system.

enterprises and local governments). The deficit of the Central Government (including the *Banco de Previsión Social*) was unchanged, despite the increase in transfers to support drought-affected sectors and the impact on tax collection caused by the situation in Argentina. The faster-than-expected disinflation in 2023, which is a welcome development, had adverse implications for the fiscal accounts, because real spending in wages and social security benefits increased while weighing on revenues as a share of GDP, driven by a lower-than-expected GDP deflator (Annex II). Extreme dry conditions particularly affected the power company (UTE), forcing lower hydropower generation and larger energy purchases from neighboring countries, and affecting its operating surplus.

10. Gross NFPS debt increased in 2023 but remains below pandemic levels. Gross NFPS debt was 64.5 percent of GDP at the end of 2023, about 4 percentage points below its 2020 level. The government issued a non-marketable, zero-coupon, five-year bond to recapitalize the central bank in the amount of USD 1.6 billion (2 percent of GDP) at the end of 2023, to compensate for the valuation losses incurred in the foreign exchange reserve position due to the cumulative *peso* appreciation. This bond temporarily raises NFPS gross debt but does not affect medium-term sustainability, as it represents both an asset and a liability for the government at the consolidated public sector level.

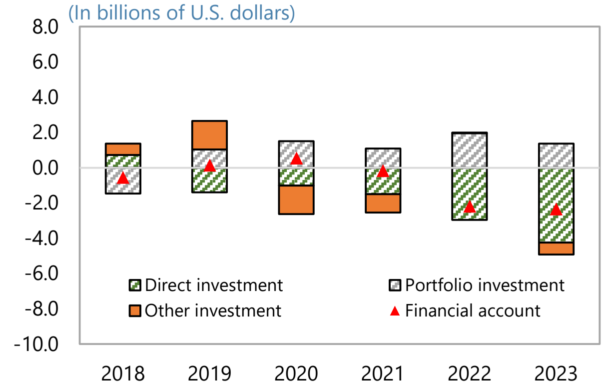
11. Uruguay's 2023 external position was broadly in line with the level implied by medium-term fundamentals and desirable policies (Annex III). The current account (CA) deficit narrowed to 3.6 percent of GDP in 2023. The weakening of the trade balance from 5.0 percent of GDP in 2022 to 2.7 percent in 2023, driven by a decline in agricultural exports, was partially offset by an improvement in the primary income balance to -7 percent of GDP in 2023 (from -9.2 percent of GDP in 2022). The post-pandemic recovery of tourist arrivals was offset by a substantial increase in the cross-border flows of Uruguay residents taking advantage of favorable relative price differentials with Argentina, affecting the services balance. Net FDI inflows reached USD 4.2 billion (5.5 percent of GDP), providing more resilient sources of external financing. The nominal exchange rate appreciated by 2.6 percent, compared to 10 percent in 2022, driven by several factors, including domestic and U.S. monetary policy, lower domestic and foreign risk, and terms-of-trade fluctuations (Box 1).

Current Account
(In billions of U.S. dollars)



Source: IMF staff calculations, BCU.

Financial Account
(In billions of U.S. dollars)



Source: IMF staff calculations, BCU.

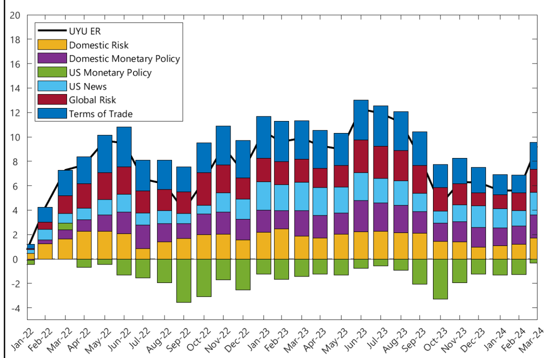
Box 1. Understanding Uruguay's Exchange Rate Fluctuations

The exchange rate can potentially respond to domestic and foreign monetary, financial, and real factors. This box presents the results of an estimated daily SVAR with sign restrictions for the Uruguay economy to understand the most recent appreciation.[1] Our estimation period starts in September 2020, when the BCU adopted the short-term interest rate as a policy instrument and ends in April 2024.

Domestic monetary policy, improved risk perceptions, and the terms of trade were partially responsible for the peso appreciation in 2022-2023. The tightening cycle of the Banco Central de Uruguay to bring inflation to within the target range (3 to 6 percent), contributed to the peso appreciation, while the easing cycle that started in April 2023 has had the opposite effect. Favorable terms of trade, which signal rising export prices compared to imports, was also an important contributor to the peso appreciation. Improved perceptions reflected in lower borrowing spread also impacted the peso favorably in 2022.

Uruguayan Peso/USD Exchange Rate Decomposition

(percent change since start-2022, +ve appreciation)



Source: IMF staff calculations, BCU, Bloomberg

Global favorable perceptions also helped appreciate the peso, while tightening US monetary policy provided a counterbalance. Contractionary monetary policy by the Federal Reserve, strengthened the dollar globally during 2022 and 2023, although expectations of Fed pausing its tightening cycle in the middle of 2023 dampened this channel. The model also finds that relatively "bad" news for the US economy, with a recession expected for most of 2023, depreciated the dollar and appreciated the peso.

Sign Restrictions Used to Decompose the Uruguayan Exchange Rate

	10-Year URY Bond Yield	UYU/USD (+ appreciation)	S&P 500	US 10-Year Treasury Yield	EMBI Spread	Terms of Trade
Domestic Risk	+	-			+	
Domestic Monetary Policy	+	+				
US Monetary Policy		-	-	+		
US News		-	+	+		
Global Risk		-	-	-	+	
Terms of Trade						+

1/ Exchange rate decomposition exercise is conducted using a Bayesian Structural Vector Autoregression (SVAR) identified using sign restrictions. This box follows a similar approach to Brandt, L., A. Saint Guilhem, M. Schröder and I. Van Robays (2021), "What drives euro area financial market developments? The role of US spillovers and global risk", *ECB Working Paper Series*, No. 2560.

OUTLOOK AND RISKS

12. The economy is expected to strongly rebound in 2024, while macroeconomic risks are broadly balanced. The recovery of agricultural exports, increased cellulose production, easing of financial conditions and robust private consumption, as real wages recover and the price differential with Argentina normalizes, are expected to support a growth rate of 3.4 percent in 2024 and 3 percent in 2025. From 2026 onwards, growth is expected to gradually converge to the potential growth rate of 2.2 percent. Inflation is projected to pick up in the second half of 2024, but stay within the target range, following a gradual easing of monetary policy and robust wage growth. Downside risks are derived from a worsening of external financial conditions, deterioration of international geopolitical tensions and the potential for further extreme climate events. Upside risks draw from events that could bring higher-than-expected agricultural export prices or lower fuel import prices (Annex IV).

13. Overall fiscal and external risks are low (Annexes V and VI). Near-term fiscal risks are limited due to several mitigating factors, including the gradual reduction of FX-denominated debt through new global issuances in domestic currency (both in nominal and in inflation-linked terms), ample liquidity buffers, access to precautionary credit lines, long debt maturities, and favorable borrowing conditions. Meanwhile, medium-term risks, stemming from the public debt composition and profile, are moderate. Additionally, staff assesses that there is some fiscal space available to address adverse shocks without impacting market access. Systemic risks remain broadly contained, owing to the low credit-to-GDP ratio, a limited sovereign-banking nexus, and the international investment position liabilities composition (mostly FDI). The financial sector is well-positioned to sustain severe funding pressure while banks are generally resilient to severe macro-financial shocks. While financial dollarization increases FX credit and liquidity risks, household indebtedness is low and corporate debt remains moderate and mostly hedged.

Authorities' Views

14. The authorities broadly concurred with the outlook and the balance of risks. They agreed that growth is likely to rebound in 2024 and that the growth momentum will continue into 2025. The authorities also expect that inflation will pick up somewhat over the second half of 2024 but will remain within the target range over the next 24 months – the monetary policy horizon target.

POLICY DISCUSSIONS

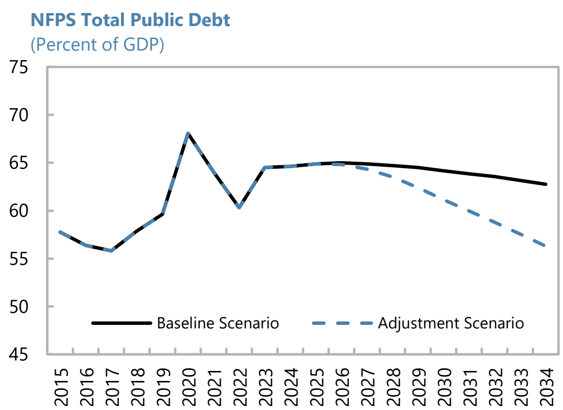
A. Fiscal Policy

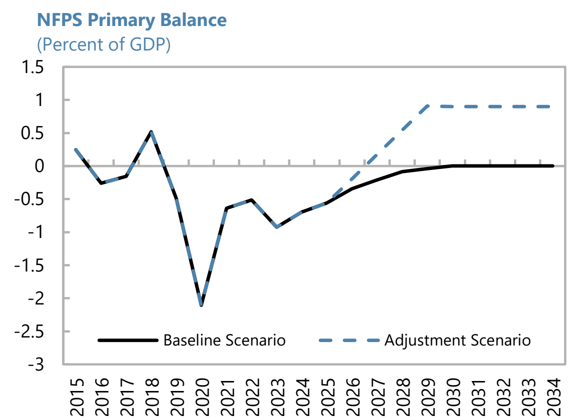
15. The 2024 revised budget is aligned with the net indebtedness target of the fiscal rule and social protection objectives. The projected NFPS deficit, excluding *cincuentones*, of 3.1 percent of GDP balances deficit reduction with safeguarding social spending, a sizeable share of total expenditures, but the ongoing disinflation could continue to adversely affect the fiscal accounts in 2024. The post-drought growth momentum creates opportunities for reinvigorating consolidation efforts. However, capitalizing on these opportunities requires navigating inherent spending rigidities that constrain policy options. Some policies that could be considered include: (i) constraining the wage bill growth through public employment attrition and increased efficiency, including through the adoption of artificial intelligence,[3] (ii) continuing efforts to improve the targeting of some subsidies, particularly for LPG (*Supergás*), and (iii) rationalizing tax expenditures. Current improvements to the

[3] Uruguay ranks third in Latin America for its governmental readiness for artificial intelligence according to the 2023 index of Government Readiness for Artificial Intelligence by Oxford Insights.

management and efficiency of state-owned enterprises (SOEs) are commendable, but further efficiency gains are needed to increase their profitability and support the budget.

16. The crafting of the next five-year budget law opens an opportunity to recalibrate the fiscal rule targets to place debt on a downward path. Under current policies, the NFPS debt-to-GDP ratio remains largely stable over the projection period with low near-term risks—as financing needs are manageable and market access remains at favorable terms. While the current fiscal rule has been successful at stabilizing the debt-to-GDP ratio under challenging circumstances, further efforts are needed to ensure a sustained downward path for the debt-to-GDP ratio and rebuild fiscal buffers over the medium term, requiring lower targets for the structural balance and net indebtedness pillars of the fiscal rule. IMF staff estimates suggest that reducing the NFPS debt to a range of 50-55 percent of GDP over the medium term would provide adequate buffers against shocks, particularly considering the country's vulnerability to more frequent climate events.[4] Lowering the NFPS debt-to-GDP ratio to 55 percent in ten years would require gradually increasing the primary balance to a constant level of about 1 percent of GDP by 2029.





Source: MEF, BCU and IMF staff estimations.

17. Refinements to the fiscal framework would help consolidate recent credibility gains. The successful implementation of the new fiscal framework under challenging circumstances has strengthened policy credibility. The authorities have complied with the fiscal rule targets for four years in a row, curbing the upward trajectory of the debt-to-GDP ratio observed between 2010 and 2019. Within the current framework, the following refinements could be considered: (i) adopting five-year binding targets, consistent with lowering the debt-to-GDP ratio to a reference level over the forecasting period, when the new budget law is approved,[5] (ii) establishing corrective mechanisms if escape clauses need to be triggered or should slippages occur, (iii) increasing the operational autonomy of the *Advisory Fiscal Council,* including through adequate resources, in line

[4] See IMF Country Report 23/179.

[5] Currently, the administration includes indicative targets for the medium-term horizon (5 years) in the Five-Year Budget and Accountability Law (*Ley de Presupuesto Quinquenal y Rendición de Cuentas*), which may be revised during subsequent annual reports to parliament *(Rendición de Cuentas)*, as macroeconomic conditions evolve.

with best international practices (see Box 2), and (iv) exploring alternative methodologies to estimate potential output, the output gap, and desirable medium-term debt-to-GDP ratios.

Box 2. Best International Practices for Fiscal Councils

Uruguay established the Advisory Fiscal Council with the 2020 Fiscal Responsibility Law. The council became operational in September 2021 and currently consists of three experts in public finance, appointed *ad-honorem* with overlapping terms, and one executive secretary. Its main function is to evaluate the Structural Fiscal Balance, with the aim of enhancing transparency and accountability and to promote fiscal sustainability. Additionally, the Advisory Fiscal Council provides accessible and detailed reports on the fiscal position and advises the MEF with technical recommendations on policies related to revenues, expenditures, and public debt.[1] Moreover, according to the Fiscal Responsibility Law, the Advisory Fiscal Council has unrestricted access to government data, a necessary condition to fulfil its mandate.

Strong independent fiscal councils support fiscal discipline. Independent scrutiny by fiscal councils enhances governments' commitment to fiscal discipline, providing objective, external and technical expert-based assessment of macro-fiscal projections and fiscal policies. Furthermore, fiscal councils play a crucial role in educating the public about fiscal issues, promoting transparency and the public understanding of government finances.

Additional efforts are needed to align the Advisory Fiscal Council with international standards. The provision of a dedicated budget mandated by law and remuneration of its members is crucial for the Advisory Fiscal Council 's operational autonomy. Such financial autonomy would also facilitate the acquisition of advanced analytical software and secure IT systems for data management. Moreover, a robust team is vital for conducting research, preparing reports, and effectively communicating fiscal matters to the public and policymakers. These additional resources would strengthen the Advisory Fiscal Council's capacity to independently assess the authorities' macro-fiscal projections, including risk analysis and scenarios.

Several countries have successful experiences with fiscal councils that can serve as reference for Uruguay, such as the Spanish Independent Authority for Fiscal Responsibility (AIReF). Also, in Latin America, Chile, Colombia, and Peru have evolving fiscal councils. These institutions demonstrate the positive impact fiscal councils can have on fiscal policy and transparency.

1/ These functions are regulated by Law No. 19.889 and Decree No. 315/021, which establish the normative framework of the Advisory Fiscal Council.

Authorities' Views

18. **The authorities reiterated their unwavering dedication to prudent fiscal policies and emphasized that changes to the fiscal framework should be introduced cautiously and gradually.** The authorities concurred that their compliance with the fiscal rule targets for a fourth year in a row had strengthened fiscal credibility, by stabilizing the debt-to-GDP ratio (despite significant external challenges and the severe drought), as reflected in sovereign debt rating upgrades and the lowest EMBI spreads in Latin America. They also highlighted the role that the Advisory Fiscal Council plays in independently verifying the achievement of the fiscal rule targets, improving transparency and credibility. While appreciating staff's recommendations, the authorities emphasized the need to proceed cautiously and gradually on any changes to the current fiscal framework, to continue building on credibility gains as the country gains experience from conducting fiscal policy under a fiscal rule. They underscored that the current objective is the stability of the debt-to-GDP ratio. The authorities will continue to assess the prudent medium-term

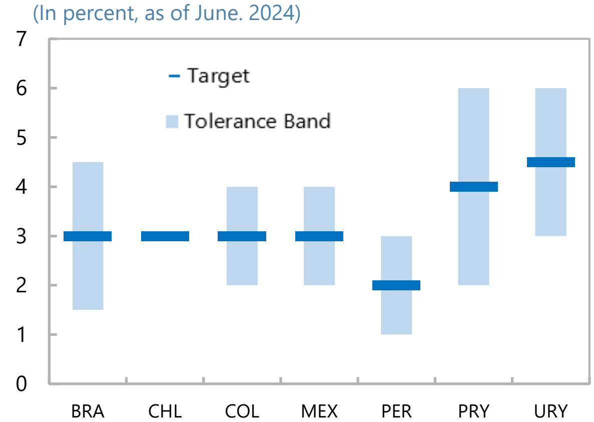
debt-to-GDP ratio and associated fiscal targets. Regarding the social security reform of 2023, they underscored that it provides long term fiscal sustainability to the system, while ensuring it is implemented in a fair and equitable way and concurred that the reform improves longer-term debt dynamics.

B. Monetary and Exchange Rate Policies

19. Monetary policy should remain contractionary to ensure that inflation and inflation expectations stay within the target range in a sustained manner. With the policy rate at 8.5 percent and one-year ahead expectations at 5.8 percent, the real interest rate is 2.7 percent – above the neutral rate, making the monetary policy stance appropriately contractionary. The BCU should continue to closely monitor the evolution of inflationary pressures and ensure monetary easing is conditional on inflation and inflation expectations remaining durably within the central bank's target range. Sustained monetary policy vigilance is crucial for continuing to build credibility and supporting de-dollarization efforts by delivering low and stable inflation rates. The exchange rate should continue to be allowed to act as a shock absorber and foreign exchange intervention should only be used to address disorderly market conditions. The presence of wage indexation in the wage bargaining process leads to a persistent response of both wage growth and CPI inflation to shocks, increasing the trade-offs faced by the central bank in stabilizing inflation and the output gap (see ¶27).

20. Further enhancements to the monetary policy framework would help increase the effectiveness of monetary policy and continue strengthening credibility. The BCU has significantly improved the monetary framework and communication since 2020, which has reduced the volatility of benchmark interest rates and facilitated the convergence of inflation to the target band for twelve months. The authorities should continue emphasizing that the inflation target is the mid-point of the target band (4.5 percent) in their public communications, to help anchor expectations. Enhancing *de jure* central bank independence, by appointing the central bank board members for fixed terms not overlapping with the electoral cycle, would further improve credibility and support policy continuity (Box 3).

Inflation Target LA7 Countries
(In percent, as of June. 2024)



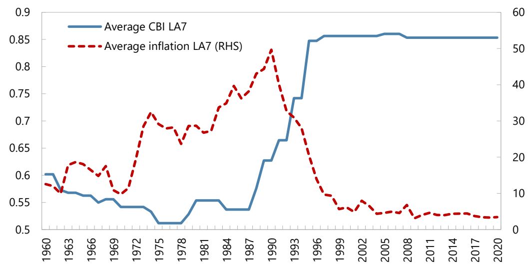
Sources: Country authorities; and IMF staff calculations.

Box 3. Enhancing *De Jure* Central Bank Independence

Improved central bank independence has been critical to deliver low and stable inflation in Latin America. One way to measure central bank independence is through the construction of a qualitative index. A recent example is the Central Bank Independence (CBI) index, that quantifies the central bank's governing arrangement, its mandate, the monetary policy autonomy, and the legal provisions to lend to the government to create a comparable measure across countries in Latin America.[1] The correlation between the CBI index and inflation from 1960 for the LA7 countries is negative, highlighting the benefits of greater autonomy of the monetary authority.

Inflation and Central Bank Independence, LA7

Average LA7 Central Bank Independence Index (LHS); Average LA7 Inflation (RHS)



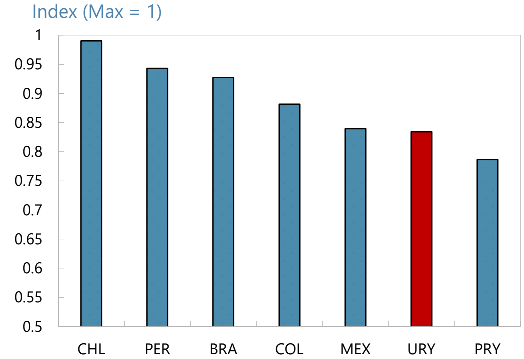
Source: Jácome and Pienknagura (2022); IMF staff calculations

Note: Inflation is transformed (100 x Inflation/(100+Inflation))

To close the gap with other central banks in the region, the appointment of BCU Board members should be aligned with best international practices. The BCU has made important strides in enhancing their monetary policy framework, continuing to improve communication and strengthing credibility. According to the CBI, the BCU is assessed as less independent than most of its LA7 peers. A crucial step to help close the gap to the top performers would be to align the appointment of the BCU Board members with best international practices. Appointing the central bank board members for fixed terms not overlapping with the electoral cycle would help increase Uruguay's rating in the Central Bank Independence index.

Central Bank Independence LA7 Countries

Index (Max = 1)



Source: Jácome and Pienknagura (2022); IMF staff calculations

[1]/ See Jácome, Luis I. and Samuel Pienknagura 2022, "Central Bank Independence and Inflation in Latin America – Through the Lens of History," IMF Working Paper 22/186, International Monetary Fund, Washington, DC.

Authorities' Views

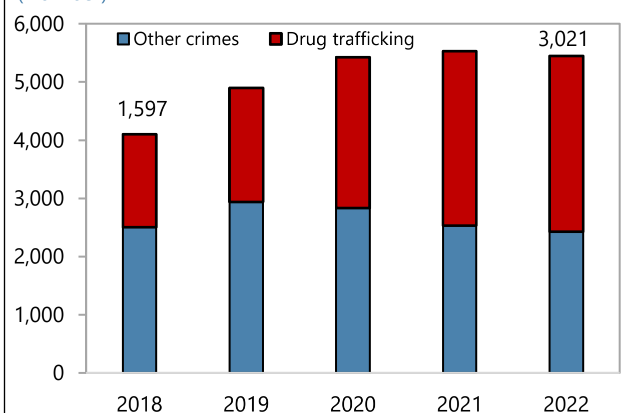
21. The authorities agreed that the monetary policy stance is appropriate and underscored their commitment to maintain inflation within the target range. The authorities emphasized that CPI inflation has remained within the target range for one year, a significant achievement that would help continue building credibility. The authorities agreed on the need to continue emphasizing that the inflation target is the mid-point of the target band (4.5 percent) in their public communications, to help make explicit the policy objective. Meanwhile, against a background of rigid inflation expectations caused by a history of inflation, expectations have been slowly converging to the central bank target range, reflecting gains in policy credibility and enhancements in communication. The authorities agreed that the exchange rate should be allowed to act as a shock absorber and to limit FX intervention to addressing disorderly market conditions. The authorities concurred with staff's external sector assessment.

C. Financial Sector Policies

22. The authorities have reaffirmed their commitment to enhancing their supervision framework, implementing the recent FSAP recommendations (Annex VII) and creating an enabling environment for the financial system to contribute to growth and development. The Superintendency of Financial Services (SSF) should continue pursuing efforts to upgrade its risk-based supervision framework, by enhancing its stress-testing framework. Closing data gaps will also be key in building more comprehensive measures for credit risk analysis (such as probability of default and loss given default) and for assessing system-wide FX liquidity and concentration risks. Operationalizing the Pillar II capital add-ons will create an opportunity to address the adverse effect on capital buffers from the bank wealth tax. The BCU aims at creating an efficient, integrated, and accessible payment system, promoting competition, preserving financial stability, and fostering compliance with AML/CFT regulations. Promoting the development of the peso capital market and fostering greater competition in the retail banking sector could provide more attractive investment opportunities and alternative sources of funding, and lower lending-deposit spreads (see Box 4).

23. The authorities should redouble efforts in increasing AML/CFT effectiveness in line with FATF standards. In recent years the country has improved its AML/CFT framework by enacting new laws and regulations—including a law creating a Special Prosecutor's Office for ML/TF. While this has to some extent mitigated its ML/TF risks, the 2023 National Risk Assessment (NRA) highlights that the main threat of drug trafficking has grown since the last NRA while new high risks relating to the use of virtual assets have emerged. Drawing on the National Anti-Money Laundering Secretariat (SENACLAFT) statistical report, the 2023 NRA also points out that convictions for money laundering remain low even though investigations on money laundering predicate offences have increased from 2018 to 2022. The NRA provides recommendations to the authorities, including: i) strengthening mechanisms for timely information sharing across agencies, ii) increasing operational coordination, iii) deepening collaboration for the identification of typologies as well as sectoral risk assessments, and iv) granting adequate resources for effective risk-based supervision.

Criminal Investigations Initiated
(Number)



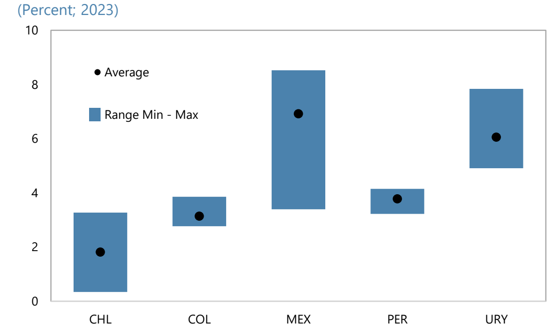
Source: SENACLAFT Statistical Report 2018-22,and IMF staff calculations.

Box 4. Uruguay's Banking Spreads: A Regional Perspective

The cost of financial intermediation in Uruguay is relatively high compared to peers, owing to a high degree of concentration and dollarization as well as relatively high operational expenses. Uruguay's largest bank held 44 percent of total banking assets, while the top five banks held 90 percent of total assets at the end of 2023. Despite the recent history of macroeconomic stability, households still prefer holding their savings in U.S. dollars, driven by the memories of the 1982 and 2002 large devaluations. This high degree of financial dollarization seems to limit the banks' supply of peso lending, which is directed mostly to households, making it relatively more expensive while corporates borrow in USD.

An analysis of the financial statements of the four largest private banks operating in Uruguay, compared to other four countries in the region where they have a presence, shows that Uruguay's banking spread was relatively high in 2023.

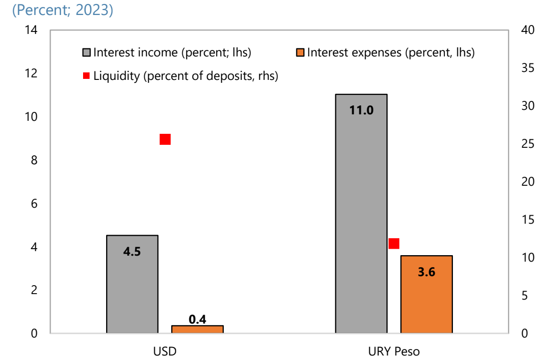
Uruguay Banking Spreads in Regional Perspective 1/
(Percent; 2023)



1/ Spreads for Chile, Colombia, Mexico, Peru and Uruguay based on the four largest private banks operating in Uruguay.
Sources: Countries' authorities; IMF staff calculations.

Lending-deposit spreads are larger in local currency. Prevalent dollarization of deposits implies that Uruguayan banks operate under tighter liquidity conditions in local currency, while foreign currency funding is less restrictive.

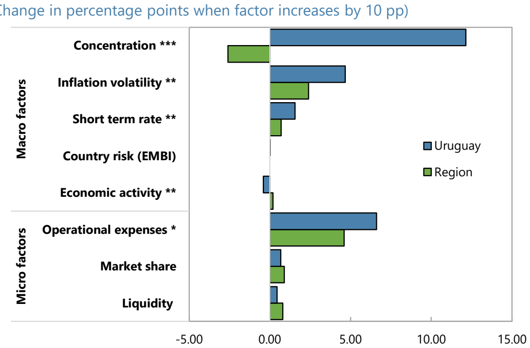
Banking Liquidity, Interest Income and Expenses 1/
(Percent; 2023)



1/ Interest income and expenses based on the four largest private banks operating in Uruguay.
Sources: BCU; IMF staff calculations.

At a regional level, a panel regression for the same four private banks in five countries shows that macroeconomic volatility and operational expenses are key spread determinants. In Uruguay, market concentration appears as an additional important determinant.

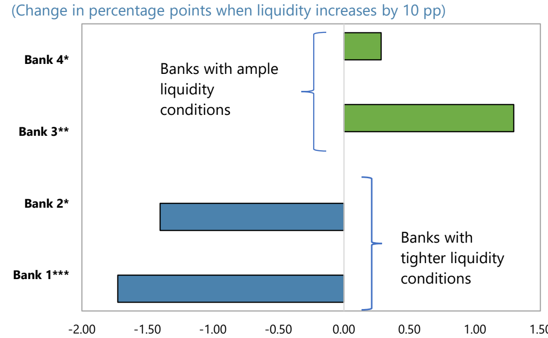
Banking Spread Determinants
(Change in percentage points when factor increases by 10 pp)



* significant at 10%; ** significant at 5%; *** significant at 1%; for Uruguay estimates.
Sources: Countries' authorities, IMF staff calculations.

A panel regression for Uruguay suggests that an increase in peso liquidity would reduce spreads for banks with tight funding conditions. For banks with ample liquidity conditions, an increase in liquidity would have the opposite effect.

Banking Spread Determinants
(Change in percentage points when liquidity increases by 10 pp)



* significant at 10%; ** significant at 5%; *** significant at 1%; for Uruguay estimates
Sources: BCU, IMF staff calculations

From the demand side, customers' savings are conservatively managed, contributing to low interest expenses. Almost 90 percent of total deposits are held in the form of sight deposits, which are not remunerated. Despite the recent introduction of new investment products, depositors have a marked preference for liquidity over profitability.

Authorities' Views

24. The authorities underscored that the financial sector remains sound and resilient. They emphasized that the banking system's profitability has increased, liquidity indicators remain strong and non-performing loans remain low despite the drought. They reaffirmed their commitment to further enhancing risk-based supervision and regulation, particularly through upgrading their stress-testing framework. The SSF highlighted its efforts to improve data collection for households and firms allowing for enhanced assessments of credit risks as well as systemic FX liquidity risks. The authorities concurred with the need to increase financial sector efficiency and to foster greater competition while developing the peso capital market. The authorities noted they are advancing with the recommendations from the 2023 National Risk Assessment, particularly on increasing operational coordination and information sharing protocols to better support the Special Prosecutor's office in AML/CFT issues. The authorities also noted that they are continuing to pursue a modernization plan for the payments system.

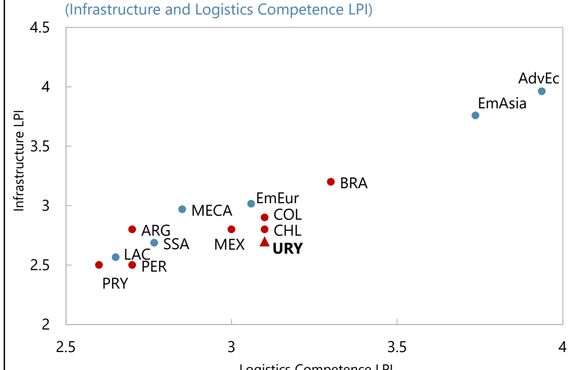
D. Structural Reforms

25. Efforts to continue implementing structural reforms are key to unlock potential growth, create policy space to preserve the country's safety net and social cohesion, and support favorable sovereign debt ratings.

- *Education and human capital development*. The implementation of the education reform is critical to provide the human capital Uruguay needs in the medium-term to foster the adoption of innovative technologies, increase productivity and particularly sustain the growth of its non-traditional sectors (ICT, deep tech, green tech, and bio tech). In the short-term, drawing on the successful implementation of on-demand training programs, coordinated public-private initiatives should be prioritized to bridge the skills gap in high-growth and high-demand technology sectors. The country's *Innovation Hub* could play a pivotal role in bolstering the digital transformation of local businesses, which would help accelerate the country's development and productivity.

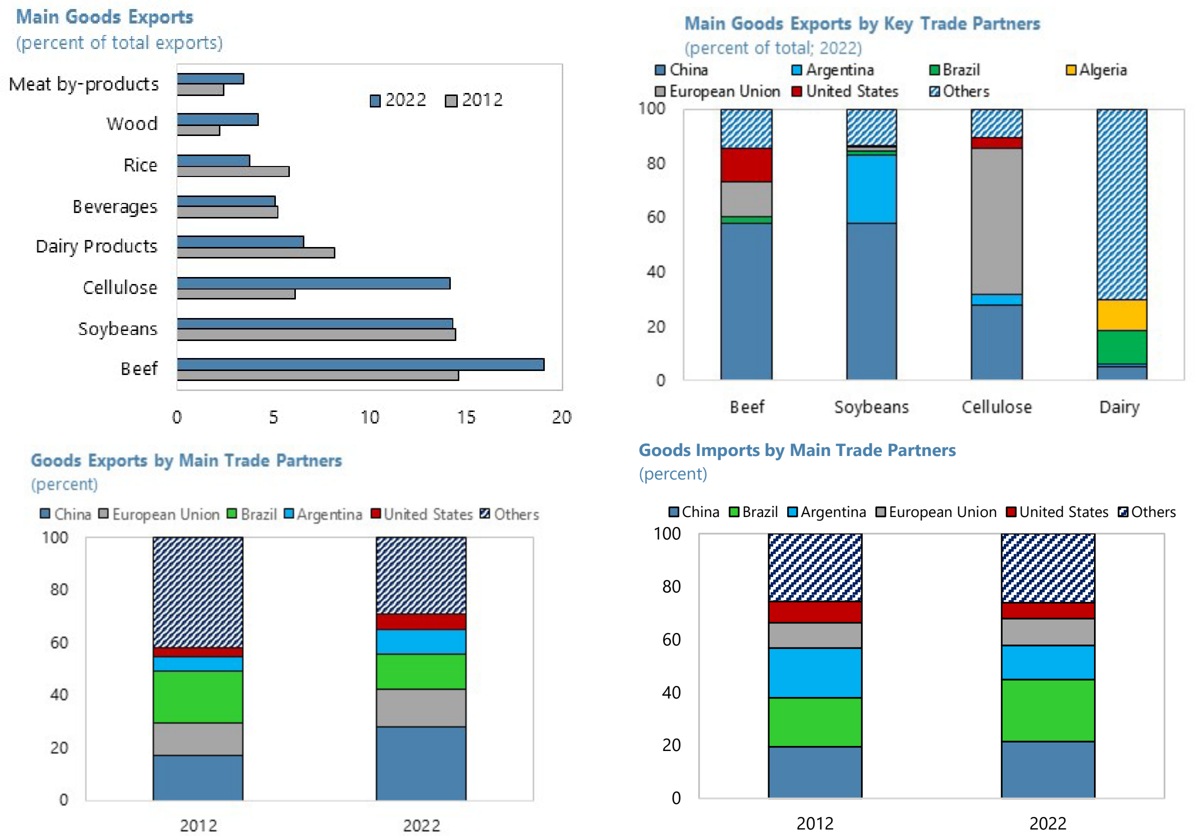
- *Trade policy and competitiveness*. The deepening of Uruguay's global integration should focus on pursuing efforts for trade facilitation, addressing non-tariff barriers and red tape, and reducing logistics costs. In 2023, the country consolidated its trade openness within Mercosur by agreeing on a flexibilization of rules of origin and signed a free trade agreement with Singapore. Amid a fast-growing global services industry in Uruguay, the BCU is enhancing its international trade in services statistics compilation, focusing on improving coverage and granularity.

Logistics Performance Index 2023
(Infrastructure and Logistics Competence LPI)



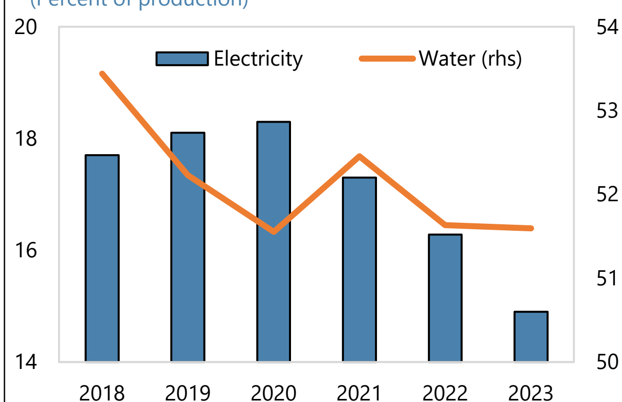
Sources: World Bank and IMF staff calculations.
Note: LPI=Logistics Performance Index; LAC=Latin America and Caribbean; SSA=Sub-Saharan Africa; EmAsia=Emerging and Developing Asia; EmEur=Emerging and Developing Europe; AdvEc=Advanced Economies; MECA=Middle East Central Asia.

Main Goods Trade Flows



- *State-Owned Enterprises*. The authorities' efforts to strengthen SOEs corporate governance and management are commendable. Recent initiatives from the electrical power company (UTE) to reduce electricity commercial losses should contribute to lowering overall energy costs and improve competitiveness. The state fuel company (ANCAP) has improved the targeting of the LPG (*Supergás*) subsidy to focus on vulnerable households. Similarly, curbing relatively high freshwater distribution losses will also be key in increasing the country's resilience to extreme weather events. Consistent with past Fund advice, SOE tariffs should be cost reflective, and the cost of their social programs should be transparently financed from the budget (instead of the current practice of using cross-subsidies).

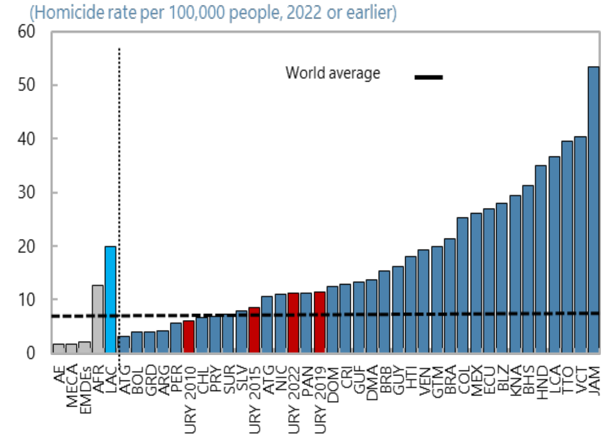
Public Utilities: Water and Electricity Losses
(Percent of production)



Sources: OSE, UTE, and IMF staff calculations.

- *Crime*. While traditionally exhibiting some of the lowest crime rates in the region, Uruguay has undergone a steady rise in crime, much of which is linked to drug trafficking. Higher crime rates have a damaging macroeconomic impact, reducing output growth by lowering both capital accumulation and productivity.[6] The increase in crime over the last decade, albeit from a low base, needs to be addressed before it starts weighing on growth.

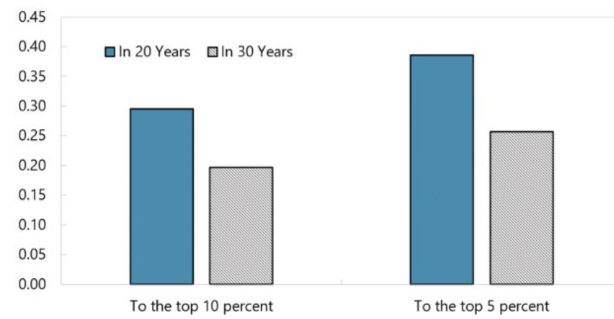
Crime across Regions/Countries
(Homicide rate per 100,000 people, 2022 or earlier)



Sources: U.N. Office on Drugs and Crime; and IMF staff calculations.

26. Closing the labor force participation gender gap would help increase long run growth. Uruguay has made significant gains in raising female labor force participation, from 51 percent in 2006 to 56 percent in early 2024. Compared to regional peers, Uruguay's gender participation gap is relatively narrow, but is wider than the top 10 percent of countries worldwide.[7] Closing the gender participation gap to the top 10 percent countries over the next 30 years would result in a growth increase of 0.2 percentage points per year – a more ambitious goal would bring further output growth gains. Expanding childcare support programs, providing training opportunities for women and removing asymmetric parental leave policies that discourage hiring of women or affect their pay can help raise female participation.

Potential Output Gains Per Year From Closing the Labor Force Participation Gender Gap
(Percent)



Source: Ostry, Alvarez, Espinoza and Papageorgiou (2018), and IMF staff calculations.

27. Reducing backward-looking indexation and introducing more sectoral differentiation in wage negotiations would support the disinflation process and competitiveness (Annex VIII). The wage bargaining process is characterized by widespread collective bargaining that covers all formal employment in practice. Wage indexation is prevalent in wage negotiations because expected inflation is a key input to the wage bargaining guidelines, and wages are adjusted if actual inflation exceeds inflation expectations. The presence of wage indexation leads to a persistent

[6] October 2023 Regional Economic Outlook – Western Hemisphere – Online Annex 4.

[7] Uruguay's female labor force participation gap stands at 13 percentage points as of March 2024. To reach the top 10 percent of countries worldwide the gap would need to narrow to under 7 percentage points. Output gain estimates from closing the labor force participation gender gap (text chart) are based on the toolkit described in Ostry, J.D., J. Alvarez, R. Espinoza, and C. Papageorgiou (2018), "Economic gains from gender inclusion: New mechanisms, new evidence" *International Monetary Fund, Staff Discussion Notes 18/06*. The toolkit is further calibrated to Uruguay using data on the gender-wage gap and findings from the 2020 World Bank study on gender in Uruguay.

response of both wage growth and CPI inflation to shocks, increasing the trade-offs faced by the central bank in stabilizing inflation and the output gap. Moreover, the wage bargaining outcomes at the sectoral level do not generally include sector-specific considerations. Additional efforts to incorporate measures of productivity and other sector-specific conditions could be useful to increase the efficient allocation of labor and competitiveness, such as the current proposal to differentiate wage guidelines between tradable and non-tradable sectors in the next wage bargaining round.

28. Uruguay has been a trailblazer in climate mitigation and finance, but climate adaptation efforts need to be intensified. Uruguay has been at the forefront of climate finance innovation, with the issuance of its pioneering sustainability-liked bond and securing access from multilateral banks to global-first loans with financing conditions linked with the achievement of environmental targets. As climate hazards have become more frequent, the authorities' adaptation efforts need to be intensified. Droughts are becoming particularly relevant considering the output losses to the agricultural sector and the required recurrent fiscal interventions. Staff estimates that a one standard deviation drought shock could lower output by 0.3 percent, with a severe drought causing around a one percent loss in GDP (Annex I). Against this backdrop, it is critical to enhance water resource management, promote sustainability, and increase resilience to droughts. Key actions include: i) strengthening institutional coordination and planning for a sustainable use of water, ii) increasing capital expenditure for water security and reduction of losses in the drinking water distribution system, and iii) creating a drought response protocol.

Authorities' Views

29. The authorities agreed on the importance of continuing the implementation of structural reforms to boost potential growth and maintain favorable credit ratings and international markets access. The authorities also highlighted the innovation and digital transformation agenda to propel Uruguay to the forefront of the knowledge economy. The education reform is a key landmark to build highly skilled human capital and support the fast-paced IT sector growth. Newly implemented measures, such as the reduction in import tariffs, the introduction of trade-facilitating procedures and the planned logistical upgrade of the Port of Montevideo should contribute to the country's competitiveness. The authorities also stressed their efforts to improve the performance of SOEs by transparently reporting their financial statements and the cost of subsidies, improving risk management, and reducing inefficiencies, particularly electricity distribution losses. The authorities appreciated the importance of closing the labor force participation gender gap to increase potential growth yet noted that further analysis is needed to understand the impact of focused gender policies implemented in the past. The authorities reaffirmed that Uruguay remains at the forefront of the design of economic policies and financial instruments to address climate change mitigation while mobilizing resources for climate adaptation. They highlighted efforts on the way to enhance the water management regulatory framework, ensure the sustainable use of natural resources and to reduce losses in water distribution networks.

30. Past Fund advice. The authorities sound and prudent economic policies are consistent with key principles advocated by the Fund. The updating of the risk-based supervisory framework in line with international initiatives and the deployment of macroprudential tools to safeguard financial sector stability are in line with previous Fund advice. The recent upgrading of the monetary policy framework and communication, including allowing the exchange rate to act as a shock absorber, are in line with past Fund advice. Recent efforts to improve the targeting of some SOEs subsidies are also consistent with Fund advice. Staff and the authorities agree with the need to maintain fiscal prudence as it is key to preserve favorable market access and low sovereign spreads, while safeguarding social cohesion.

STAFF APPRAISAL

31. In 2023, Uruguay confronted the impact of a once-in-a-century severe drought and external headwinds, but the economy remained resilient, owing to the authorities' sound macroeconomic policies, the country's political stability, and strong institutions. Despite the challenging environment, Uruguay maintained favorable market access with improved sovereign debt ratings and sovereign spreads at historically low levels, including the lowest spreads in the region. The current administration, in office since 2020, has implemented a significant upgrade of the fiscal and monetary policy frameworks and has advanced decisive structural reforms. In 2023, the authorities approved a key pension reform, placing medium-term public finances on a more sustainable path, and started implementing an education reform. Consolidating these gains should be the most important priority, as they provide the necessary macroeconomic policy space to confront domestic and external risks and support long-term growth.

32. While the 2024 revised budget is aligned with the net indebtedness target of the fiscal rule and social protection objectives, further efforts are needed to ensure a sustained downward path for the debt-to-GDP ratio over the medium term. The projected NFPS deficit, excluding *cincuentones*, of 3.1 percent of GDP in 2024 balances deficit reduction with safeguarding social spending, a sizeable share of total expenditures. While the current fiscal rule has been successful at stabilizing the debt-to-GDP ratio under challenging circumstances, further efforts are needed to ensure a sustained downward path for the debt-to-GDP ratio and rebuild fiscal buffers over the medium term, requiring lower targets for the structural balance and net indebtedness pillars of the fiscal rule. Refinements to the fiscal framework would help consolidate recent credibility gains.

33. Monetary policy should remain contractionary to ensure that inflation and inflation expectations stay within the target range in a sustained manner. Sustained monetary policy vigilance is crucial for continuing to build credibility and supporting de-dollarization efforts by delivering low and stable inflation rates. The authorities should continue emphasizing that the inflation target is the mid-point of the target band (4.5 percent) in their public communications, to help anchor expectations. Enhancing *de jure* central bank independence would further improve credibility and support policy continuity.

34. The financial sector remained resilient. The banking system is well capitalized, highly liquid, and profitable. Amid higher international interest rates and a more stable exchange rate, profitability increased. Despite last year's economic slowdown and losses in the agricultural sector, non-performing loans remained low with adequate loan loss provisions. In line with past FSAP recommendations, the SSF should continue pursuing efforts to upgrade its risk-based supervision framework, by enhancing its stress-testing framework and closing data gaps. Operationalizing the Pillar II capital add-ons will create an opportunity to address the adverse effect on capital buffers from the bank wealth tax.

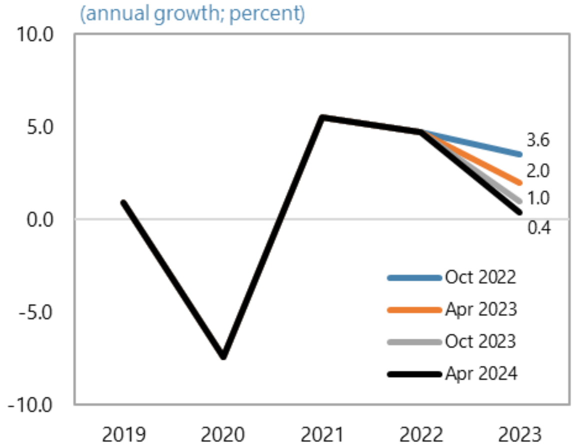
35. Efforts to continue implementing structural reforms are key to unlock potential growth, while climate adaptation efforts need to be intensified. The implementation of the education reform is critical to provide the human capital Uruguay needs in the medium-term to foster the adoption of innovative technologies and increase productivity. The deepening of Uruguay's global integration should focus on pursuing efforts for trade facilitation, addressing non-tariff barriers and red tape, and reducing logistics costs. Reducing backward-looking indexation and introducing more sectoral differentiation in wage negotiations would support the disinflation process and competitiveness. Uruguay has been at the forefront of climate finance innovation. Droughts are becoming particularly relevant considering the output losses to the agricultural sector and the required recurrent fiscal interventions. Against this backdrop, it is critical to enhance water resource management, promote sustainability, and increase resilience to droughts.

36. Staff recommends that the next Article IV consultation take place on the standard 12-months cycle.

Figure 1. Uruguay: Real Activity

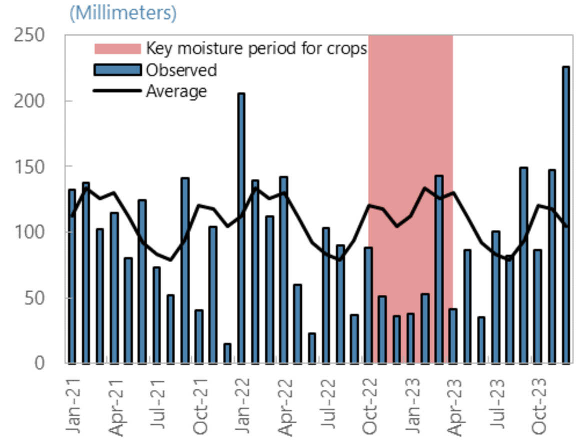
In 2023, the economy suffered the effects of the worst drought in the last century....

Real GDP: Exogenous shocks impact 2023
(annual growth; percent)



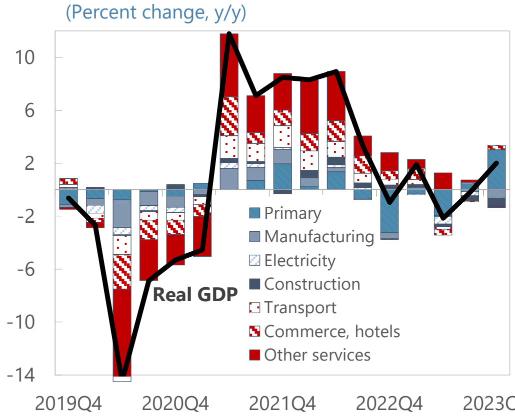
...during the key harvest months of the season.

Monthly Cumulated Rainfall
(Millimeters)



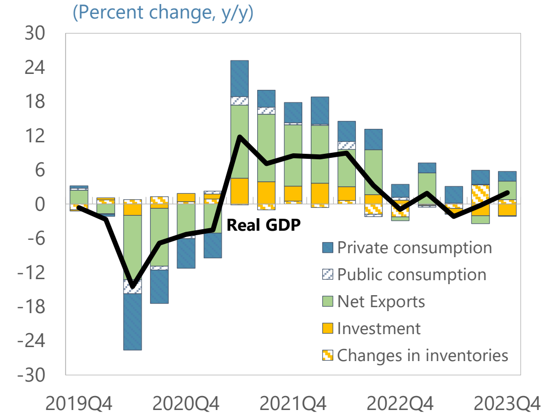
The primary and manufacturing sectors were the most affected....

Contributions to Real GDP Growth, Production Components
(Percent change, y/y)



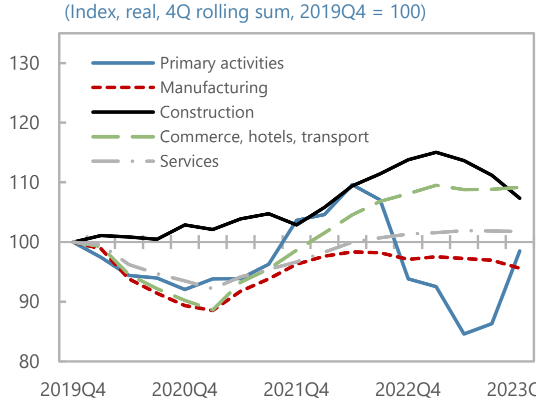
... resulting in a drag for net exports and investment.

Contributions to Real GDP Growth, Demand Components
(Percent change, y/y)



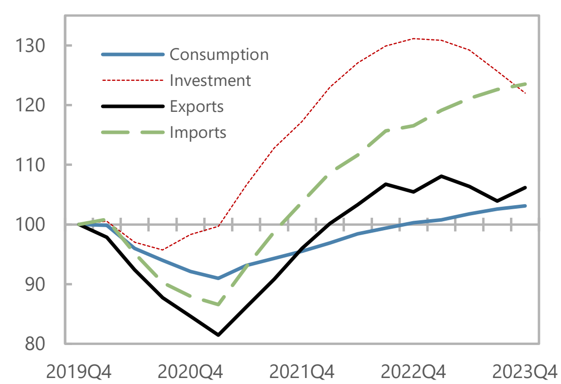
Agricultural production contracted between mid-2022 and mid-2023...

Economic Activity
(Index, real, 4Q rolling sum, 2019Q4 = 100)



...weighing on export volumes.

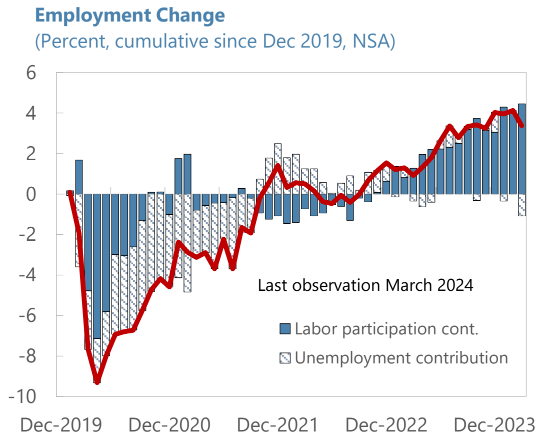
GDP Demand Components
(Index, real, 4Q rolling sum, 2019Q4 = 100)



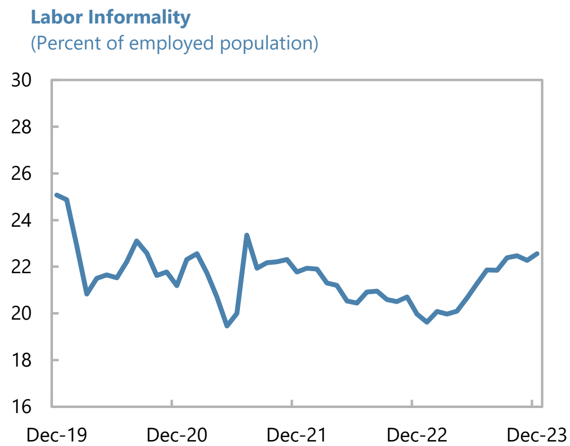
Sources: World Economic Outlook, Haver Analytics, Banco Central del Uruguay (BCU), Instituto Nacional de Estadistica, Bloomberg L.P., and IMF staff calculations.

Figure 2. Uruguay: Labor Market

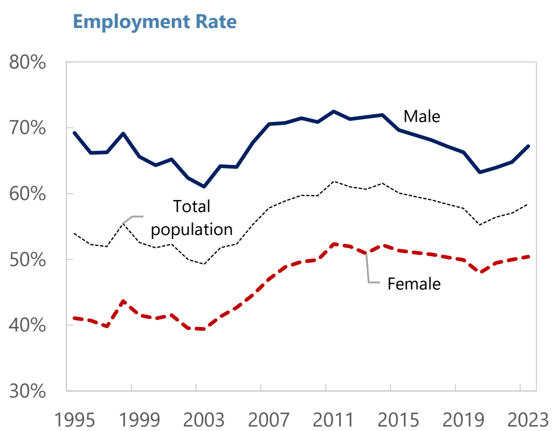
Despite the economic slowdown, the labor market remained dynamic....



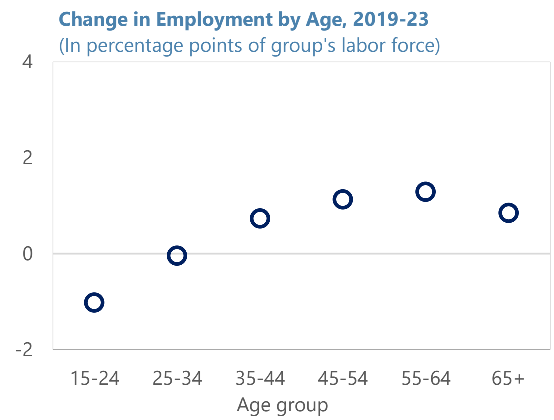
...with informality ticking up but remaining below pre-pandemic levels.



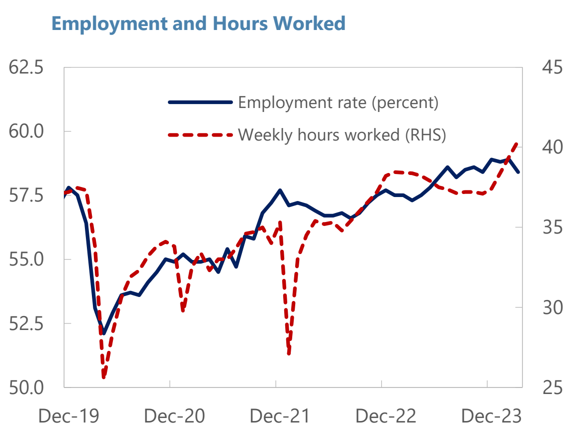
Employment rates improved for men and women....



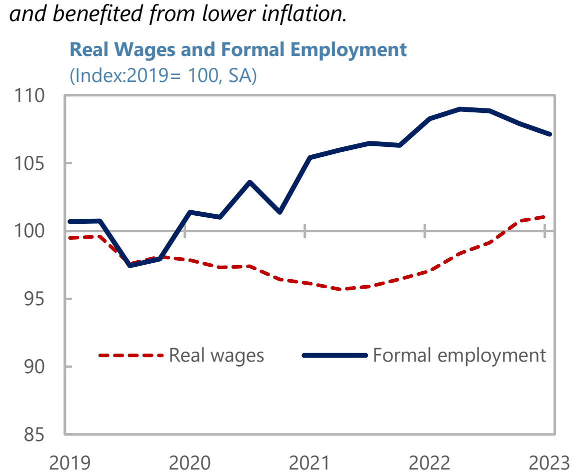
... albeit younger workers have not fully recovered.



Hours worked have stabilized...



...while real wages have recovered to pre-pandemic levels and benefited from lower inflation.

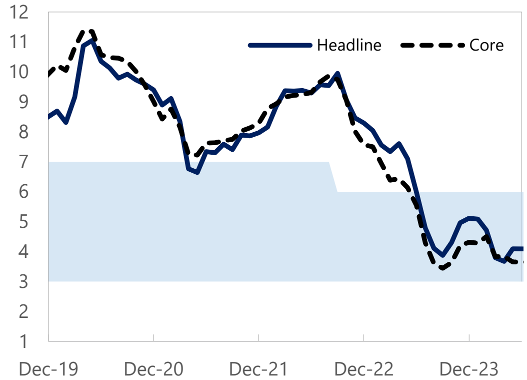


Sources: Haver, ILOSTAT, INE, and IMF staff calculations.

Figure 3. Uruguay: Inflation

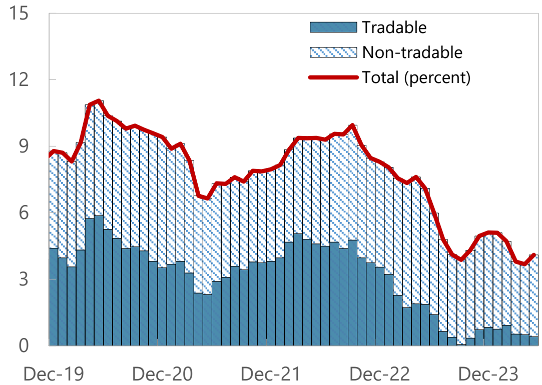
In 2023, inflation converged to the BCU target range....

Consumer Prices
(y-o-y percent change)



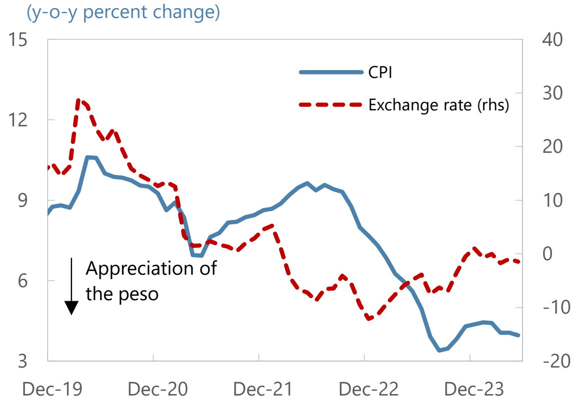
...benefiting from lower pressures on tradable components.

Contributions to Inflation
(In percentage points)



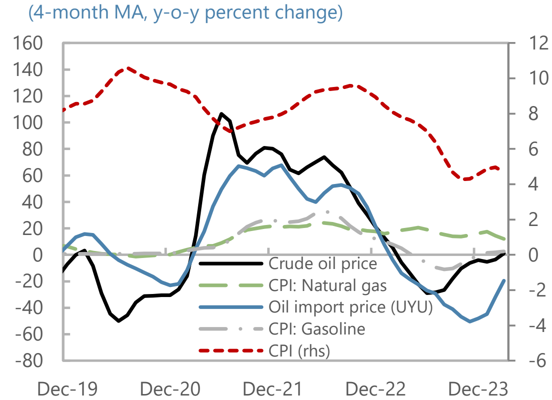
The appreciation of the peso contributed to the disinflation....

CPI and Exchange Rate
(y-o-y percent change)



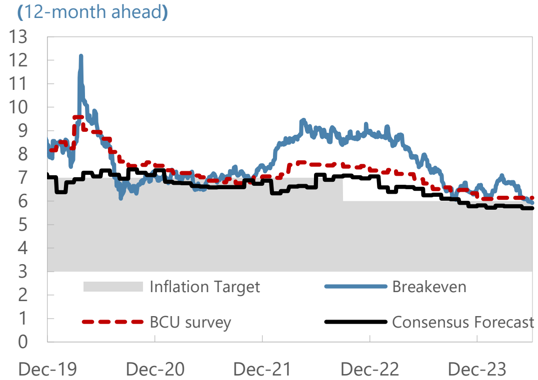
... in a context of lower fuel prices.

Imported Inflation: Crude Oil
(4-month MA, y-o-y percent change)



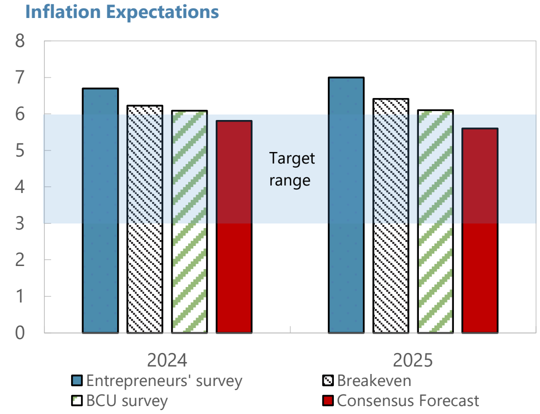
Inflation expectations have eased further...

Inflation Expectations
(12-month ahead**)**



...gradually converging to the upper bound of the BCU's target range.

Inflation Expectations

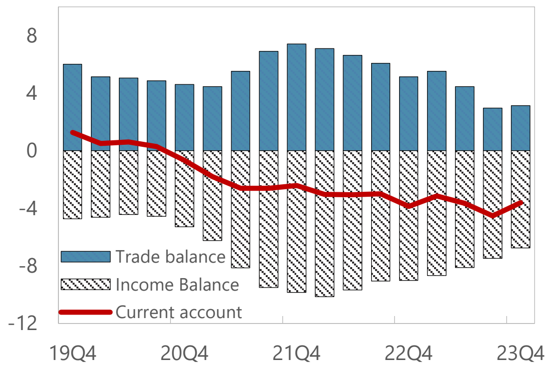


Sources: World Economic Outlook, Haver Analytics, Banco Central del Uruguay (BCU), Instituto Nacional de Estadistica, Bloomberg L.P., and IMF staff calculations.

Figure 4. Uruguay: External Accounts

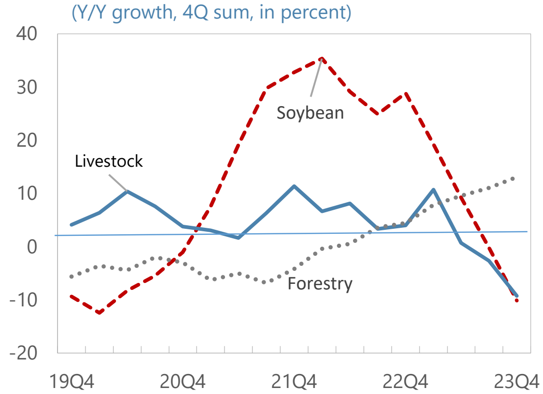
The drought impact weakened the current account....

Current Account
(In percent of GDP, 4Q sum)



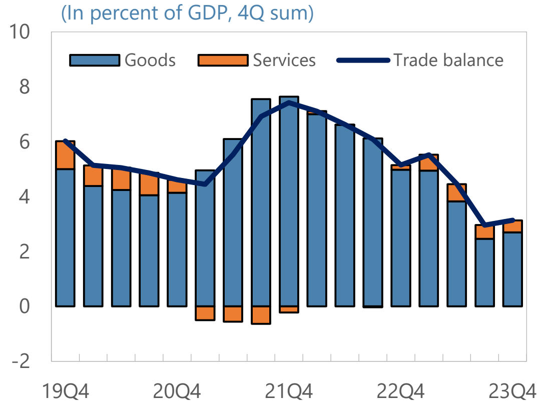
...in the context of lower prices for key commodities.

Export Prices
(Y/Y growth, 4Q sum, in percent)



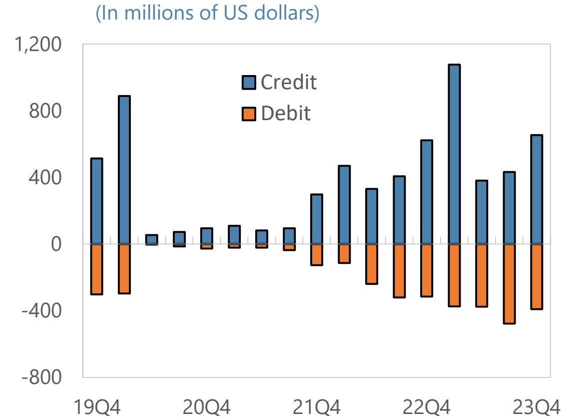
Lower soybeans and beef exports weighed on the goods balance ...

Trade Balance
(In percent of GDP, 4Q sum)



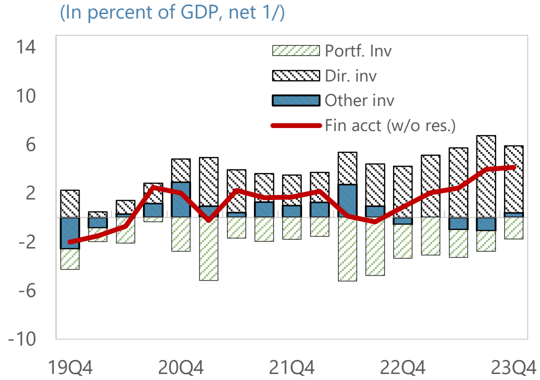
...while increased flows of Uruguayans visiting Argentina reversed earlier gains in travel services.

Gross Travel Imports and Exports
(In millions of US dollars)



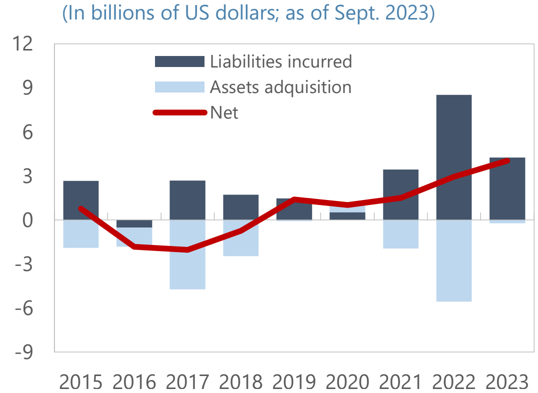
FDI flows showed a sustained increase...

Financial Account Balance
(In percent of GDP, net 1/)



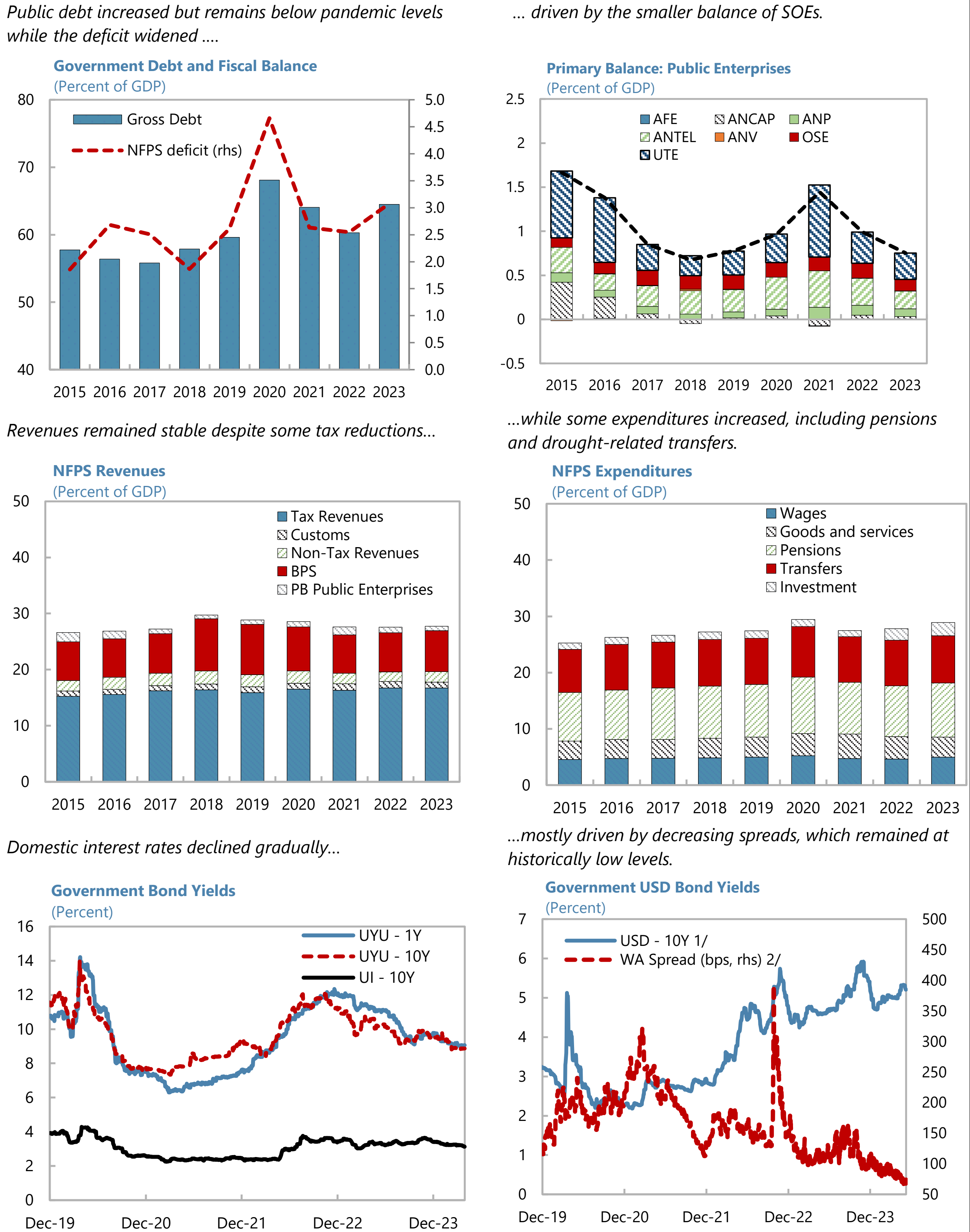
... and financed the current account deficit.

Direct Investment
(In billions of US dollars; as of Sept. 2023)



Sources: Banco Central de Uruguay (BCU), World Economic Outlook, Instituto Nacional de Estadistica, Haver Analytics, and IMF staff calculations.
1/ Positive means inflow.

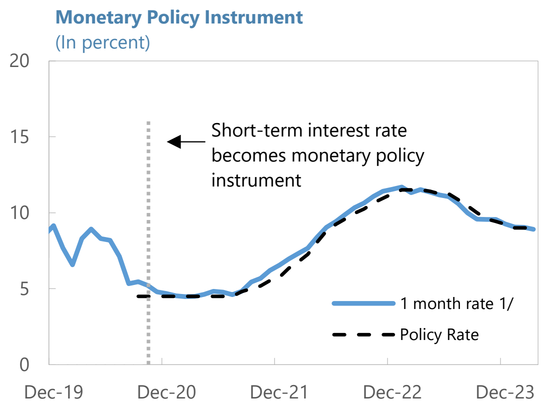
Figure 5. Uruguay: Fiscal Sector



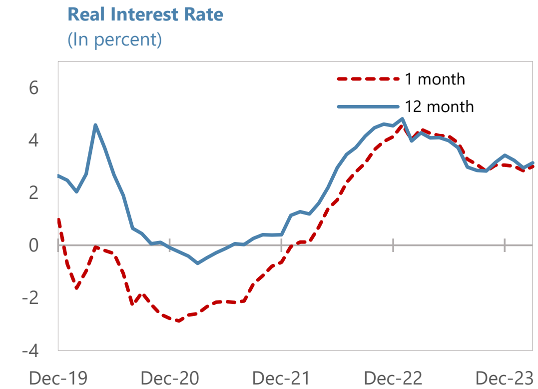
1/ USD-10Y: Yield on 10-year dollar-denominated securities.
2/ WA Spread: Weighted average spread vis-à-vis US Treasuries of comparable maturity.
Source: Uruguayan authorities, Bloomberg, Bolsa Electrónica de Valores del Uruguay, and IMF staff calculations.

Figure 6. Uruguay: Monetary Policy

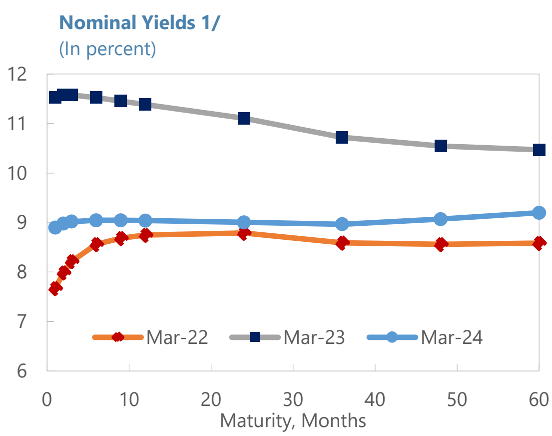
The central bank has gradually lowered the policy rate....



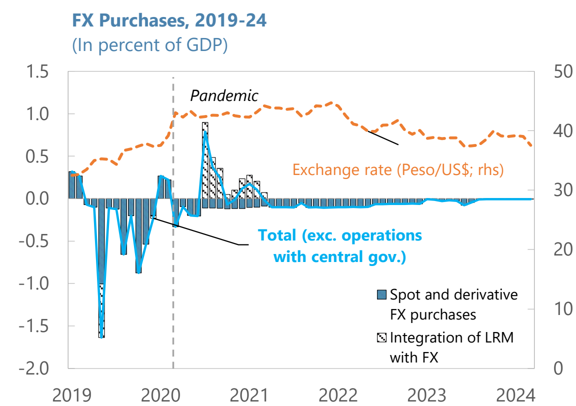
...keeping short-term real interest rates above the neutral rate...



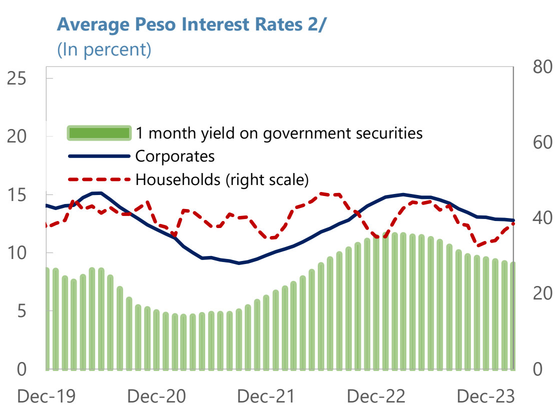
...while the yield curve became upward sloping...



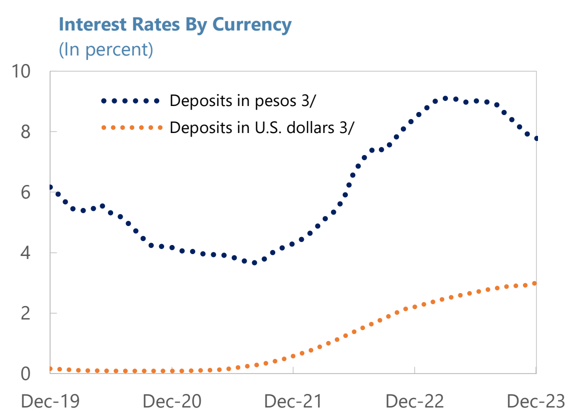
...with no spot and forward FX interventions in 2023.



Lower policy rates have eased borrowing costs ...



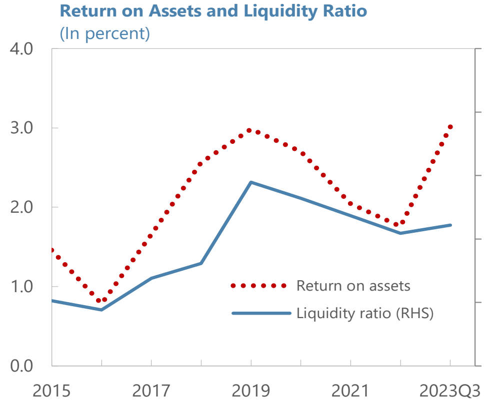
... as well as deposit rates in local currency, while US dollar rates increased.



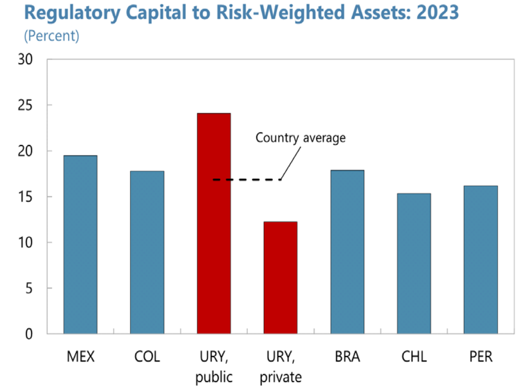
Sources: IMF, World Economic Outlook; Banco Central del Uruguay (BCU), and IMF staff calculations.
1/ Yields on BCU paper issued in nominal pesos (Letras de Regulación Monetaria).
2/ Average interest rates on new peso loans of up to one year.
3/ Weighted average rate on totality of fixed term deposits.

Figure 7. Uruguay: Credit and Banking

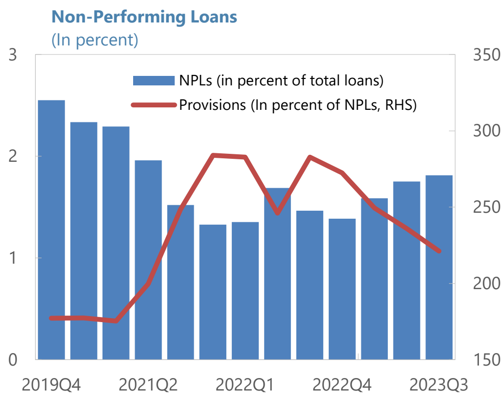
Uruguayan banks improved their profitability supported by higher interest rates...



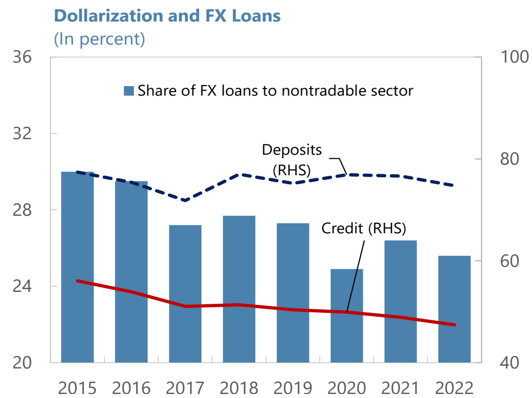
...while capital buffers remained adequate, particularly for state-owned banks.



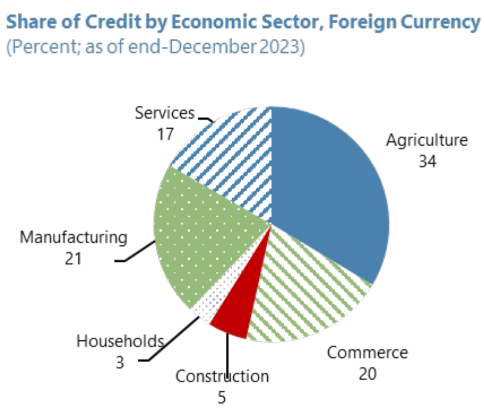
Non-performing loans ticked up, amid increased provisioning.



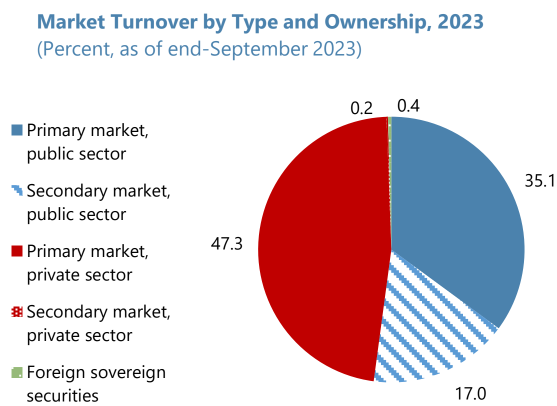
Dollarization, especially for deposits, remains high...



With the agricultural sector receiving the largest share of FX loans among corporates.



The securities market is dominated by the private sector's certificate of deposits and public sector bonds.

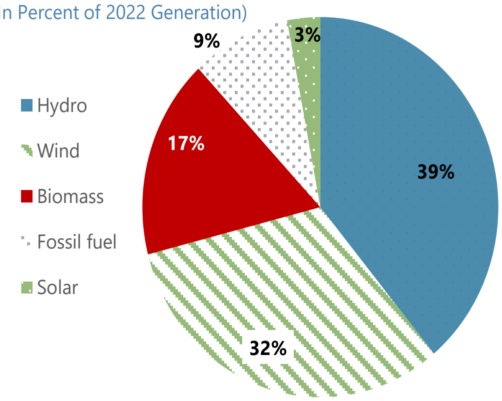


Sources: IMF, World Economic Outlook; Banco Central del Uruguay (BCU), and IMF staff calculations.

Figure 8. Uruguay: Climate

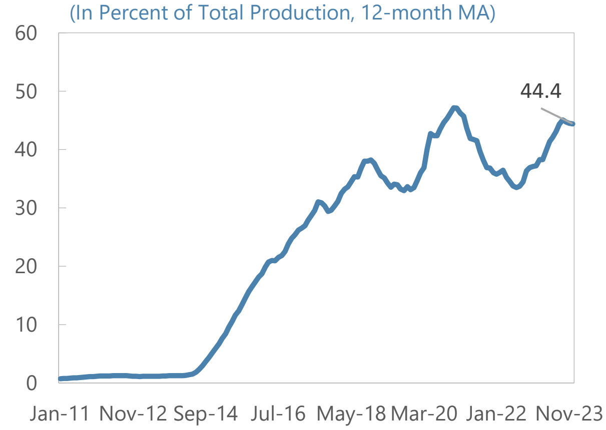
Uruguay is leading the green energy transition in the region...

Electric Generation by Source
(In Percent of 2022 Generation)



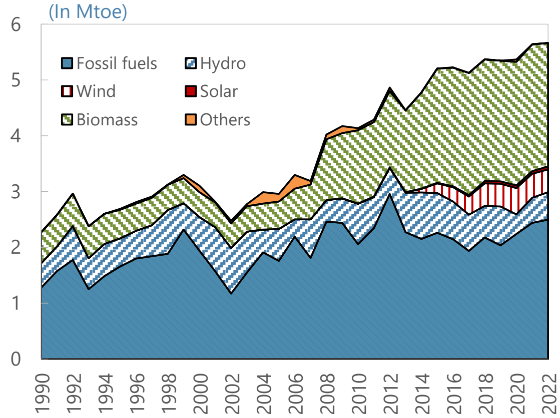
...with renewable sources accounting for 90 percent of total electricity produced....

Wind Energy Production
(In Percent of Total Production, 12-month MA)



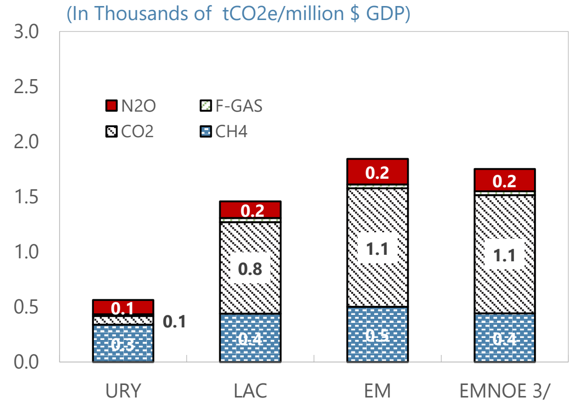
...and a lower dependence of the economy on fossil fuels.

Energy Consumption by Source
(In Mtoe)



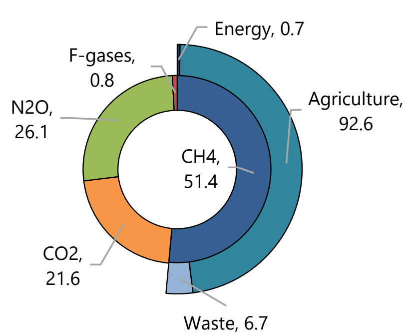
Despite being a low global emitter of GHGs....

GHG per PPP $ of GDP
(In Thousands of tCO2e/million $ GDP)



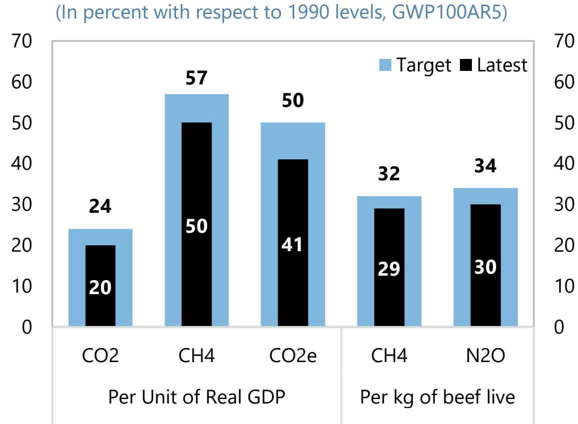
...with half of emissions being comprised of methane...

Historical GHG Emissions by Gas and Source
(percent of total; excl. LULUCF; 2019)



...Uruguay has set ambitious targets in its NDCs.

NDC 2025 Overall and Specific Reduction Targets
(In percent with respect to 1990 levels, GWP100AR5)



Sources: UNFCCC, WRI CAIT, Ministerio de Industria Energia y Mineria, WEO, IEA, INGEI, IMF staff calculations.

Table 1. Uruguay: Selected Economic Indicators, 2021-25

	2021	2022	2023	2024	2025
				Projections	
Output, prices, and employment					
Real GDP (percent change)	5.6	4.7	0.4	3.4	3.0
GDP (US$ billions)	60.8	70.2	77.2	82.8	87.0
Unemployment (in percent, pa)	9.4	7.9	8.3	8.2	8.0
Output gap (percent of potential output)	-2.0	-0.5	-1.7	-0.9	-0.4
CPI inflation (in percent, end of period)	8.0	8.3	5.1	5.5	5.4
	(Percent change, unless otherwise indicated)				
Monetary and banking indicators 1/					
Base money	9.1	1.7	9.0	...	...
M2	16.2	7.2	11.3	...	...
Growth of credit to households (in real pesos)	4.4	6.4	7.0	...	...
Growth of credit to firms (in US$)	7.0	19.1	11.2	...	...
Bank assets (in percent of GDP)	75.0	68.0	63.8	...	...
Private credit (in percent of GDP) 2/	26.7	26.8	28.8	...	...
Monetary policy rate (end of period)	5.8	11.3	9.0	...	...
	(In percent of GDP, unless otherwise indicated)				
Fiscal sector indicators 3/					
Revenue CG-BPS (A)	27.3	27.5	27.7	27.7	27.8
excluding *cincuentones*	27.0	27.4	27.7	27.7	27.8
Primary expenditure CG-BPS (B)	28.2	28.2	28.6	28.6	28.6
Primary balance of local governments (C)	0.1	0.1	0.0	0.0	0.0
Primary balance of BSE (D)	0.1	0.0	-0.1	0.2	0.2
Primary balance NFPS (A-B+C+D)	-0.6	-0.5	-0.9	-0.7	-0.6
excluding *cincuentones* 4/	-0.9	-0.6	-0.9	-0.7	-0.6
Interest NFPS	2.0	2.0	2.1	2.3	2.1
Overall balance CG-BPS	-3.7	-2.9	-3.0	-3.3	-3.0
excluding *cincuentones* 4/	-4.1	-3.1	-3.1	-3.4	-3.1
Overall balance NFPS	-2.6	-2.5	-3.1	-3.0	-2.6
excluding *cincuentones* 4/	-3.1	-2.7	-3.2	-3.1	-2.7
Gross debt NFPS	64.1	60.3	64.5	64.6	64.9
Gross debt CG-BPS (authorities' definition)	60.0	56.7	58.6	58.7	59.0
External indicators					
Merchandise exports, fob (US$ billions)	15.8	17.0	15.1	16.6	17.9
Merchandise imports, fob (US$ billions)	11.2	13.5	13.0	14.1	15.0
Terms of trade (percent change)	2.0	-1.8	0.3	0.3	2.5
Current account balance	-2.4	-3.9	-3.6	-3.1	-2.8
Total external debt + non-resident deposits	79.7	76.0	67.2	69.4	68.4
Of which: External public debt	35.1	29.6	29.9	34.0	33.4
External debt service (in percent of exports of g&s)	56.9	53.7	58.0	51.9	45.6
Gross official reserves (US$ billions)	17.0	15.1	16.2	16.4	16.6
In months of imports of goods and services	13.4	9.6	10.3	9.9	9.5
In percent of:					
Short-term external (STE) debt	646	636	690	576	563
STE debt plus banks' non-resident deposits	300	272	288	261	254

Sources: Banco Central del Uruguay, Ministerio de Economia y Finanzas, Instituto Nacional de Estadistica, and IMF staff calculations.
1/ Percent change of end-of-year data.
2/ Includes bank and non-bank credit.
3/ Non-financial public sector (NFPS) includes the Central Government (CG), Banco de Prevision Social (BPS), Banco de Seguros del Estado (BSE), and Non-Financial Public Enterprises (NFPE).
4/ Temporary proceeds resulting from the pension reform that allowed workers above 50 years old (and with certain income level) to voluntarily move back to the public pension system. Proceeds are projected to end in 2022.

Table 2. Uruguay: Balance of Payments and External Sector Indicators, 2020-29

	2020	2021	2022	2023	2024	2025	2026	2027	2028	2029
					Projections					
	(In billions of U.S. dollars, unless otherwise indicated)									
Balance of Payments										
Current account	-0.4	-1.5	-2.7	-2.8	-2.6	-2.5	-2.4	-2.3	-2.0	-2.1
Trade balance	2.2	4.6	3.5	2.1	2.5	2.8	3.2	3.7	4.5	4.9
Exports of goods	9.9	15.8	17.0	15.1	16.6	17.9	19.1	20.5	22.2	23.7
Imports of goods	7.9	11.2	13.5	13.0	14.1	15.0	15.9	16.8	17.8	18.8
Of which: Fuel products	0.8	1.3	2.0	1.6	1.8	1.8	1.8	1.9	1.9	2.0
Of which: Non-fuel products	7.1	9.9	11.5	11.4	12.4	13.3	14.1	14.9	15.8	16.8
Services balance	0.3	-0.1	0.1	0.3	0.7	0.9	1.0	1.2	1.3	1.4
Exports, f.o.b.	3.8	3.8	5.6	6.2	6.4	6.9	7.5	8.1	8.7	9.4
Imports, f.o.b.	3.5	3.9	5.5	5.9	5.7	6.0	6.5	7.0	7.4	8.0
Income balance	-2.8	-6.0	-6.3	-5.2	-5.7	-6.1	-6.6	-7.2	-7.8	-8.3
Financial and capital account balance	0.6	-0.2	-2.2	-2.3	-2.5	-2.4	-2.4	-2.3	-2.0	-2.0
Foreign direct investment	-1.0	-1.5	-3.0	-4.2	-3.7	-3.5	-3.2	-3.3	-3.5	-3.7
Portfolio investment	1.5	1.1	2.0	1.4	1.5	1.6	1.5	1.5	1.5	1.5
Financial derivatives and other investments (net)	-1.6	-0.6	0.4	-0.3	-0.5	-0.8	-0.9	-0.7	-0.2	-0.1
Change in reserve assets	1.6	0.8	-1.6	0.8	0.2	0.2	0.2	0.2	0.2	0.2
Net errors and omissions	0.9	1.3	0.5	0.5	0.0	0.0	0.0	0.0	0.0	0.0
Reserve Adequacy and External Indicators										
Gross official reserves (stock)	16.2	17.0	15.1	16.2	16.4	16.6	16.8	17.0	17.2	17.4
In months of imports of goods and services	17.0	13.4	9.6	10.3	9.9	9.5	9.0	8.6	8.2	7.8
In percent of short-term debt	557.3	645.8	636.1	690.1	575.7	562.8	551.6	536.5	522.5	507.7
	(In percent of GDP)									
Balance of Payments										
Current account	-0.7	-2.4	-3.9	-3.6	-3.1	-2.8	-2.6	-2.4	-2.0	-2.0
Trade balance	4.1	7.6	5.0	2.7	3.0	3.2	3.5	3.9	4.5	4.6
Exports of goods	18.9	26.1	24.3	19.5	20.0	20.5	21.1	21.5	22.2	22.6
Imports of goods	-14.7	-18.5	-19.3	-16.8	-17.1	-17.3	-17.5	-17.7	-17.8	-17.9
Of which: Fuel products	1.4	2.2	2.8	2.1	2.1	2.1	2.0	2.0	1.9	1.9
Of which: Non-fuel products	13.3	16.2	16.5	14.7	14.9	15.2	15.5	15.7	15.8	16.0
Services balance	0.5	-0.2	0.2	0.4	0.8	1.0	1.1	1.2	1.3	1.3
Exports	7.0	6.2	7.9	8.0	7.7	7.9	8.3	8.5	8.7	8.9
Imports	6.6	6.5	7.8	7.6	6.9	6.9	7.1	7.3	7.4	7.6
Income balance	-5.3	-9.8	-9.0	-6.8	-6.8	-7.0	-7.3	-7.5	-7.8	-7.9
Financial and capital account balance	1.1	-0.3	-3.1	-3.0	-3.1	-2.8	-2.6	-2.4	-2.0	-1.9
Foreign direct investment	-1.9	-2.5	-4.2	-5.5	-4.5	-4.0	-3.5	-3.5	-3.5	-3.5
Portfolio investment	2.8	1.8	2.8	1.8	1.8	1.8	1.6	1.6	1.5	1.4
Financial derivatives and other investments (net)	-2.9	-1.0	0.6	-0.4	-0.6	-0.9	-1.0	-0.7	-0.2	-0.1
Change in reserve assets	3.0	1.4	-2.2	1.1	0.2	0.2	0.2	0.2	0.2	0.2
Total external debt	87.7	79.7	76.0	67.2	69.4	68.4	67.6	67.2	66.5	65.9
Of which: Short-term debt (residual maturity)	13.2	12.8	11.6	10.4	7.5	7.4	7.4	7.3	7.2	7.1
Of which: External public debt	37.6	35.1	29.6	29.9	34.0	33.4	32.9	32.7	32.4	32.0
	(In percent of annual exports of goods and services)									
External Debt										
Total external debt (including non-resident deposits)	339	247	236	244	250	241	231	224	215	209
Debt service	76.0	56.9	53.7	58.0	51.9	45.6	43.5	42.8	40.7	39.9
Of which: Interest payments	1.3	1.2	1.4	1.5	1.6	2.0	2.4	2.5	2.7	2.9
	(Annual percent change)									
External Trade										
Exports of goods in US$	-14.6	56.5	7.5	-11.5	10.1	7.6	7.2	7.1	8.4	6.6
Imports of goods in US$	-9.7	41.8	20.8	-4.1	8.9	6.4	5.9	5.6	5.7	5.9
Export prices in US$	0.8	17.4	9.8	-4.8	1.3	2.9	2.9	3.1	4.3	4.6
Import prices in US$	-3.6	12.6	11.4	-2.6	2.2	1.1	1.0	1.2	1.4	1.7
Terms of trade for goods	7.3	2.0	-1.8	0.3	0.3	2.5	2.5	2.4	3.0	1.4
Export volume (goods and non-factor services)	-18.2	25.8	1.8	-3.9	6.9	4.2	4.1	3.8	3.8	3.7
Import volume (goods and non-factor services)	-3.8	22.2	7.2	1.3	10.9	5.9	5.5	5.1	4.9	4.9
Export volume (goods)	-15.3	33.3	-2.0	-7.1	8.7	4.5	4.2	3.9	3.9	1.9
Import volume (goods)	-3.8	22.2	7.2	1.3	10.9	5.9	5.5	5.1	4.9	4.9
Of which: Non-fuel products	-5.2	25.6	8.7	2.9	6.6	5.6	5.3	4.9	4.7	4.8
Of which: Fuel products	11.8	6.0	7.0	-3.2	8.9	7.7	6.6	6.2	5.9	5.8

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

Table 3. Uruguay: Main Fiscal Aggregates, 2020-29

					Projections					
	2020	2021	2022	2023	2024	2025	2026	2027	2028	2029
	(In billions of pesos, unless otherwise indicated)									
Revenues	631	723	794	832	908	988	1,066	1,147	1,233	1,325
Taxes	416	479	536	553	604	655	707	761	818	880
Other	45	54	60	62	68	73	79	85	92	99
Non tax	30	33	30	36	40	43	46	50	54	58
Social security (BPS)	163	173	199	218	236	256	276	297	319	343
of which: *cincuentones*	13	8	3	0	0	0	0	0	0	0
Primary balance NFPE	22	38	29	24	28	34	36	39	42	45
Primary expenditures	680	746	813	858	938	1,015	1,087	1,165	1,247	1,338
Current	635	698	744	797	871	943	1,009	1,080	1,156	1,240
Wages	118	125	134	149	159	170	180	190	202	217
Goods and services	89	116	114	107	119	129	136	146	157	168
Pensions	226	244	261	288	322	353	380	407	435	467
Transfers	202	214	235	252	270	291	313	337	362	389
Capital	45	48	69	61	67	73	79	84	91	98
Central government	29	29	45	36	40	43	46	50	54	58
Public enterprises	16	19	24	25	28	30	32	35	37	40
Primary balance of CG, BPS and NFPE 1/ 2/	-49	-23	-19	-26	-30	-28	-22	-18	-14	-12
Primary balance of local governments	2	3	4	1	1	1	1	1	1	1
Primary balance of BSE 3/	0	3	1	-2	7	7	8	8	9	10
Primary balance NFPS	-47	-17	-15	-28	-23	-20	-13	-9	-4	-2
excluding *cincuentones*	-60	-25	-17	-28	-23	-20	-13	-9	-4	-2
Interest of the NFPS	58	53	59	64	77	74	80	84	90	98
Overall balance of the CG-BPS	-115	-98	-83	-90	-108	-105	-106	-107	-109	-116
excluding *cincuentones*	-130	-110	-89	-93	-111	-109	-109	-111	-113	-121
Overall balance of the NFPS	-105	-70	-74	-92	-100	-94	-93	-93	-94	-100
excluding *cincuentones*	-121	-81	-79	-95	-103	-97	-97	-97	-99	-105
Gross debt NFPS	1,535	1,695	1,742	1,934	2,121	2,307	2,493	2,676	2,869	3,073
Net debt NFPS	1,292	1,433	1,490	1,672	1,837	2,004	2,169	2,333	2,500	2,676
	(In percent of GDP, unless otherwise indicated)									
Revenues	28.0	27.3	27.5	27.7	27.7	27.8	27.8	27.8	27.8	27.8
Taxes	18.5	18.1	18.6	18.4	18.4	18.4	18.4	18.4	18.5	18.5
Other	2.0	2.0	2.1	2.1	2.1	2.1	2.1	2.1	2.1	2.1
Non tax	1.3	1.2	1.0	1.2	1.2	1.2	1.2	1.2	1.2	1.2
Social security (BPS)	7.2	6.6	6.9	7.3	7.2	7.2	7.2	7.2	7.2	7.2
of which: *cincuentones*	0.6	0.3	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Primary balance NFPE	1.0	1.4	1.0	0.8	0.9	1.0	1.0	1.0	1.0	1.0
Primary expenditures	30.2	28.2	28.2	28.6	28.6	28.6	28.4	28.2	28.1	28.1
Current	28.2	26.4	25.8	26.6	26.6	26.5	26.3	26.2	26.1	26.0
Wages	5.2	4.7	4.7	5.0	4.8	4.8	4.7	4.6	4.6	4.5
Goods and services	4.0	4.4	4.0	3.6	3.6	3.6	3.5	3.5	3.5	3.5
Pensions	10.0	9.2	9.0	9.6	9.8	9.9	9.9	9.9	9.8	9.8
Transfers	9.0	8.1	8.1	8.4	8.2	8.2	8.2	8.2	8.2	8.2
Capital	2.0	1.8	2.4	2.0	2.0	2.0	2.0	2.0	2.0	2.0
Central government	1.3	1.1	1.6	1.2	1.2	1.2	1.2	1.2	1.2	1.2
Public enterprises	0.7	0.7	0.8	0.8	0.8	0.8	0.8	0.8	0.8	0.8
Primary balance of CG, BPS and NFPE 1/ 2/	-2.2	-0.9	-0.7	-0.9	-0.9	-0.8	-0.6	-0.4	-0.3	-0.3
Primary balance of local governments	0.1	0.1	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Primary balance of BSE 3/	0.0	0.1	0.0	-0.1	0.2	0.2	0.2	0.2	0.2	0.2
Primary balance NFPS	-2.1	-0.6	-0.5	-0.9	-0.7	-0.6	-0.3	-0.2	-0.1	0.0
excluding *cincuentones*	-2.7	-0.9	-0.6	-0.9	-0.7	-0.6	-0.3	-0.2	-0.1	0.0
Interest of the NFPS	2.6	2.0	2.0	2.1	2.3	2.1	2.1	2.0	2.0	2.1
Overall balance of the CG-BPS	-5.1	-3.7	-2.9	-3.0	-3.3	-3.0	-2.8	-2.6	-2.5	-2.4
excluding *cincuentones*	-5.8	-4.1	-3.1	-3.1	-3.4	-3.1	-2.9	-2.7	-2.6	-2.5
Overall balance of the NFPS	-4.7	-2.6	-2.5	-3.1	-3.0	-2.6	-2.4	-2.3	-2.1	-2.1
excluding *cincuentones*	-5.3	-3.1	-2.7	-3.2	-3.1	-2.7	-2.5	-2.4	-2.2	-2.2
Gross debt NFPS	68.1	64.1	60.3	64.5	64.6	64.9	65.0	64.9	64.7	64.5
Net debt NFPS	57.3	54.1	51.6	55.8	56.0	56.3	56.6	56.5	56.4	56.2
Memorandum Items:										
Real revenues growth (in percent)	-6.8	3.1	5.3	1.3	3.2	3.3	2.7	2.5	2.3	2.3
Real primary spending growth (in percent)	0.6	1.7	-0.5	-0.4	4.3	2.6	1.9	2.2	2.3	2.7
GDP (in billions of pesos)	2,255	2,646	2,889	2,999	3,281	3,556	3,836	4,126	4,434	4,763
Gross debt CG-BPS (authorities' definition)	61.7	60.0	56.7	58.6	58.7	59.0	59.1	59.0	58.8	58.6
Net debt CG-BPS (authorities' definition)	56.6	55.3	52.7	54.8	55.1	55.4	55.6	55.6	55.4	55.2

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

1/ Banco de Prevision Social (BPS).

2/ Non-financial public enterprises (NFPE).

3/ Banco de Seguros del Estado (BSE).

Table 4. Uruguay: Monetary Survey, 2016-23

	2016	2017	2018	2019	2020	2021	2022	2023
	(End of period, in billion of pesos)							
Banco Central del Uruguay (BCU)								
Net foreign assets	399	461	565	560	705	764	615	634
Gross international reserves	394	459	546	542	687	758	606	633
Net domestic assets	-285	-330	-443	-413	-542	-584	-421	-412
Net credit to the public sector	60	104	112	108	66	35	63	135
Net credit to the financial system	-202	-176	-272	-284	-323	-346	-288	-276
Credit to the private sector	1	1	1	1	1	0	0	0
Securities issued by the BCU	-125	-250	-222	-205	-280	-291	-283	-333
Other	-55	-56	-162	-105	-76	-30	94	28
Peso monetary liabilities 1/	113	131	122	147	163	180	194	222
Public and Private Banks 2/								
Net foreign assets	177	168	318	281	395	477	449	394
Net domestic assets	611	633	735	757	899	1,039	998	1,062
Net credit to the public sector	39	36	62	56	63	77	70	86
Net credit to the financial system	250	285	339	351	439	497	403	405
Credit to the private sector	445	445	548	554	627	706	773	865
Other	-123	-133	-214	-204	-229	-241	-248	-293
Liabilities to the private sector (residents)	788	801	1,051	1,038	1,293	1,516	1,491	1,505
Banking System (Central, Private, and Public Banks)								
Net foreign assets	575	629	883	841	1,100	1,241	1,064	1,027
Net domestic assets	236	197	42	230	229	313	463	520
Credit to the public sector	98	140	174	164	129	112	133	221
Credit to the rest of financial system	-6	50	-83	24	57	57	-5	33
Credit to the private sector	445	446	549	555	627	706	773	865
Other	-302	-439	-598	-514	-585	-562	-438	-598
Broad money (M3)	811	826	925	1,070	1,329	1,554	1,528	1,548
	(In percent of total private credit) 3/							
Composition of Credit								
Credit to firms	60.9	57.3	56.7	57.9	60.3	63.2	62.0	…
Credit to households	39.1	42.7	43.3	42.1	39.7	36.8	38.0	…
Consumption	46.7	45.8	44.5	44.2	55.0	50.5	51.1	…
Car loans	0.0	0.0	0.0	0.3	3.6	4.2	5.4	…
Mortgages	25.9	25.8	25.1	25.4	41.5	45.3	43.3	…
	(Percent change) 3/							
Memorandum Items:								
Base money	9.7	3.6	-6.5	27.2	5.8	9.1	1.7	9.0
M1	6.6	10.3	2.8	8.8	15.7	16.4	-0.1	6.1
Broader M1 (M1 plus savings deposits)	8.4	15.0	5.7	8.3	18.5	17.8	0.4	9.9
M2	14.4	13.3	9.9	6.3	16.8	16.2	7.2	11.3
M3	3.9	1.9	11.9	15.7	24.2	16.9	-1.7	1.3
Credit to firms (in US$)	1.5	-4.2	2.4	-3.7	1.1	7.0	19.1	11.2
Credit to households (in real pesos) 4/	-0.5	2.7	1.3	1.9	-0.6	4.4	6.4	7.0

Source: Banco Central del Uruguay and IMF staff calculations.

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/ Percentage change from previous year. In pesos, unless otherwise indicated.

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

Table 5. Uruguay: Medium-Term Macroeconomic Framework, 2020-29

					Projections					
	2020	2021	2022	2023	2024	2025	2026	2027	2028	2029
	(Annual percent change, unless otherwise indicated)									
National Accounts										
Real GDP	-7.4	5.6	4.7	0.4	3.4	3.0	2.6	2.4	2.3	2.2
Total domestic demand	-6.1	6.2	5.2	1.8	2.3	3.1	2.9	2.7	2.5	2.5
Final consumption expenditure	-7.9	3.7	5.0	2.8	2.7	2.6	2.3	2.2	2.1	2.1
Private final consumption expenditure	-8.4	3.2	5.7	3.6	2.6	2.5	2.4	2.3	2.2	2.2
Public final consumption expenditure	-5.7	5.2	2.5	-0.2	2.8	2.7	1.7	1.8	1.9	1.7
Gross capital formation	4.1	19.3	5.7	-2.7	0.6	5.7	5.9	4.6	4.2	4.2
Gross fixed capital formation	-1.7	19.3	11.8	-7.0	0.4	5.7	5.9	4.6	4.1	4.1
Private fixed capital formation	-1.8	19.4	9.9	-6.7	-0.2	5.6	5.9	4.5	3.9	3.9
Public fixed capital formation	-0.5	17.7	36.2	-9.2	6.9	6.4	6.0	5.8	5.6	5.4
Change in inventories (contribution to growth)	0.8	0.1	-1.0	0.8	0.0	0.0	0.0	0.0	0.0	0.0
Net exports (contribution to growth)	-1.6	-0.4	-0.3	-1.4	1.2	-0.1	-0.2	-0.2	-0.2	-0.2
Consumer Prices										
CPI inflation (average)	9.8	7.7	9.1	5.9	4.9	5.4	5.1	4.8	4.6	4.5
CPI inflation (end of period)	9.4	8.0	8.3	5.1	5.5	5.4	5.1	4.8	4.6	4.5
Balance of Payments										
Current account balance (percent of GDP)	-0.7	-2.4	-3.9	-3.6	-3.1	-2.8	-2.6	-2.4	-2.0	-2.0
Exports of goods and services (volume)	-18.2	25.8	1.8	-3.9	6.9	4.2	4.1	3.8	3.8	3.7
Export of goods (volume)	-15.3	33.3	-2.0	-7.1	8.7	4.5	4.2	3.9	3.9	1.9
Imports of goods and services (volume)	-12.2	17.6	12.6	2.0	3.1	4.8	5.3	4.9	4.6	4.6
Imports of goods (volume)	-3.8	22.2	7.2	1.3	10.9	5.9	5.5	5.1	4.9	4.9
Terms of trade (goods)	4.5	4.3	-1.5	-2.2	-0.9	1.8	1.9	1.9	2.9	2.9
	(In percent of GDP, unless otherwise indicated)									
Non Financial Public Sector										
Revenues	28.0	27.3	27.5	27.7	27.7	27.8	27.8	27.8	27.8	27.8
of which: cincuentones transactions	0.6	0.3	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Primary expenditures	30.2	28.2	28.2	28.6	28.6	28.6	28.4	28.2	28.1	28.1
Primary balance NFPS 1/	-2.1	-0.6	-0.5	-0.9	-0.7	-0.6	-0.3	-0.2	-0.1	0.0
excluding cincuentones transactions	-2.7	-0.9	-0.6	-0.9	-0.7	-0.6	-0.3	-0.2	-0.1	0.0
Cyclically adjusted primary balance	-0.5	0.9	0.0	-0.4	-0.5	-0.4	-0.3	-0.2	-0.1	0.0
Overall balance NFPS	-4.7	-2.6	-2.5	-3.1	-3.0	-2.6	-2.4	-2.3	-2.1	-2.1
excluding cincuentones transactions	-5.3	-3.1	-2.7	-3.2	-3.1	-2.7	-2.5	-2.4	-2.2	-2.2
Gross NFPS debt	68.1	64.1	60.3	64.5	64.6	64.9	65.0	64.9	64.7	64.5
Net NFPS debt (gross debt minus financial assets)	57.3	54.1	51.6	55.8	56.0	56.3	56.6	56.5	56.4	56.2
External Debt										
Gross external debt	87.7	79.7	76.0	67.2	69.4	68.4	67.6	67.2	66.5	65.9
NFPS gross external debt	37.6	35.1	29.6	29.9	34.0	33.4	32.9	32.7	32.4	32.0
Gross international reserves (US$ billions)	16.2	17.0	15.1	16.2	16.4	16.6	16.8	17.0	17.2	17.4
Saving and Investment										
Gross domestic investment	16.4	18.3	18.9	17.3	16.9	16.8	16.7	16.6	16.4	16.2
Public sector gross investment	3.4	3.8	5.0	4.3	4.3	4.3	4.3	4.3	4.3	4.3
Private sector gross investment	13.1	14.5	13.9	12.9	12.6	12.5	12.4	12.3	12.1	11.9
Gross national saving	15.8	15.9	15.0	13.6	13.8	14.0	14.1	14.2	14.4	14.3
Public sector gross saving	-2.7	-0.8	-0.2	-1.0	-1.0	-0.6	-0.4	-0.2	-0.1	-0.1
Private sector gross saving	18.4	16.7	15.2	14.7	14.8	14.5	14.5	14.4	14.5	14.3
Unemployment and Output Gap										
Population (Mil)	3.5	3.5	3.6	3.6	3.6	3.6	3.6	3.6	3.6	3.6
Labor force participation (percent)	60.5	61.4	61.9	63.4	63.4	63.4	63.4	63.4	63.4	63.4
Employment growth (percent)	-3.9	2.9	2.8	2.2	0.5	0.5	0.2	0.4	0.2	0.3
Unemployment rate (percent)	10.4	9.4	7.9	8.3	8.2	8.0	8.0	8.0	8.0	8.0
Output gap (percent of potential output)	-4.5	-2.0	-0.5	-1.7	-0.9	-0.4	-0.2	-0.1	0.0	0.0

Sources: Banco Central del Uruguay, Haver Analytics and IMF staff calculations.
1/ The non-financial public sector (NFPS) includes the Central Government, Banco de Prevision Social, Banco de Seguros del Estado, local governments and Non-Financial Public Enterprises.

Table 6. Uruguay: Selected Financial Soundness Indicators, 2015-23

	2015	2016	2017	2018	2019	2020	2021	2022	2023
Capital Adequacy									
Regulatory capital in percent of risk-weighted assets	12.6	14.2	15.6	16.6	16.8	17.7	16.3	16.9	17.0
Regulatory Tier 1 capital to risk-weighted assets	11.4	13.0	14.5	15.6	15.7	16.6	15.4	15.8	16.0
Capital to assets	7.4	8.6	9.2	10.3	10.4	9.7	8.9	9.6	10.1
Asset Quality									
Non-performing loans in percent of total loans	1.6	2.4	2.7	2.8	2.6	2.3	1.3	1.4	1.7
Specific loan-loss provisions in percent of non-performing loans	148.0	152.0	158.3	159.7	177.1	177.4	283.9	272.4	256.1
Earnings and Profitability									
Return on assets	1.5	0.8	1.7	2.6	3.0	2.7	2.0	1.8	3.0
Return on equity	11.8	2.7	11.4	19.1	21.5	20.8	15.4	11.6	22.7
Interest marging to gross income	62.9	60.8	61.8	70.1	70.5	68.3	65.3	69.2	57.0
Trading income to total income	4.9	6.2	5.6	1.1	0.8	2.6	0.5	-2.5	15.3
Liquidity									
Liquid assets to total assets	52.1	50.7	52.0	53.4	70.2	59.4	59.5	55.9	58.8
Liquid assets to short-term liabilities	70.1	69.4	71.9	73.1	79.5	78.2	76.8	75.4	81.4
Customer deposits to total (noninterbank) loans	188.4	180.4	179.1	169.9	182.4	205.5	205.8	178.9	159.5
Net open position in foreign exchange to capital	50.6	36.1	34.5	35.7	36.2	32.6	29.9	30.6	35.1
Dollarization									
Foreign-Currency-Denominated Loans to Total Loans	67.3	64.9	62.0	70.4	57.0	55.8	53.8	51.2	50.6
Foreign-Currency-Denominated Liabilities to Total Liabilities	78.2	73.9	70.6	70.0	73.3	74.3	73.8	71.1	68.7

Sources: Uruguayan authorities and IMF Financial Soundness Indicators.

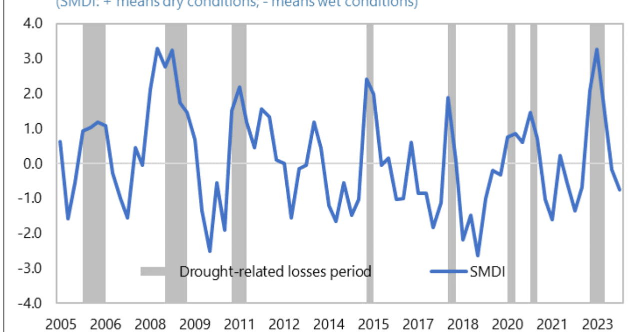
Annex I. Macroeconomic Impacts of Droughts in Uruguay

1. Uruguay's exposure to extreme climate events has been increasing, causing substantial economic losses. Uruguay confronted the impact of a once-in-a-century severe drought, which mostly affected the agricultural sector lowering agricultural output between the last quarter of 2022 and the second quarter of 2023 by 25 percent on a year-on-year basis. Rain and floods are also becoming more frequent, forcing vulnerable groups to relocate (3 percent of the population in 2015-19) and impacting livelihoods. Uruguayan agricultural sectors are increasingly exposed to weather events impacting on crop yields and food production more broadly. As La Niña conditions prevailed for four consecutive years since 2020, Uruguay confronted the impacts of one of the worst dry spells in the last century, causing significant direct losses to the primary sector in 2023, especially for soybean production and cattle farming.

2. As weather events have become more frequent, the modelling of climate change impacts has become a priority. As recurrent responses to climate shocks have put pressure on fiscal space, the authorities have focused in enhancing the modelling of fiscal impacts from climate change (i.e. coastal floods, excessive rainfall, droughts) and integrating them into the national budget. This study's approach contributes to widening the authorities' toolkit for impact assessments.[1]

3. Considering the predominance of the agriculture in Uruguay's economy, weather shock events are captured through soil moisture conditions. A key input for this endeavor is the *soil water available (PAD)* indicator produced by the National Institute of Agriculture Research (INIA). This high frequency indicator relies on INIA's spatially distributed hydrologic modeling and daily inputs captured through a nation-wide grid coverage. The *PAD* allows for a comprehensive assessment of soil moisture conditions as it factors in precipitations, surface runoff, infiltration, evaporation, water plant uptake and soil properties. For the modeling of macroeconomic impacts of weather shocks, the *PAD* is used to develop a *soil moisture deficit indicator (SMDI)* following the methodology of Narasimhan and Srinivasan (2005).[2] Long-term *PAD* reference values for each month are obtained from the 2000-2023 period. As drought impacts are larger when dry conditions are sustained over time, the *SMDI* is calculated in an incremental basis. The SMDI succeeds in capturing periods of drought-related losses in agricultural output (see text chart).

Soil Moisture Deficit and Weather-related Losses Periods
(SMDI: + means dry conditions; - means wet conditions)



Source: INIA-GRAS; IMF staff calculations.

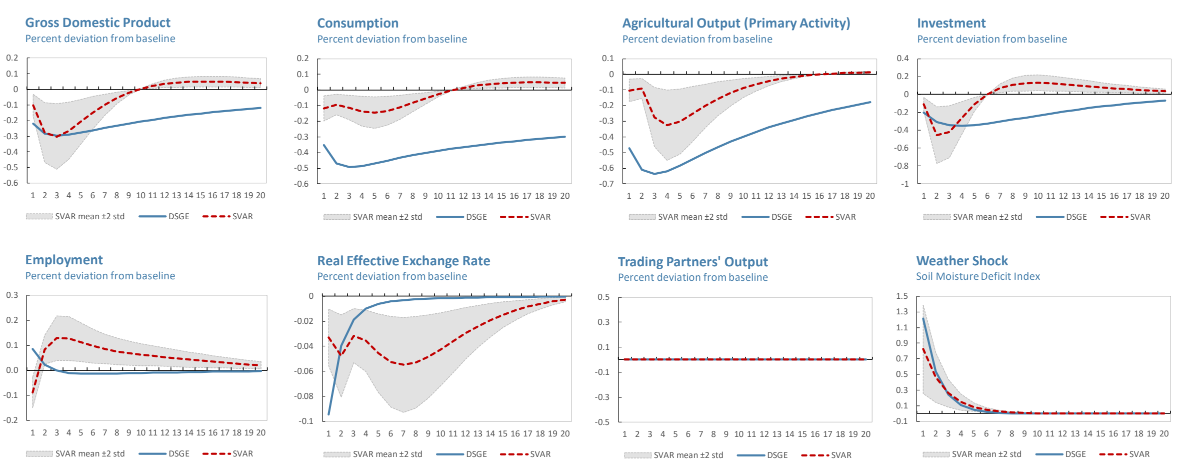
[1] See Clevy and Evans (2024) for further details.

[2] The indicator is developed based on the relevant grids for agriculture production, covering particularly the departments of Colonia, Durazno, Flores, Paysandú, Río Negro, San José and Soriano.

4. A rise in the soil moisture deficit index (drought) causes a prolonged fall in overall GDP, agricultural output and investment. According to a Structural VAR model that includes key macroeconomic variables and the soil moisture deficit index, an adverse weather shock, a one-standard deviation rise in the drought variable (Figure 1), generates a contraction in Uruguay's economy.[3] A rise in soil moisture deficits implies a contemporaneous 0.1 percent decrease in the agricultural sector (primary activities: agricultural, fishing and mining) and a peak decline in GDP of 0.3 percent after 3 quarters. The weather variable vanishes after a year, however its impact on the economy is persistent – impacting agricultural output for 2 years in the SVAR and up to 5 years in the DSGE model. The weather shock manifests itself through the labor market by a fall on impact of employment followed by a rebound, which mimics the behavior of a TFP shock.

5. A similar fall in key macroeconomic variables from the drought is seen in an estimated DSGE model of Uruguay economy. A small open economy DSGE quarterly model with a flexible exchange rate and agricultural and non-agricultural sector estimated to the Uruguay economy shows that droughts have persistent negative impacts on output and consumption. The weather shock acts as a negative supply shock through a combination of rising employment and falling output. Land productivity is negatively affected by the drought, weighing heavily on agricultural output. The real exchange rate, which acts as a shock absorber, depreciates driven by the depressed competitiveness of farmers, which helps to restore part of their competitiveness.

Figure 1. Uruguay: Response of the Uruguayan Economy from a Drought Shock



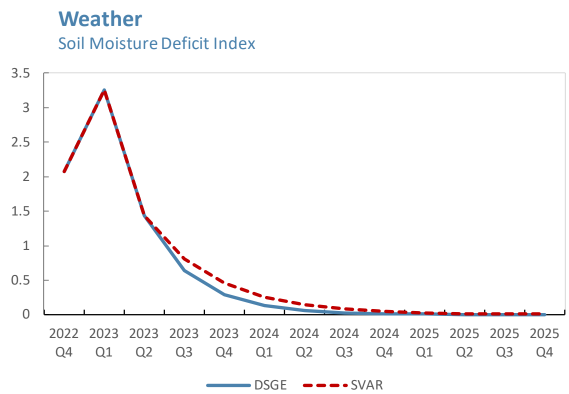
Source: IMF staff calculations.
Note: Time period is quarterly.

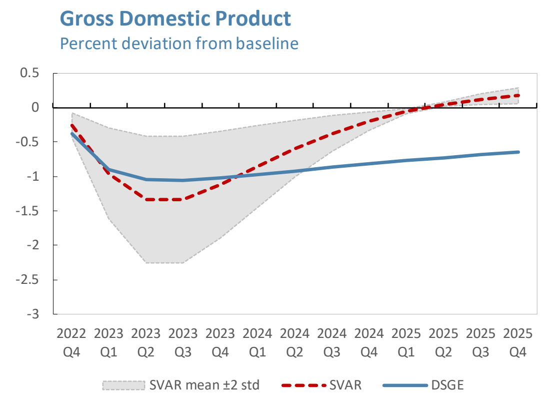
6. Model estimates show around one percent GDP loss due to the recent drought episode. Simulating the recent drought by matching the rise in the soil moisture deficit index seen between 2022Q4 and 2023Q2 provides around a one percent fall in GDP for 2023, driven by losses

[3] Figure 1 outlines the impulse response of each macroeconomic variable to a one-standard-deviation increase in the soil moisture deficit index in a SVAR and DSGE model. In the SVAR the weather shock is identified using a Choleski decomposition. The analysis follows work by Gallic and Vermandel (2020), who find similar results for New Zealand.

in agricultural output and investment. A third of the downward revision to 2023 GDP growth, comparing the October 2022 WEO forecast to the latest data, can be explained by the drought where the rest is partly explained by the closing of the ANCAP oil refinery and consumption leakage to Argentina. According to the Structural VAR model, the impact of the drought should subside in 2024, while the DSGE model shows a longer lasting effect. However, normalization of rainfall in the second half of 2023, shown by a fall in the SMDI, has bolstered the primary sector recovery.

Figure 2. Uruguay: Estimated Impact of the 2022/23 Drought





Source: IMF Staff calculations

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Narasimhan, B. and Srinivasan, R. (2005). Development and evaluation of Soil Moisture Deficit Index (SMDI) and Evapotranspiration Deficit Index (ETDI) for agricultural drought monitoring. *Agricultural and Forest Meteorology,* 133, 69-88.

Annex II. Estimating the Budgetary Impact of Disinflation Surprises[1]

1. The faster-than-expected disinflation in 2023 was a welcome new development, but it has implications for the fiscal accounts. CPI inflation was 5.1 percent at the end of 2023, while at the time of the 2023 Article IV Staff Report the projection was 7 percent. Following these developments, the authorities revised their 2024 macroeconomic assumptions compared to the 2023 *Rendición de Cuentas*. Disinflation surprises can impact budget outcomes in two ways. First, the nominal value of both spending and tax receipts change, and the real (inflation-adjusted) value of those spending and taxes that depend on past (rather than current) prices increase. Second, if unexpected inflation surprises are linked to unforeseen changes in the GDP deflator, the budget can be impacted by the difference between actual nominal GDP and the originally projected GDP, leading to mismatches between the planned and executed ratio of spending and revenue to GDP.

2. Counterfactual projections are needed to estimate the direct impact of inflation surprises on the budget. Counterfactual projections aim at isolating the partial equilibrium effect of inflation shocks, independent of other factors influencing the budget. Using actual inflation outturns and updated projections for 2024, revised paths for GDP, revenues, and spending are estimated, based on the macro and fiscal parameters implicit in the 2023 and 2024 budget projections (from the June 2022 and 2023 *Rendición de Cuentas*, respectively). The methodology to construct a counterfactual projection is as follows:

- Counterfactual GDP. The real growth rate is kept constant at the original budget projections. The actual CPI inflation outturns from 2022 and 2023 alongside the updated 2024 inflation projections are used, together with the elasticities of the GDP deflator to the CPI implicit in the budget projections.

- Counterfactual revenues. The counterfactual GDP projections, together with estimated revenue elasticities with respect to GDP that are implicitly embedded within the original budget projections, are used to construct counterfactual paths for taxes collected by the DGI (internal revenue administration), foreign trade taxes, social security contributions, and other revenue streams.

- Counterfactual spending. Some additional assumptions are needed to construct counterfactual spending figures, accounting for the impact of inflation on various components while holding quantities constant. These quantities, including number of employees, recipients of pensions and social transfers, and volumes of goods and services and investment, are derived from budget projections and knowledge on how inflation affects wages, pensions, and transfers (directly or indirectly). Due to current indexation practices, it is assumed that a surprise in inflation during one-year impacts only the wages, pensions, and cash transfers of the following year. Based on the breakdown of goods and services as well as investment goods, unexpected

[1] Prepared by Paolo Dudine and Rodrigo Cerda (both FAD).

inflation in a single year is assumed to have a contemporaneous impact on 56 percent of the planned budget for goods and services and on 25 percent of planned budget for investment. Finally, it is assumed that the amount budgeted for transfers to entities, and other unclassified transfers are not affected by inflation surprises, while outlays related to health insurance are fully affected by the inflation surprise of the same year.

3. **Keeping constant the growth projections, elasticities, and real spending as in the budget allows to isolate the direct effect of inflation on nominal variables (and on their ratio to GDP)**, by filtering out (i) second order (general equilibrium) effects of inflation surprises (on growth, income, employment, domestic demand, etc.), (ii) forecast errors (such as real growth or the GDP deflator), (iii) estimation errors of elasticities such as revenues to GDP), and (iv) endogenous fiscal policy responses.

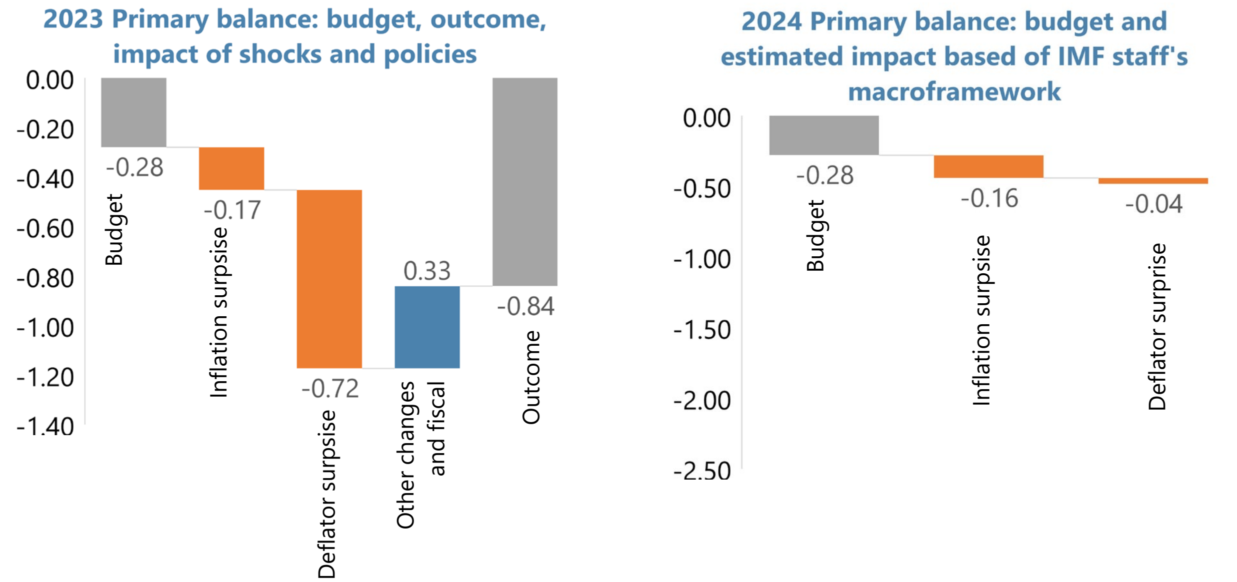
4. **The faster-than-expected disinflation added about 0.17 percent of GDP to the primary deficit projected in the 2023 budget and about 0.16 percent of GDP to the primary deficit in the 2024 budget.** The estimated effects mostly reflect that nominal spending decreases with lower inflation, but by less than nominal GDP does. Moreover, the same framework is used to quantify the direct impact of shocks to the growth of the GDP deflator on GDP and revenues.[2] The impact of lower-than-expected GDP deflator is quantified as a further deterioration of the primary deficit of about 0.72 percent of GDP in 2023, and as a slight further deterioration of the primary balance of 0.04 percent in 2024.[3]

5. **These estimates mean that, in 2023, other changes to macroeconomic variables and fiscal policy had a positive impact on the primary balance of about 0.3 percent of GDP.** Real GDP growth was lower than projected and revisions to past GDP levels lowered nominal GDP. At the same time, revenue elasticity surprised on the upside (both DGI revenues and social security contributions were stronger than anticipated) driven by strong employment creation. These developments helped offset the deterioration of the primary balance from lower inflation and lower GDP deflator.

[2] While the 2023 budget was predicated on a deflator elasticity to the CPI of about 1, which is consistent with historical data, the growth of the GDP deflator is projected to be about two/thirds of inflation for 2023.

[3] Moreover nominal GDP in 2023 turned out to be 7.9 percent lower than in the 2023 budget, and in 2024, it is projected to be 5.5 percent lower than in the 2024 budget. This is due to both lower GDP deflator inflation and real growth, and to recent historical revisions to the GDP series since 2019.

Figure 1. Uruguay: Estimated Impact of Faster-than Expected Disinflation in 2023 and 2024



Source: IMF staff estimates.

Annex III. External Sector Assessment

Overall Assessment: *The external position in 2023 was broadly in line with the level implied by medium-term fundamentals and desirable policies. The current account (CA) deficit is expected to narrow to 3.0 percent of GDP in 2024. This improvement is expected to be driven by the recovery in agricultural exports, amid favorable precipitations, and the strengthening in the balance of services as price differentials and cross-border flows with Argentina normalize. The CA balance is expected to converge to a deficit of about 2.0 percent of GDP in the medium term, driven by a strengthening of the balance of goods and services and a stabilizing primary income balance.*

Potential Policy Responses: *Policies that would help keep the CA in line with its norm include maintaining fiscal consolidation into the medium term as well as structural reforms to raise potential growth, improve competitiveness and make the economy more resilient to climate change, thereby maintaining the savings-investment balance. The exchange rate should continue to act as shock absorber while FX interventions should be limited to respond to disorderly market conditions.*

Foreign Assets and Liabilities: Position and Trajectory

Background. Uruguay's NIIP was –22 percent of GDP at the end of 2023, broadly similar to the previous year (–21 percent of GDP). Foreign assets in 2023 were mostly comprised of direct investment (37 percent of GDP) while international reserves accounted for 21 percent of GDP. Foreign direct investment accounted for almost 63 percent of the country's liabilities. Over the medium term, as real GDP growth converges to its potential and the current account stabilizes around its norm, the NIIP is projected to hover around –32 percent of GDP (average 2026-29).

Assessment. While Uruguay's NIIP is negative, the composition of its liabilities (mainly FDI) and low sovereign risk spreads create favorable conditions. Over the medium term, underpinned by a strong institutional framework and a prudent macroeconomic management, the NIIP-to-GDP ratio is expected to become slightly more negative on the account of steady FDI flows. Vulnerabilities arise from financial dollarization and the share of public foreign-currency public debt, although declining.

2023 (% GDP)	NIIP: –22.1	Gross Assets: 104	Debt Assets: 70.5	Gross Liab.: 126	Debt Liab.: 45.5

Current Account

Background. The CA deficit reached 3.6 percent of GDP in 2023. Recent data revisions to services and primary income debits increased the 2022 current account deficit to 3.9 percent of GDP, from the 3.2 percent previously reported. This revision reflects newly available survey data from large corporations. Despite the post pandemic recovery in travel services exports, the impact of the severe drought and substantial price differentials with Argentina weakened the 2023 balance of goods and services. The latter was offset by lower FDI payouts, with a primary income balance shifting from –9.2 to –7.0 percent of GDP during that period. In 2024, the recovery in agricultural exports and the strengthening of the balance of services will improve the CA deficit at 3.0 percent of GDP. Over the medium term, the CA deficit is expected to gradually converge to about 2.0 percent of GDP.

Assessment. The EBA model estimates a cyclically adjusted CA norm of –2.0 percent of GDP in 2023. This implies an EBA CA gap of –2.3 percent of GDP, with a range from –2.8 to –1.8 percent of GDP. Staff adjustments were made to account for the transitory impact of the 2023 drought on soybeans exports (–1.1 percent of GDP) and surge in cross-border flows with Argentina (–0.3 percent of GDP). Including these adjustments, staff assesses the midpoint CA gap at –0.9 percent of GDP, with a range of –1.4 to –0.4 percent of GDP.

2023 (% GDP)	CA: –3.6	Cycl. Adj. CA: –4.3	EBA Norm: –2.0	EBA Gap: –2.3	Adjustors: 1.4	Other Adj.: 0.0	Staff Gap: –0.9

Real Exchange Rate

Background. In 2023, the peso appreciated 2.6 percent, decreasing from 40.1 to 39.0 pesos per U.S. dollar. After a cumulative 9 percent real depreciation during 2019-21, the REER appreciated by about 17 percent in 2022-23, mostly driven by a nominal *appreciation* against the U.S. dollar and key trade partners.

Assessment. The IMF staff CA gap implies a REER gap of 4.8 percent (applying a semi-elasticity of 0.19). The EBA REER level and index models estimate an overvaluation of 30.5 percent and of 17.4 percent, respectively, in 2023. The IMF staff's overall assessment, based on the CA gap, is a REER gap in the range of 2.1 to 7.4 percent, with a midpoint of 4.8 percent.

Capital and Financial Accounts: Flows and Policy Measures

Background. In 2023, Uruguay recorded net financial account inflows around 3.6 percent of GDP, slightly lower than 2022 (3.9 percent of GDP). Net capital inflows were mainly originated from foreign direct investment (5.5 percent of GDP), which offset the central bank's reserve assets accumulation (1.1 percent of GDP) and other portfolio investments.

Assessment. The lengthening of sovereign debt maturity, high share of fixed-rate debt as well as the increasing share of debt issued in local currency are positive steps towards reducing the exposure of public finances to FX depreciation and refinancing risks. The FDI nature of around two-thirds of the country's external liabilities limits the risk of capital flows reversal. The banking sector maintains ample liquidity buffers while the central government's precautionary credit lines with multilaterals provide financial backstop.

FX Intervention and Reserves Level

Background. Uruguay has a floating exchange rate. Following the 2020 enhancement of the monetary policy framework, which switched to the short-term interest rate as the main policy instrument, the exchange rate has gradually been allowed to act as shock absorber. In 2023, the central bank did not conduct FX interventions either in the spot or forward markets, while reserves remained high at US$16 billion.

Assessment. Reserves are adequate relative to various criteria, including the IMF's reserve adequacy metric (around 170 percent as of the end of 2023) and serve as insurance against external shocks. The exchange rate should continue to act as a shock absorber and FX interventions should be limited to respond to disorderly FX market conditions.

Annex IV. Risk Assessment Matrix[1]

Source of Risks	Likelihood	Impact	Horizon	Policy Advice
Conjunctural Risks				
Intensification of regional conflicts. Escalation or spread of the conflict in Gaza and Israel, Russia's war in Ukraine, and/or other regional conflicts or terrorism disrupt trade (e.g., energy, food, tourism, supply chains), remittances, FDI and financial flows, payment systems, and increase refugee flows.	High	Medium	ST	Rising oil prices could lead to higher import costs and upward pressure on inflation. Tighten monetary policy to anchor inflation expectations. Fiscal policy should remain neutral while supporting the most vulnerable. Uruguay likely to benefit from higher agriculture prices but volatility could make forward planning difficult. Allow the exchange rate to adjust.
Commodity price volatility. A succession of supply disruptions (e.g., due to conflicts, export restrictions, and OPEC+ decisions) and demand fluctuations causes recurrent commodity price volatility, external and fiscal pressures in EMDEs, cross-border spillovers, and social and economic instability.	High	Medium	ST	Tighten monetary policy to anchor inflation expectations. Fiscal policy should remain neutral overall but provide targeted assistance to low-income households. Impact would be medium since higher agricultural prices generally affect Uruguay's growth positively.
Monetary policy miscalibration. Amid high economic uncertainty, major central banks loosen policy stance prematurely, hindering disinflation, or keep it tight for longer than warranted, causing abrupt adjustments in financial markets and weakening the credibility of central banks.	Medium	Medium	ST	Tighten monetary policy to anchor inflation expectations and limit second-round effects. Fiscal policy should remain neutral while supporting the most vulnerable. The exchange rate should be allowed to act as a shock absorber.
Abrupt global slowdown. Global and idiosyncratic risk factors cause a synchronized sharp growth downturn, with recessions in some countries, adverse spillovers through trade and financial channels, and market fragmentation triggering sudden stops in EMDEs.	Medium	Medium	ST	Provide monetary stimulus as long as inflation and inflation expectations remain within the target band. Use existing policy space to support the economy and protect the most vulnerable, consistent with the limits of the fiscal rule, to maintain market access and low sovereign spreads. Allow the exchange rate to adjust.
Structural Risks				
Deepening geoeconomic fragmentation. Broader conflicts, inward-oriented policies, and weakened international cooperation result in a less efficient configuration of trade and FDI, supply disruptions, protectionism, policy uncertainty, technological and payments systems fragmentation, rising shipping and input costs, financial instability, a fracturing of international monetary system, and lower growth.	High	Medium	ST,MT	Implement structural reforms to ensure the economy can adjust flexibly to rotations in export demand. Allow for sectoral reallocation and reforms to strengthen business climate. Allow the exchange rate to act as a shock absorber for changing external demand patterns.
Extreme climate events. Extreme climate events driven by rising temperatures cause loss of human lives, severe damage to infrastructure, supply disruptions, lower growth, and financial instability.	Medium	High	ST,MT	Continue the implementation of climate change strategies focused on mitigation and adaptation.
Domestic Risks				
Unfavorable economic shocks combined with insufficient fiscal adjustment. Higher debt-to-GDP with insufficient fiscal adjustment due to spending rigidities leading to sovereign-rating downgrades and higher yields, as there is no credible plan to regain macroeconomic stability in the medium run.	Low	Medium	ST,MT	Recalibrate plans to introduce a credible adjustment plan, underpinned by concrete measures that will lead to macroeconomic stability.
Delayed progress in structural reforms. Growth remains anemic due to competitiveness problems.	Medium	Medium	ST,MT	Implement envisaged structural reforms (to education, labor market, business environment, SOEs), which are urgently needed to raise potential growth.

[1] The Risk Assessment Matrix (RAM) shows events that could materially alter the baseline path. The relative likelihood is the staff's subjective assessment of the risks surrounding the baseline ("low" is meant to indicate a probability below 10 percent, "medium" a probability between 10 and 30 percent, and "high" a probability between 30 and 50 percent). The RAM reflects staff views on the source of risks and overall level of concern as of the time of discussions with the authorities. Non-mutually exclusive risks may interact and materialize jointly. The conjunctural shocks and scenarios highlight risks that may materialize over a shorter horizon (between 12 to 18 months) given the current baseline. Structural risks are those that are likely to remain salient over a longer horizon.

Annex V. Public Sector DSA

Table 1. Uruguay: Risk of Sovereign Stress

Horizon		Mechanical signal	Final assessment	Comments
Overall		...	**Low**	The final assessment is a low overall sovereign stress risk, despite a medium-term assessment with moderate risk due to the relatively high proportion of foreign currency and indexed debt. Staff expects that the authorities will continue to prioritize reducing the share of FX debt and smoothing the profile of amortizations while extending maturities, in order to minimize risks. These actions inform staff's assessment of overall low risk.
Near term 1/				
Medium term		**Low**	**Moderate**	Medium-term vulnerabilities are moderate as a relatively large proportion of public debt is denominated in foreign currency and the share of holdings by non-residents is large.
	Fanchart	**Moderate**	...	
	GFN	**Moderate**	...	
	Stress test		...	
Long term		...	**Moderate**	Long-term risks are moderate reflecting spending rigidities and a relatively high tax burden. The recently enacted pension reform is expected to help stabilize pension spending in the long term.
Sustainability assessment 2/		Not required for surveillance countries	Not required for surveillance countries	
Debt stabilization in the baseline				Yes

DSA Summary Assessment

Uruguay has a low risk of sovereign stress. The country's access to readily available financial reserves and emergency credit lines acts as a strong safeguard against sudden external shocks. While debt witnessed a slight increase in 2023 due to the drought's impact on production and subsequent government support measuresm and smaller SOEs balances, medium-term projections anticipate the removal of these temporary drought-related spending measures. Additionally, wage and pension increases are expected to adhere to currently announced plans.

Source: IMF staff estimates.

Note: The risk of sovereign stress is a broader concept than debt sustainability. Unsustainable debt can only be resolved through exceptional measures (such as debt restructuring). In contrast, a sovereign can face stress without its debt necessarily being unsustainable, and there can be various measures—that do not involve a debt restructuring—to remedy such a situation, such as fiscal adjustment and new financing.

1/ The near-term assessment is not applicable in cases where there is a disbursing IMF arrangement. In surveillance-only cases or in cases with precautionary IMF arrangements, the near-term assessment is performed but not published.

2/ A debt sustainability assessment is optional for surveillance-only cases and mandatory in cases where there is a Fund arrangement. The mechanical signal of the debt sustainability assessment is deleted before publication. In surveillance-only cases or cases with IMF arrangements with normal access, the qualifier indicating probability of sustainable debt ("with high probability" or "but not with high probability") is deleted before publication.

Table 2. Uruguay: Debt Coverage and Disclosures

						Comments
1. Debt coverage in the DSA: 1/	CG	GG	NFPS	CPS	Other	
1a. If central government, are non-central government entities insignificant?					n.a.	

2. Subsectors included in the chosen coverage in (1) above:

CPS	NFPS	GG: expected	CG		Subsectors captured in the baseline	Inclusion	Comments
CPS	NFPS	GG: expected	CG	1	Budgetary central government	Yes	Not applicable
CPS	NFPS	GG: expected	CG	2	Extra budgetary funds (EBFs)	No	
CPS	NFPS	GG: expected	CG	3	Social security funds (SSFs)	Yes	
CPS	NFPS	GG: expected		4	State governments	Yes	
CPS	NFPS	GG: expected		5	Local governments	Yes	
CPS	NFPS			6	Public nonfinancial corporations	Yes	
CPS				7	Central bank	No	
CPS				8	Other public financial corporations	No	

3. Instrument coverage:	Currency & deposits	Loans	Debt securities	Oth acct. payable 2/	IPSGSs 3/

4. Accounting principles:	Basis of recording		Valuation of debt stock		
	Non-cash basis 4/	Cash basis	Nominal value 5/	Face value 6/	Market value 7/

5. Debt consolidation across sectors:	Consolidated	Non-consolidated

Color code: chosen coverage; Missing from recommended coverage; Not applicable

Reporting on Intra-Government Debt Holdings

Issuer \ Holder	Budget. central govt	Extra-budget. funds	Social security funds	State govt.	Local govt.	Nonfin. pub. corp.	Central bank	Oth. pub. fin corp	Total
1 Budget. central govt									0
2 Extra-budget. funds									0
3 Social security funds									0
4 State govt.									0
5 Local govt.									0
6 Nonfin pub. corp.									0
7 Central bank									0
8 Oth. pub. fin. corp									0
Total	0	0	0	0	0	0	0	0	0

1/ CG=Central government; GG=General government; NFPS=Nonfinancial public sector; PS=Public sector.

2/ Stock of arrears could be used as a proxy in the absence of accrual data on other accounts payable.

3/ Insurance, Pension, and Standardized Guarantee Schemes, typically including government employee pension liabilities.

4/ Includes accrual recording, commitment basis, due for payment, etc.

5/ Nominal value at any moment in time is the amount the debtor owes to the creditor. It reflects the value of the instrument at creation and subsequent economic flows (such as transactions, exchange rate, and other valuation changes other than market price changes, and other volume changes).

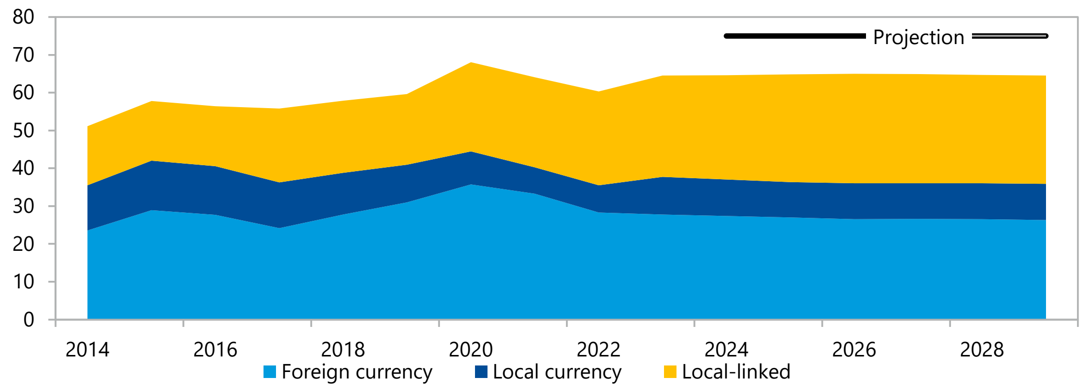
6/ The face value of a debt instrument is the undiscounted amount of principal to be paid at (or before) maturity.

7/ Market value of debt instruments is the value as if they were acquired in market transactions on the balance sheet reporting date (reference date). Only traded debt securities have observed market values.

The NFPS covers the central government, Banco de Prevision Social (BPS), local governments, state-owned enterprises and Banco de Seguros del Estado (BSE). Most of the debt is issued by the CG. In all figures reported by IMF staff the ratio of debt to GDP is measured as the stock of debt at the end of each year measured in Uruguayan pesos divided by GDP in Uruguayan pesos. The authorities' report stock of debt in USD divided by GDP also in USD. This difference generates a small difference in the two ratios. No outstanding arrears are incorporated in the debt series.

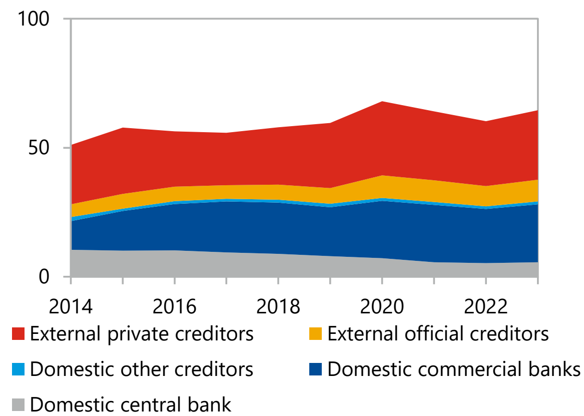
Table 3. Uruguay: Public Debt Structure Indicators

Debt by Currency (Percent of GDP)



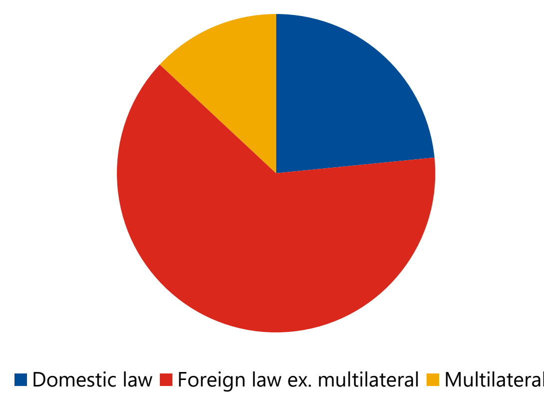
Note: The perimeter shown is nonfinancial public sector.

Public Debt by Holder (Percent of GDP)



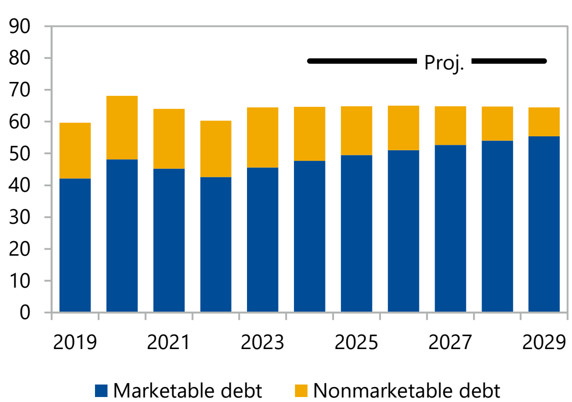
Note: The perimeter shown is nonfinancial public sector.

Public Debt by Governing Law, 2023 (percent)



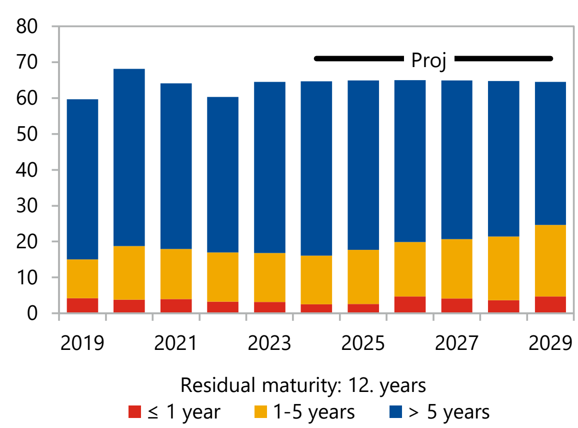
Note: The perimeter shown is nonfinancial public sector.

Debt by Instruments (Percent of GDP)



Note: The perimeter shown is nonfinancial public sector.

Public Debt by Maturity (Percent of GDP)



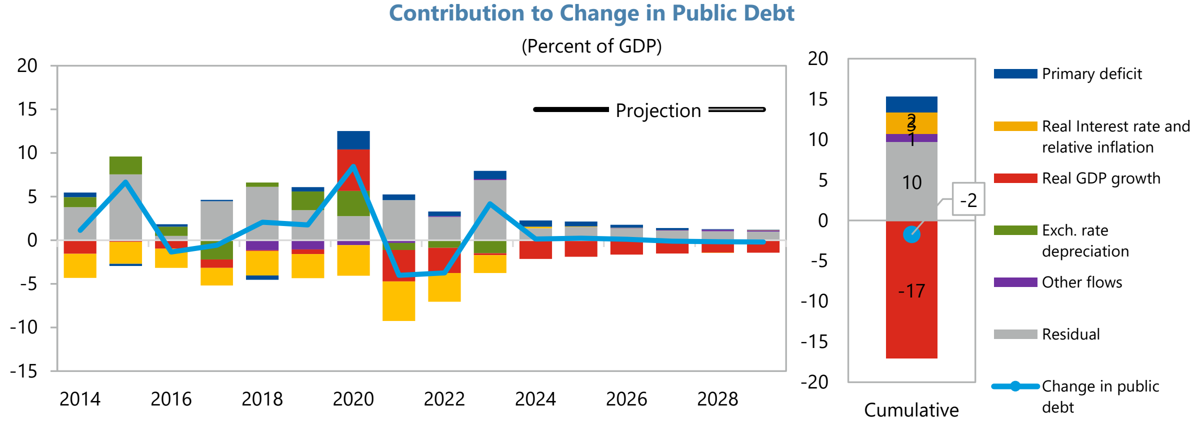
Note: The perimeter shown is nonfinancial public sector.

The composition of public debt by currency and maturities is expected to remain fairly stable.

Table 4. Uruguay: Baseline Scenario
(in percent of GDP unless indicated otherwise)

	Actual	Medium-term projection						Extended projection			
	2023	2024	2025	2026	2027	2028	2029	2030	2031	2032	2033
Public debt	64.5	64.6	64.9	65.0	64.9	64.7	64.5	64.2	63.8	63.6	63.2
Change in public debt	4.2	0.1	0.2	0.1	-0.1	-0.2	-0.2	-0.4	-0.3	-0.3	-0.4
Contribution of identified flows	-2.7	-1.2	-1.3	-1.2	-1.2	-1.2	-1.2	-1.2	-1.0	-0.8	-0.6
Primary deficit	0.9	0.7	0.6	0.3	0.2	0.1	0.0	0.0	0.0	0.0	0.0
Noninterest revenues	27.7	27.3	27.5	27.5	27.6	27.6	27.6	27.2	27.2	27.2	27.2
Noninterest expenditures	28.7	28.0	28.0	27.9	27.8	27.7	27.6	27.2	27.2	27.2	27.2
Automatic debt dynamics	-3.8	-1.9	-1.8	-1.6	-1.5	-1.4	-1.4	-1.3	-1.1	-0.9	-0.8
Real interest rate and relative inflation	-2.1	0.2	0.1	0.0	0.0	0.0	0.0	0.1	0.3	0.5	0.6
Real interest rate	-2.0	-0.7	-0.7	-0.7	-0.8	-0.8	-0.7	-0.6	-0.5	-0.3	-0.2
Relative inflation	-0.1	0.9	0.8	0.8	0.8	0.8	0.8	0.8	0.8	0.8	0.8
Real growth rate	-0.2	-2.1	-1.9	-1.7	-1.5	-1.4	-1.4	-1.4	-1.4	-1.4	-1.4
Real exchange rate	-1.5	…	…	…	…	…	…	…	…	…	…
Other identified flows	0.1	0.0	0.0	0.0	0.1	0.2	0.2	0.1	0.1	0.1	0.1
Contingent liabilities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
(minus) Interest Revenues	0.0	-0.4	-0.3	-0.3	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2
Other transactions	0.1	0.4	0.3	0.3	0.3	0.4	0.4	0.4	0.4	0.4	0.4
Contribution of residual	6.9	1.4	1.5	1.4	1.1	1.0	1.0	0.8	0.6	0.5	0.2
Gross financing needs	3.9	5.5	5.0	4.9	6.7	6.1	5.6	6.6	7.3	7.2	7.4
of which: debt service	3.0	5.2	4.7	4.8	6.7	6.2	5.7	6.8	7.5	7.4	7.7
Local currency	0.5	1.0	0.8	0.9	0.9	0.8	1.1	1.3	1.6	1.9	2.0
Foreign currency	1.3	2.3	2.3	2.2	2.3	2.1	2.0	1.9	1.9	1.9	1.9
Memo:											
Real GDP growth (percent)	0.4	3.4	3.0	2.6	2.4	2.3	2.2	2.2	2.2	2.2	2.2
Inflation (GDP deflator; percent)	3.4	5.8	5.2	5.1	5.0	5.1	5.1	5.1	5.1	5.1	5.1
Nominal GDP growth (percent)	3.8	9.4	8.4	7.9	7.6	7.5	7.4	7.4	7.4	7.4	7.4
Effective interest rate (percent)	0.0	4.7	4.0	3.9	3.8	3.8	3.8	4.0	4.3	4.5	4.8

Contribution to Change in Public Debt



Public debt is expected to remain largely unchanged during the projection period. Growth in 2024 is expected to accelerate as the effect of the drought subsides converging to potential over the medium term. The primary deficit is expected to decrease as some remaining pandemic spending is withdrawn as well as the measures implemented in 2023 to mitigate the impact of the drought. The residual incorporates the effect of changes in the value of indexed-debt and for that reason is non-zero during the projection period.

Table 5. Uruguay: Realism of Baseline Assumptions

Forecast Track Record 1/	t+1	t+3	t+5
Public debt to GDP			
Primary deficit			
r - g			
Exchange rate depreciaton			
SFA			
	real-time	**t+3**	**t+5**
Historical Output Gap Revisions 2/			

Comparator Group:

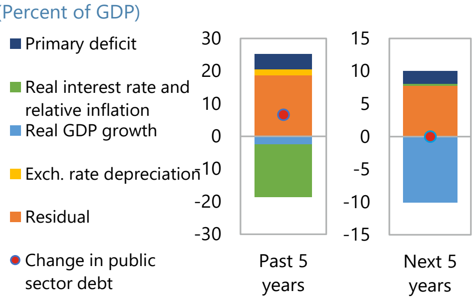
Emerging Markets, Commodity Exporter, Surveillance

Color Code:

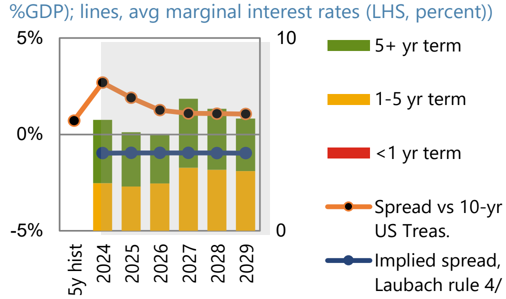
Optimistic	> 75th percentile
	50-75th percentile
Pessimistic	25-50th percentile
	< 25th percentile

Public Debt Creating Flows

(Percent of GDP)

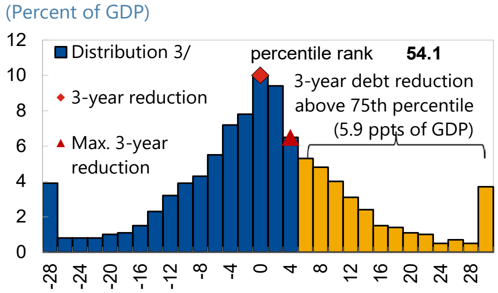


Bond Issuances (Bars, debt issuances (RHS, %GDP); lines, avg marginal interest rates (LHS, percent))

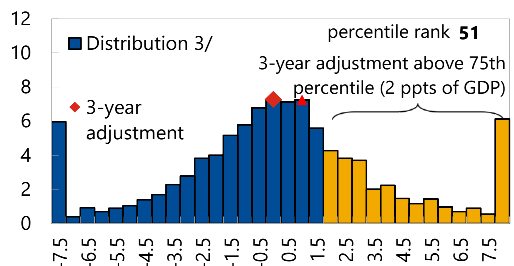


3-Year Debt Reduction

(Percent of GDP)

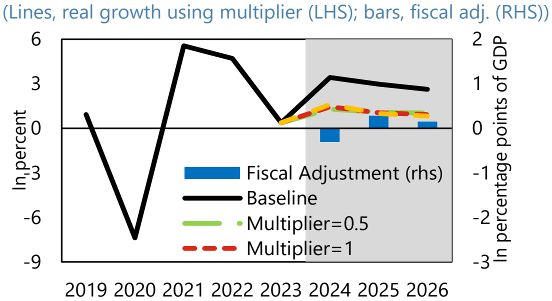


3-Year Adjustment in Cyclically-Adjusted Primary Balance (Percent of GDP)



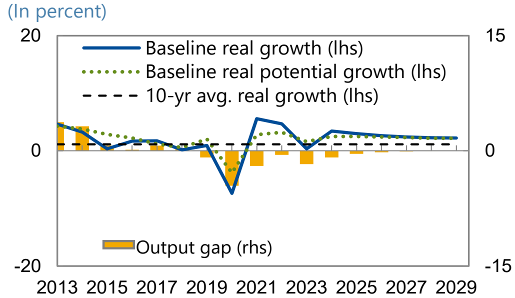
Fiscal Adjustment and Possible Growth Paths

(Lines, real growth using multiplier (LHS); bars, fiscal adj. (RHS))



Real GDP Growth

(In percent)



Realism charts show that assumptions behind projections are in line with history and balanced. The large residual in the debt decomposition incorporates the impact of adjustments to the principal of linked-bonds. The forecast track-record is broadly neutral with no large biases.The assumption for interest rates reflects the expected path for US rates while spreads on FX debt remain constant. For peso debt, staff assumption is that these would decline with inflation during the projection period.

Source: IMF Staff calculations.

1/ Projections made in the October and April WEO vintage.

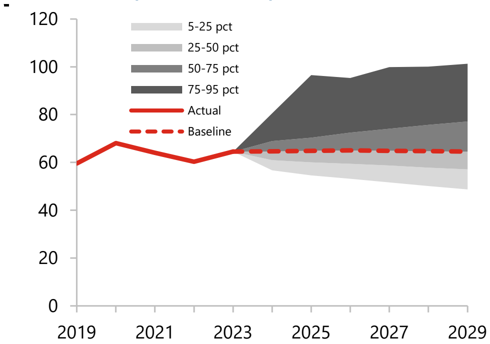
2/ Calculated as the percentile rank of the country's output gap revisions (defined as the difference between real time/period ahead estimates

3/ Data cover annual observations from 1990 to 2019 for MAC advanced and emerging economies. Percent of sample on vertical axis.

4/ The Laubach (2009) rule is a linear rule assuming bond spreads increase by about 4 bps in response to a 1 ppt increase in the projected debt-to-GDP ratio.

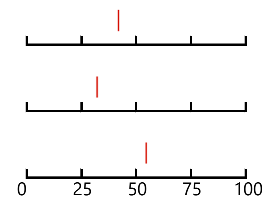
Table 6. Uruguay: Medium-Term Risk Analysis

Final Fanchart (Percent of GDP)

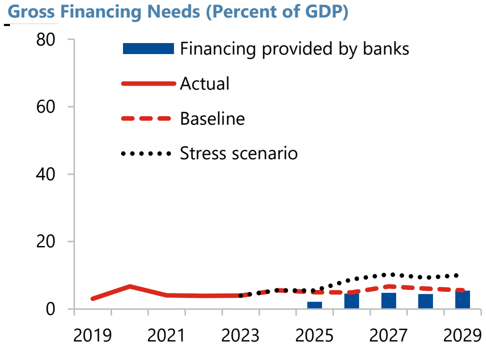


Debt fanchart module

	Value	Contrib 1/	Percentile in peer group 2/
Fanchart width *(percent of GDP)*	52.6	0.8	
Probability of debt non-stabilizaiton *(percent)*	16.3	0.1	
Terminal debt-to-GDP x institutions index	25.0	0.5	
Debt fanchart index (DFI)		1.4	
Risk signal: 3/		**Moderate**	

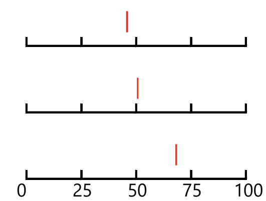


Gross Financing Needs (Percent of GDP)



Gross financing needs (GFN) module

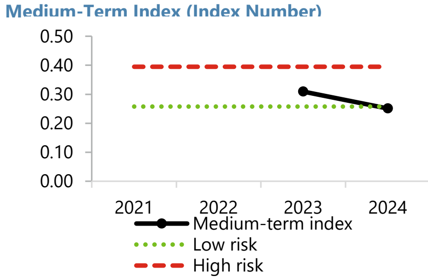
	Value	Contrib 1/	Percentile in peer group 2/
Average baseline GFN *(percent of GDP)*	5.6	1.9	
Initial Banks' claims on the gen. govt *(pct bank assets)*	5.3	1.7	
Chg. In banks' claims in stress *(pct banks' assets)*	17.3	5.8	
GFN financeability index (GFI)		9.4	
Risk signal: 4/		**Moderate**	



Triggered stress tests (stress tests not activated in gray)

Banking crisis | Commodity prices | Exchange rate | Contingent liab. | Natural disaster

Medium-Term Index (Index Number)



Medium-term risk analysis

	Value	Value	Weight	Contribution
Debt fanchart index	1.4	0.3	0.5	0.2
GFN finaceability index	9.4	0.2	0.5	0.1
Medium-term index		0.3		
Risk signal: 5/		**Low**		
Final assessment:		**Moderate**		

Prob. of missed crisis, 2024-2029, if stress not predicted: 9.1 pct.

Prob. of false alarms, 2024-2029, if stress predicted: 42.0 pct.

The medium-term analysis shows that risks increase but remain moderate.

Source: IMF staff estimates and projections.

1/ See Annex IV of IMF, 2022, Staff Guidance Note on the Sovereign Risk and Debt Sustainability Framework for details on index calculation.

2/ The comparison group is emerging markets, commodity exporter, surveillance.

3/ The signal is low risk if the DFI is below 1.13; high risk if the DFI is above 2.08; and otherwise, it is moderate risk.

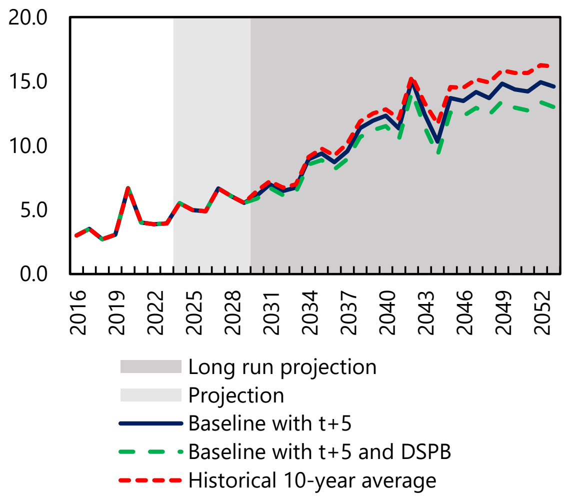
4/ The signal is low risk if the GFI is below 7.6; high risk if the DFI is above 17.9; and otherwise, it is moderate risk.

5/ The signal is low risk if the GFI is below 0.26; high risk if the DFI is above 0.40; and otherwise, it is moderate risk.

Table 7. Uruguay: Long-Term Risk Analysis: Large Amortizations

Projection	Variable	Risk Indication
Medium-term extrapolation	GFN-to-GDP ratio	
	Amortization-to-GDP ratio	
	Amortization	
Medium-term extrapolation with debt stabilizing primary balance	GFN-to-GDP ratio	
	Amortization-to-GDP ratio	
	Amortization	
Historical average assumptions	GFN-to-GDP ratio	
	Amortization-to-GDP ratio	
	Amortization	
Overall Risk Indication		

GFN-to-GDP Ratio



Total Public Debt-to-GDP Ratio

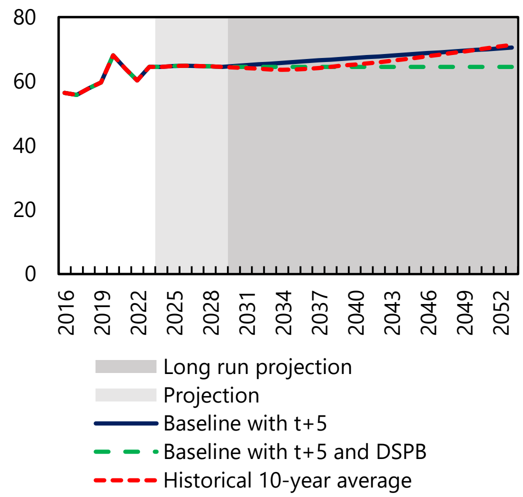
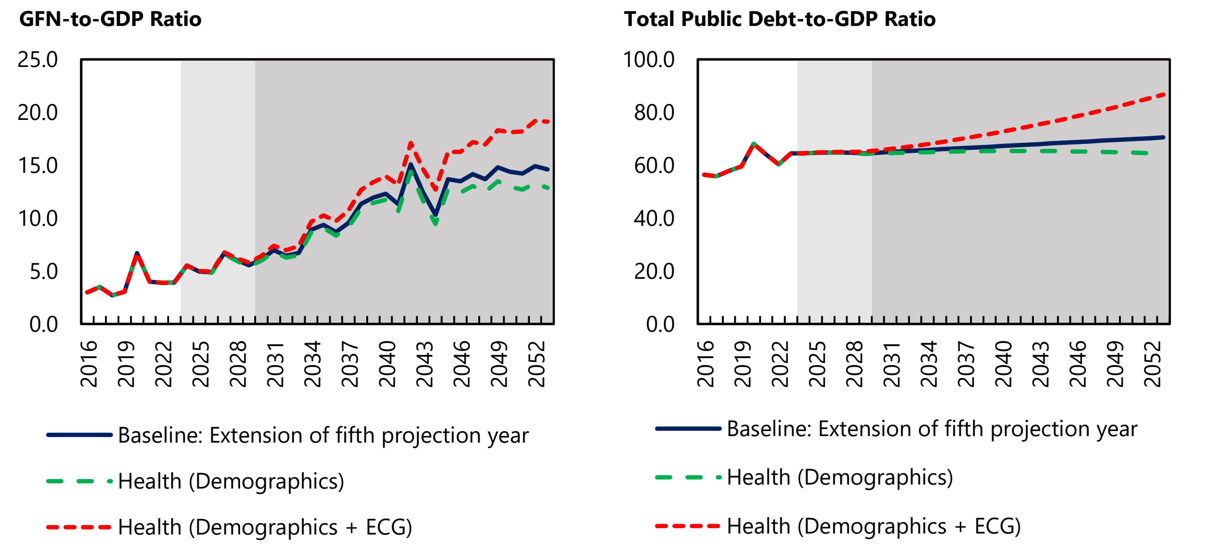


Table 8. Uruguay: Long-Term Risk Analysis II, Demographics, Health



Annex VI. External Sector DSA

1. After peaking in 2020, external debt in Uruguay reached 67.2 percent of GDP in 2023, trending down for the third consecutive year (see Table 1). In 2023, despite the widening of the trade balance deficit, debt dynamics (including exchange rate appreciation) and non-debt creating flows helped bringing down the debt ratio. About 46 percent of the external debt is owed by the public sector.

2. Gross external debt is forecasted to increase in 2024, leveling at around 69 percent of GDP. Over the medium term, external debt is projected on a downward trend owing to favorable automatic debt dynamics, the contribution of non-debt creating capital inflows, as well as narrower fiscal and current account deficits.

3. Gross external financing requirements are expected to gradually converge to 12 percent of GDP. This reduction would be underpinned by a stronger non-interest current account surplus and stable amortization of longer-term debt.

4. Stress tests indicate that the standard interest rate shocks would have a limited impact on external debt. Shocks to the non-interest current account, growth or a combined shock (to the real interest rate, growth and current account) would have a greater, but still moderate (lower than 10 percentage points increase), impact.

5. The main risk to Uruguay's external debt sustainability is an exchange rate depreciation. A one-off 30 percent exchange rate depreciation would increase the external debt-to-GDP ratio to 100 percent of GDP in the short-term, while stabilizing in the medium-term around 95 percent of GDP (see Figure).

6. Overall, the outlook for external debt sustainability has improved on the back of stronger macroeconomic performance and favorable debt dynamics. Despite an external context marked by higher interest rates and the impacts of an historical drought, under the baseline scenario, the medium-term external debt is lower in almost 8 percentage points when compared to the previous external DSA in 2023. Considering that Uruguay's external liabilities are mainly comprised of foreign direct investments and that the country maintains sizeable gross international reserves and fiscal liquidity buffers, risks to external debt sustainability remain limited.

Table 1. Uruguay: External Debt Sustainability Framework, 2017–2029

(In percent of GDP, unless otherwise indicated)

	Actual									Projections						
	2017	2018	2019	2020	2021	2022	2023			2024	2025	2026	2027	2028	2029	Debt-stabilizing non-interest current account 7/
Baseline: External debt 1/	65.0	65.8	72.6	87.7	79.7	76.0	67.2			**69.4**	**68.4**	**67.6**	**67.2**	**66.5**	**65.9**	**-3.8**
Change in external debt	-5.2	0.8	6.8	15.1	-8.0	-3.7	-8.8			2.2	-1.0	-0.9	-0.4	-0.7	-0.6	
Identified external debt-creating flows	-5.0	1.2	-0.2	10.4	-10.1	-10.8	-8.8			-5.8	-4.4	-3.8	-4.1	-4.6	-4.6	
Current account deficit, excluding interest payments	-1.9	-1.8	-3.5	-1.8	0.5	1.9	1.7			1.2	0.5	0.0	-0.2	-0.7	-0.8	
Deficit in balance of goods and services	-5.3	-5.1	-6.0	-4.6	-7.4	-5.2	-3.1			-3.7	-4.2	-4.7	-5.1	-5.8	-6.0	
Exports	25.9	26.4	27.7	25.9	32.3	32.2	27.6			27.8	28.4	29.3	30.0	31.0	31.5	
Imports	-20.5	-21.4	-21.7	-21.3	-24.9	-27.1	-24.4			-24.0	-24.2	-24.6	-25.0	-25.2	-25.5	
Net non-debt creating capital inflows (negative)	3.1	1.1	-2.2	-1.8	-2.3	-4.1	-5.4			-4.4	-3.9	-3.4	-3.4	-3.4	-3.4	
Automatic debt dynamics 2/	-6.2	1.9	5.5	13.9	-8.3	-8.7	-5.0			-2.6	-1.0	-0.4	-0.4	-0.5	-0.4	
Contribution from nominal interest rate	1.9	2.2	2.2	2.4	2.0	2.0	1.9			1.9	2.3	2.6	2.7	2.7	2.8	
Contribution from real GDP growth	-1.1	-0.1	-0.6	6.2	-4.3	-3.3	-0.3			-2.1	-2.0	-1.7	-1.5	-1.5	-1.4	
Contribution from price and exchange rate changes 3/	-7.0	-0.2	3.9	5.3	-6.0	-7.4	-6.7			-2.4	-1.4	-1.3	-1.6	-1.7	-1.7	
Residual, incl. change in gross foreign assets 4/	-0.2	-0.4	7.0	4.7	2.1	7.1	0.0			8.1	3.4	2.9	3.7	4.0	4.0	
External debt-to-exports ratio (in percent)	251.2	249.1	262.0	338.6	246.7	235.8	243.9			250.2	240.6	230.6	223.5	214.7	209.3	
Gross external financing need (in billions of US dollars) 5/	10.0	9.9	8.4	9.6	11.5	13.5	13.7			12.9	11.7	11.6	12.0	11.9	12.3	
in percent of GDP	15.4	15.1	13.5	17.9	18.9	19.2	17.7			15.6	13.5	12.8	12.6	11.9	11.8	
Scenario with key variables at their historical averages 6/								7-Year Historical Average	7-Year Standard Deviation	**72.1**	**72.1**	**71.6**	**71.9**	**72.5**	**73.2**	**-2.8**
Key Macroeconomic Assumptions Underlying Baseline																
Nominal GDP (US dollars)	65.1	65.4	62.2	53.7	60.8	70.2	77.2			82.8	87.0	91.0	95.3	100.0	105.0	
Real GDP growth (in percent)	1.7	0.2	0.9	-7.4	5.6	4.7	0.4	0.9	4.2	3.4	3.0	2.6	2.4	2.3	2.2	
GDP deflator in US dollars (change in percent)	11.1	0.3	-5.7	-6.9	7.3	10.3	9.7	3.7	7.7	3.7	3.7	2.0	1.9	2.3	2.6	
Nominal external interest rate (in percent)	3.1	3.4	3.2	2.9	2.5	2.9	2.8	3.0	0.3	3.1	3.5	4.0	4.1	4.3	4.4	
Growth of exports (US dollar terms, in percent)	8.6	2.6	-0.2	-19.4	41.2	15.1	-5.9	6.0	19.0	8.0	7.6	7.7	7.4	8.2	6.7	
Growth of imports (US dollar terms, in percent)	7.4	4.5	-3.4	-15.3	32.4	25.5	-0.7	7.2	16.6	5.4	6.0	6.4	6.1	6.1	6.3	
Current account balance, excluding interest payments	1.9	1.8	3.5	1.8	-0.5	-1.9	-1.7	0.7	2.1	-1.2	-0.5	0.0	0.2	0.7	0.8	
Net non-debt creating capital inflows	-3.1	-1.1	2.2	1.8	2.3	4.1	5.4	1.6	2.9	4.4	3.9	3.4	3.4	3.4	3.4	

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.

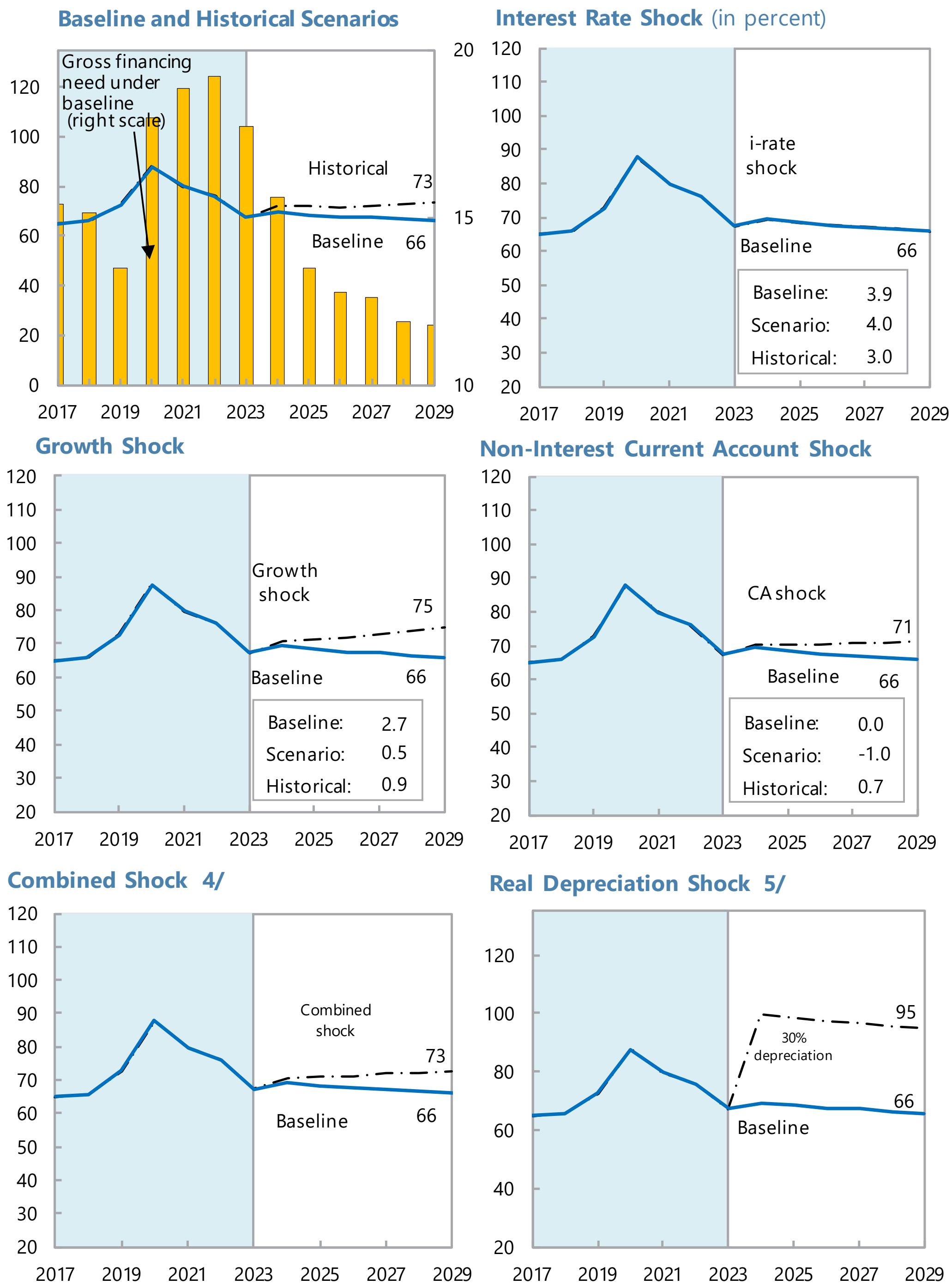
5/ Defined as current account deficit, plus amortization on medium- and long-term debt, plus short-term debt at end of previous period. Projections assume that 10% of long-term private debt is amortized every year and 10% of total private debt stock is short-term debt.

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 IMF 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 seven-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 2024.

Annex VII. List of FSAP Recommendations

Key Recommendations	Agency	Time[1]
Macroprudential Policy, Systemic Risk Analysis and De-Dollarization		
Develop a comprehensive macroprudential framework: (i) clearly assign a mandate for macroprudential policy, (ii) strengthen powers for data collection and implementation of tools. Update: **In progress.** The BCU prepared and published a macroprudential framework ("Documento marco de la política macroprudencial") and also proposed some changes to the institutional arrangements for the macroprudential authority, which are currently under consideration by the Board.	MEF, BCU, SSF, COPAB	ST
Close data gaps to enable comprehensive risk analysis of system-wide FX liquidity risk, climate risks and risks in the non-financial sectors. Update**: In progress**. Drawing on the recommendations from an IMF stress testing technical assistance (December 2023) the SSF prepared a roadmap to improve top-down stress testing and the definition of the tools to be developed. The implementation of the first phase of the roadmap, which deals with solvency stress testing, will take place in 2024.	BCU, MOE, SSF	ST
Incorporate enhanced solvency stress tests into risk-based supervision, including for calibration of Pillar 2 capital add-ons and restrictions on dividend distribution for banks that fail the tests. Update: **In progress** - The second part of the IMF technical assistance to address this recommendation was delivered in May 2024.	BCU, SSF	ST
Continue progress on de-dollarization by strengthening the monetary policy framework and developing peso capital markets. Update: **In progress**- The BCU has been working since 2020 in the study of regulatory reforms to promote de-dollarization and the development of peso markets. In particular, in 2023, the recommendations and proposals of the FSAP were analyzed and the second phase of the dialogue with the real estate and automotive sectors was undertaken. By 2024, work will continue with the drafting of regulatory reforms in the banking system, drafting of legislative initiatives and changes in the regulation of the payment system and reserve requirements.	MEF, BCU, SSF	I
Banking Supervision and Regulation		
Increase and protect SSF's operational autonomy and provide budgetary autonomy. Update: **Pending** The BCU has given consideration to the decentralization granted to the SSF. In compliance with the provisions of articles 63, 185, and 221 of the Constitution, the functional organization as well as budget matters, are kept in the BCU Board, despite the SSF's possibility of dictating preparatory acts addressed to the Board of Directors. On the other hand, the SSF made a proposal to BCU Board, for a legal reform of the Regulatory Control Fee to contribute to a more equitable distribution of the collection regarding the costs of regulation and supervision of each type of entity.	MEF, BCU	I
Establish a fixed mandate for the Directors of the BCU and define a list of justified causes for dismissal of BCU Directors and of the Superintendent. Update: **Pending.** This change requires a constitutional reform (as it relates to the Special Regime of Autonomous Entities).	MEF, BCU	MT
Increase resources, including to strengthen work on credit risk reviews. Update: **Pending** Considering that the current budget will be in effect until the end of 2025, this analysis will be undertaken in the medium term (2025-2026)	MEF, BCU, SSF	ST
Redesign the *"Impuesto al Patrimonio"* (wealth tax) for banks. Update: **Pending**. This recommendation should be evaluated in the context of the next government's budget.	MEF	ST
Expand early intervention powers over SOBs and strengthen SOBs' governance. Update: **Pending.** Constitutional constraints limit progress in this area (as it relates to the Special Regime of Autonomous Entities).	MEF	ST

Key Recommendations	Agency	Time[1]
Expand the prudential consolidation perimeter. Update: **Pending**. This recommendation will be considered in the medium term (2025-2026).	SSF	ST
Develop Pillar 2-type of supervisory expectations on capital levels. Update: **In progress.** The second part of the IMF technical assistance to implement this recommendation was delivered in May 2024.	SSF	ST
Crisis Management, Resolution and Safety Nets		
Fully include SOBs in the resolution framework and redefine the government's role in funding resolution. Update: **Pending**.	MEF	ST
Design an effective ELA framework. Update: **In progress**. A working group has been formed with the legal department to address these recommendations. A threefold proposal has been prepared: the inclusion of a contingency line for banks guaranteed with high quality liquid assets in domestic and foreign currency, the establishment of internal definitions to face shocks in the FX position, and the modification of Art. 32 of the BCU's Organic Charter (that regulates the Lender of Last Resort function).	BCU, MEF	I
Strengthen COPAB's operational independence and expand its resolution tools. Update: **In progress.** COPAB will assess the recommendations received during the FSAP. The necessary changes in its structure will be linked to the new functions and tasks.	MEF, COPAB	ST
Introduce a Recovery and Resolution Planning framework. Update: **In progress**. The SSF prepared a proposal to require recovery plans for domestic systemic banks, which was discussed with industry representatives and COPAB. This will be included in the regulation in 2024, as well as the issuance of a guide for the preparation of recovery plans.	SSF, COPAB	I
Financial Integrity		
Ensure availability of accurate and current beneficial ownership information on companies and trusts, including by increasing the resources of supporting authorities, and strengthen AML/CFT supervision for higher risk sectors. Update**: In progress.** The National Risk Assessment (NRA) was completed and approved in 2023. Subsequently, the development of a National Strategy to Combat ML/FT has already begun, which will include a set of strategic objectives aimed at mitigating the risks identified in the NRA, and each of these objectives will include concrete actions with specific responsible parties and a medium-term timeline.	SSF, SENACLAFT, UIAF, AIN	ST
Financial Development Issues		
Improve BROU's corporate governance practices, operational autonomy and encourage the gradual increase of its domestic lending portfolio to creditworthy firms based on robust and sound solvency, profitability and risk analysis criteria. Update: **Pending**. The authorities agree that the BROU could play a more important role in the Uruguayan financial sector, but this must be done through independent management decisions of the institution as an Autonomous Entity (art. 185 of the Constitution) and without compromising its solvency, profitability and good risk management practices.	MEF, BCU	MT
Increase the role of SoEs in the capital markets. Update**: Pending**. No action has been taken on this recommendation.	MEF, BCU	ST
Continue adapting capital markets regulations to the size and capacity of Uruguayan companies. Update: **In progress.** The increased flexibility is consistent with the authorities' ongoing work to adapt the regulatory framework, such as the issuance of Circular 2405, which amended the simplified public offering regulations, and includes plans to continue	MEF, BCU	I

Key Recommendations	Agency	Time[1]
reviewing other regulations such as crowdfunding and investment fund regulations. In addition, the five-year initiative IQ4 to develop actions for the development of the securities market is under review, to find a new approach for the remaining period (2024-2025) and/or to provide input for the review of the BCU's next strategic plan.		
Strengthen monitoring, regulatory and supervisory frameworks for new Fintech entrants, ensure a level playing field and fast-track implementation of full range of open banking services and expand to open finance and open data. Update: **In progress**. The agreed-upon actions with the innovation office involve defining a BCU strategy that focuses on innovation and development for 2024. This strategy should have a set of strategic objectives that can be revised. Additionally, there is a need to clarify the definition of fintech and design a monitoring tool that includes fintechs, their services, and quantitative aspects to access market data. In addition, the Innovation Office will endeavor to establish the necessary conditions to provide services that are in line with the principles of Open Finances. This involves creating and releasing a conceptual framework, suggesting legal reforms, and maintaining cooperation with the industry.	BCU, SSF, CC	MT
Improve the quality of MSME data available in private credit bureaus and credit registry and unify movable asset and pledges registries to support asset-based finance. Update: **In progress.** In 2024, SSF will begin registering credit-granting entities (EOCs), which will provide more information on loans and debtors. The inclusion of company size data into the credit risk registry (CRC) is also in the work plan. Additionally, the SSF is continuing to work on the line of action LA 2.1.3 established in its 2020-2028 plan to participate in defining public policies aimed at increasing credit to MSMEs through a guarantee system with sustainable credit quality. In 2024, the SSF plans to launch an operational initiative that involves internal and external coordination with MIEM, MEF, and ANDE to promote actions aimed at developing credit for SMEs.	MOED, TA	ST

[1] I —Immediate (within 1 year), ST—Short term (within 1-2 years), MT—Medium term (within 3-5 years)

Annex VIII. Collective Wage Bargaining and Macroeconomic Outcomes in Uruguay

1. **Understanding the link between inflationary shocks and wage setting has become increasingly important as it affects the ability of central banks in achieving their mandates.** A recent example of this mechanism was the inflation shock of 2021-2022, when inflation increased globally due to a succession of supply (post-Covid supply chain constraints and Russia's war in Ukraine) and demand shocks (fiscal and monetary expansions in advanced economies). As discussed by Lorenzoni and Werning (2023) for the United States, the initial CPI inflation increase was followed by a delayed pick-up in the employment costs index, with the concern that high wage growth would further complicate the return of inflation to target or even set-off a "price-wage" spiral. Similar discussions took place in other advanced and emerging market economies (see IMF WEO, October 2022, Chapter 2).

2. **In Uruguay, the wage setting process is characterized by widespread collective bargaining that covers in practice all formal employment, with substantial indexation to inflation.** Negotiations are tripartite, including labor unions, employer associations, and the government, with agreements negotiated at the sector level. The Tripartite Superior Council (TSC) is the body in charge of the coordination and governance of labor relations. The duration and scope of the agreements as well as the relevant parameters to adjust wages have changed over time. Contracts typically have three components for adjustment: (i) expected inflation, (ii) compensation when past actual inflation was higher than expected (*correctivo*), and (iii) recovery or real growth which has been partially linked aggregate productivity (*recuperación*). The relevant inflation expectation measure used in negotiations has changed overtime. In the first collective wage bargaining rounds, that were reinstated in 2005, the option to select among different measures of inflation was given, including past inflation or the inflation expected by private analysts. Overtime, the agreements moved to using the central bank's measure of inflation expectations. However, in most recent rounds, the measure of expected inflation has been the one published in the Ministry of Economy and Finance (MEF) fiscal reports to parliament (the "*Rendición de Cuentas*").

3. **A natural question that emerges is to what extent the prevalence of collective bargaining affects wage dynamics and macroeconomic outcomes.** As a first step, an augmented wage Phillips curve is estimated for Uruguay in the spirit of Galí (2011), who proposed the following wage inflation dynamics equation, that is derived by assuming staggered nominal wage setting with indexation, and is extended with partial nominal wage growth adjustment:

$$\pi_t^w = \rho\pi_{t-1}^w + (1-\rho)(\alpha + \beta IND_t + \gamma u_t + \delta\Delta u_t) + \varepsilon_t$$

where the "IND" variables can be either expected or lagged annual inflation. The estimates suggest that wages in Uruguay are more responsive to lagged inflation than inflation expectations, and also that there is a significant relationship between wage growth and the level of the unemployment rate, but not the change in the unemployment rate (Table 1). The importance of lagged inflation in the regression could reflect that while wage negotiations typically include a measure of expected inflation, additional wage increases are triggered if past observed inflation exceeds expected inflation. In an alternative specification, nominal wage growth is shown to react to productivity growth instead of the unemployment rate.[1] These results are broadly consistent with the cross-country evidence provided in the Chapter 2 of the October 2022 *World Economic Outlook* for a sample of emerging markets that excluded Uruguay.

Table 1. Uruguay: Aggregate Wage Equation Estimates

Constant	3.2***	3.45***	1.27***	1.64***
	(0.34)	(0.29)	(0.46)	(0.38)
Annual Inflation, Lagged	0.48**	…	0.38*	…
	(0.16)	…	(0.19)	…
Expected Inflation	…	0.36*	…	0.2
	…	(0.18)	…	(0.13)
Wage Growth, Lagged	0.35***	0.45***	0.43***	0.49***
	(0.13)	(0.09)	(0.1)	(0.1)
Unemployment, Level	-0.19***	-0.2***	…	…
	(0.04)	(0.06)	…	…
Unemployment, Change	-0.11	-0.21	…	…
	(0.4)	(0.29)	…	…
Productivity Growth	…	…	0.17***	0.16***
	…	…	(0.04)	(0.05)
Adjusted R-squared	0.43	0.44	0.43	0.43
SE regression	0.75	0.74	0.74	0.75

Source: IMF staff estimates, based on Rabanal and Sbrancia (2024).
Notes: Standard errors in parenthesis. One, two, and three stars denote significance at the 10, 5 and 1 percent levels. Wage equations is estimated via Generalized Method of Moments (GMM) method with 2 lags of all variables as instruments, and robust standard errors.

4. **A small open economy DSGE model is used to understand how wage indexation affects the joint behavior of price-wage dynamics and the role of monetary policy.** The model includes several real, nominal and financial frictions, and also international trade linkages with the rest of the world, as in Adrian et al. (2021), and is estimated with Bayesian methods and Uruguay data. Specifically, the model features wage rigidities, partial nominal wage adjustment and indexation to lagged annual CPI inflation, consistent with the reduced form estimates in Table 1. It also includes a price Phillips Curve with estimated backward-looking behavior in Uruguay. The model includes other features including slow pass-through to exchange rate movements, and a monetary policy Taylor-type rule that reacts to output and inflation fluctuations.

5. **Wage indexation increases the persistence in the response of CPI inflation to several shocks, leading to more severe monetary policy trade-offs.** The estimated reaction of the economy to different shocks (Figure1, blue line) is compared to a counterfactual where wages are

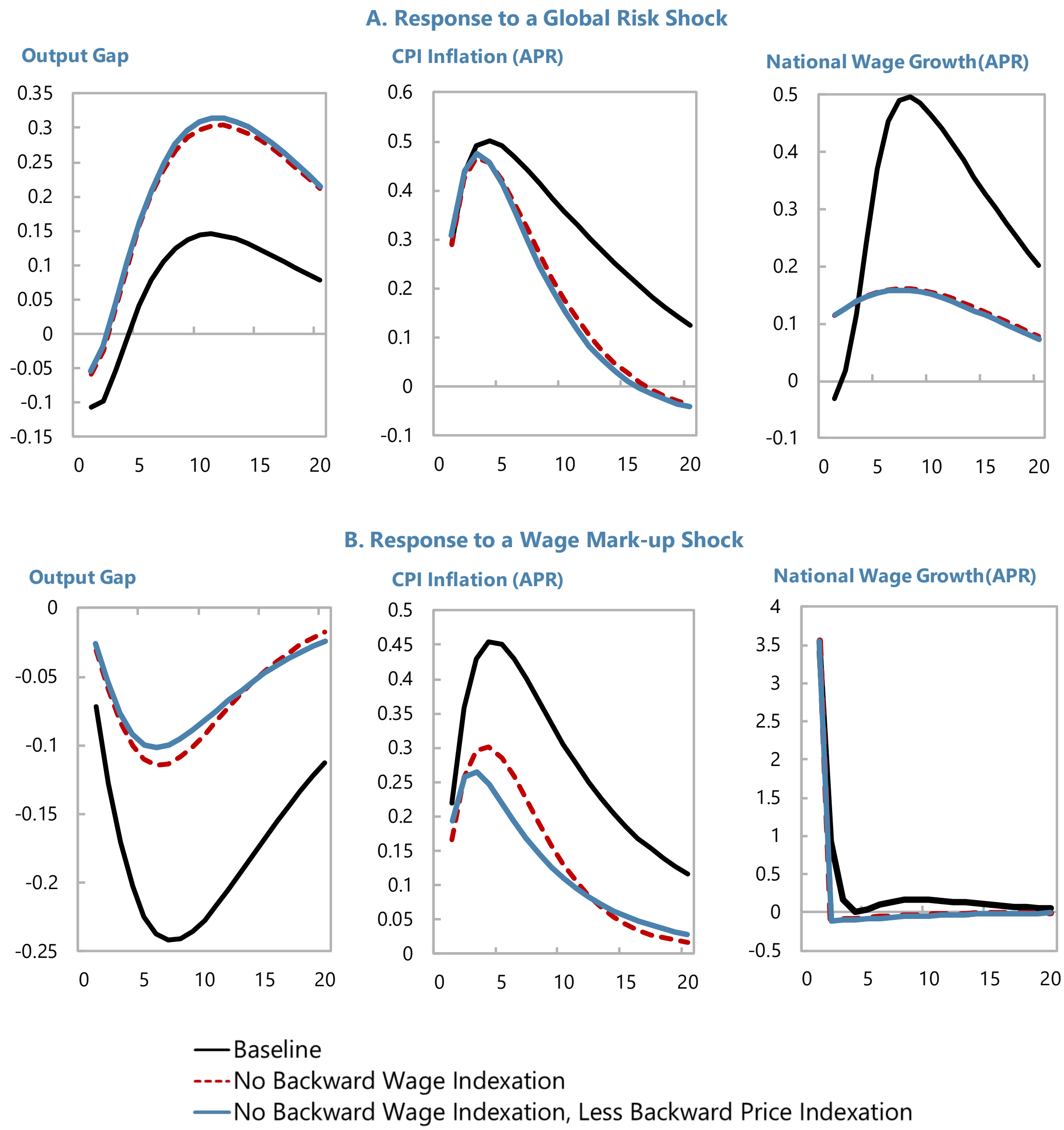
[1] When both unemployment and productivity growth are included in the regression, none of these variables is significant, likely due to multicollinearity. See Rabanal and Sbrancia (2024) for details.

only indexed to the inflation target of the central bank (red dashed line), and in addition, the price Phillips curve becomes more forward looking (black line).

- *In response to a large depreciation* driven by an increase in global risk, CPI inflation initially increases because of the reaction of imports prices, but the lagged response of nominal wage growth due to indexation leads to a persistent response of inflation through the increase in labor costs. Initially, the output gap is negative because domestic demand contracts more than the improvement in the trade balance, that builds up reflecting lagged effects of the initial depreciation. In the counterfactual economy where wages are indexed to the central bank target, the impact response of inflation is similar, but the persistence is smaller due to more muted price-wage joint effects. The initial contraction in the economy is smaller when wage indexation is no longer prevalent, and the expansionary effects of the depreciation are larger.

- *In response to a wage mark-up shock*, CPI inflation increases because of the increase in labor costs, with a highly persistent response. The output gap declines due to the tightening by the central bank, which not only leads to a decline in domestic demand but through exchange rate appreciation, of the trade balance. The reaction of CPI inflation is not only less persistent but also quantitatively smaller when wages are indexed to the central bank inflation target compared to the estimated economy. The output gap costs of bringing inflation back to target are also smaller in the counterfactual economy, because the smaller and less persistent response of CPI inflation requires less tightening to bring inflation back to target.

Figure 1. Uruguay: Estimated and Counterfactual Responses



Source: IMF staff estimates, based on Rabanal and Sbrancia (2024).

Note: Time period is quarterly.

6. **Given the centralized wage bargaining process in Uruguay, an additional question to explore is to what extent wages at the sectoral level respond to sector-specific conditions.** To analyze this question, a database with wages at the sector level from *Banco de Previsión Social* (BPS) is used to estimate a similar equation to the Galí (2011) framework with aggregate and sector-specific variables.[1] Specifically, the framework is extended by including a panel data dimension (sector and

[1] The regressions are estimated at quarterly frequency for the period 2010Q1- 2022Q4. The data on wages is originally at monthly frequency and contains data for 22 economic sectors. Productivity is defined as output per

(continued)

time), and employment and labor productivity at the sectoral level (Table 2). The two main results from this analysis are as follows. First, wages respond to lagged inflation and to the unemployment rate. This result is consistent across specifications, and with the aggregate results. Moreover, the specification with expected inflation measures delivers the wrong sign for this variable. Second, sector-specific employment or productivity growth measures are not significant. This finding is consistent with the fact that measures of productivity are not systematically incorporated in the rounds of negotiations and confirmed by plotting real wage growth and productivity growth at the sector level (Figure 2).

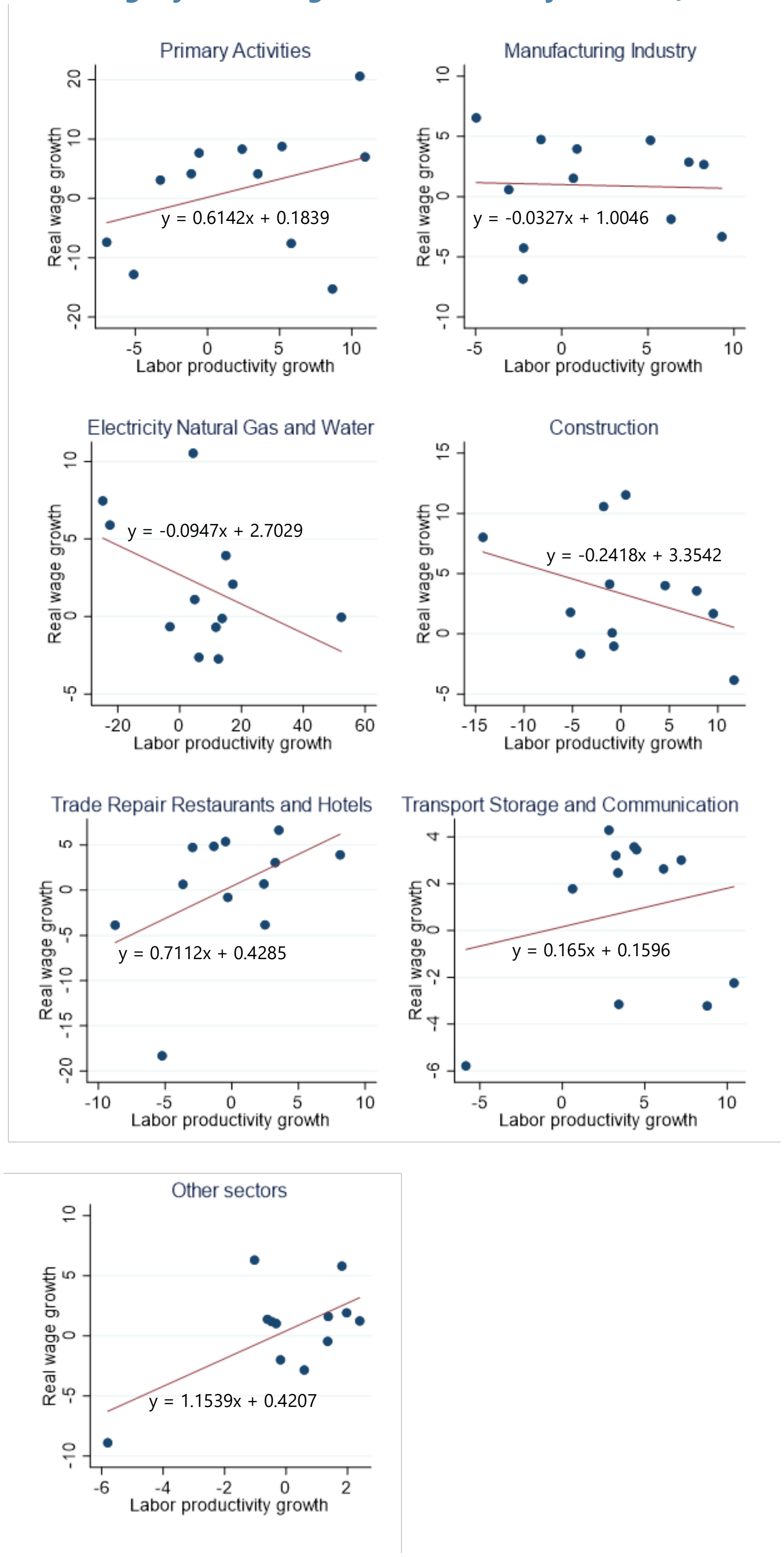
Table 2. Uruguay: Sector Wage Equation Estimates

Aggregate Variables					
Constant	3.11**	8.65***	2.33	6.2**	2.2***
	(1.17)	(1.35)	(1.75)	(2.3)	(0.7)
Annual Inflation, Lagged	1.5*	...	1.62*	...	...
	(0.69)	...	(0.68)	...	...
Expected Inflation	...	-1.41*	...	-1.27	...
	...	(0.85)	...	(0.78)	...
Unemployment, Level	-0.51***	-0.47***	-0.45***	-0.41***	...
	(0.06)	(0.06)	(0.06)	(0.05)	...
Unemployment, Change	0.25	0.42	0.21	0.39	...
	(0.25)	(0.34)	(0.25)	(0.25)	...
Sector-Specific Variables					
Wage Growth, Lagged	-0.21*	-0.19	-0.21*	-0.2*	-0.18
	(0.1)	(0.11)	(0.1)	(0.1)	(0.08)
Employment, Deviation from Mean	...	...	0.01	0.01	0.04
	...	...	(0.02)	(0.02)	(0.02)
Employment Growth	...	...	0.03	0.04	0.02
	...	...	(0.04)	(0.04)	(0.04)
Productivity Growth	...	...	0.07	0.08	0.09
	...	...	(0.07)	(0.07)	(0.07)
R-squared	0.08	0.07	0.09	0.08	0.05

Source: IMF staff estimates.
Notes: Standard errors in parenthesis. One, two, and three stars denote significance at the 10, 5 and 1 percent levels. Wage equations are estimated with fixed effects and robust standard errors.

worker which reduces the number of sectors to 7 once the data on GDP for the whole period is spliced (there is no GDP data available on public administration and financial services for the period prior to 2016). Employment data, instead of unemployment, is used at the sectoral level.

Figure 2. Uruguay: Real Wage and Productivity Growth (2011-2022)



Source: IMF staff estimates and calculations, Banco de Previsión Social, Banco Central del Uruguay.

7. To summarize, there would be gains from reducing the degree of indexation in wage contracts, and current efforts to incorporate sector-specific conditions in the wage bargaining process should continue. Using a structural model, the analysis shows that the prevalence of wage indexation increases the persistence in the response of CPI inflation to shocks, through the joint dynamics of prices and wages. Moreover, additional efforts to incorporate measures of productivity and other sector-specific variables could be useful to increase the efficient allocation of labor and competitiveness, such as the current proposal to differentiate wage guidelines between tradable and non-tradable sectors.

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Annex IX. Data Issues

(As of May 9, 2024)

Table 1. Uruguay: Data Adequacy Assessment for Surveillance

Data Adequacy Assessment Rating 1/

B

Questionnaire Results 2/

Assessment	National Accounts	Prices	Government Finance Statistics	External Sector Statistics	Monetary and Financial Statistics	Inter-sectoral Consistency	Median Rating
	B	B	B	B	B	A	B

Detailed Questionnaire Results

Data Quality Characteristics	National Accounts	Prices	Government Finance Statistics	External Sector Statistics	Monetary and Financial Statistics	Inter-sectoral Consistency
Coverage	B	B	B	B	B	
Granularity 3/	B		B	B	B	
			B		B	
Consistency			A	B		A
Frequency and Timeliness	A	A	A	A	A	

Note: When the questionnaire does not include a question on a specific dimension of data quality for a sector, the corresponding cell is blank.
1/ The overall data adequacy assessment is based on staff's assessment of the adequacy of the country's data for conducting analysis and formulating policy advice, and takes into consideration country-specific characteristics.
2/ The overall questionnaire assessment and the assessments for individual sectors reported in the heatmap are based on a standardized questionnaire and scoring system (see IMF *Review of the Framework for Data Adequacy Assessment for Surveillance* , January 2024, Appendix I).
3/ The top cell for "Granularity" of Government Finance Statistics shows staff's assessment of the granularity of the reported government operations data, while the bottom cell shows that of public debt statistics. The top cell for "Granularity" of Monetary and Financial Statistics shows staff's assessment of the granularity of the reported Monetary and Financial Statistics data, while the bottom cell shows that of the Financial Soundness indicators.

A	The data provided to the Fund is adequate for surveillance.
B	The data provided to the Fund has some shortcomings but is broadly adequate for surveillance.
C	The data provided to the Fund has some shortcomings that somewhat hamper surveillance.
D	The data provided to the Fund has serious shortcomings that significantly hamper surveillance.

Rationale for staff assessment. Data provision has some shortcomings but is broadly adequate for surveillance. Most affected area is national accounts. The new national accounts statistics are not as detailed as before, and historical numbers (pre-2016) using the updated base are not available. For example, quarterly data on the decomposition of fixed capital formation (into public and private) is no longer available and investment by sector is also unavailable. Closing financial data gaps will be key in building more reliable measures for credit risk analysis (i.e., probability of default, loss given default) and for assessing system-wide FX liquidity and concentration risks. The FSAP recommended to improve the quality of MSME data available in private credit bureaus and credit registry and unify movable asset and pledges registries to support asset-based finance. Information on the informal economy is lacking and although the granularity of data in other sectors of the economy are adequate for surveillance they can be enhanced.

Changes since the last Article IV consultation. The Central Bank of Uruguay have published in November 2023 a monthly economic activity indicator (IMAE) which summarizes the evolution of activity, measured at constant 2016 prices. Granular socioeconomic data on Uruguay and revised population statistics are expected once the results of the 2023 census are released.

Corrective actions and capacity development priorities. Staff discussed with the authorities the data adequacy assessment during the Article IV consultation and highlighted areas where shortcomings of data provision have been found. The authorities agreed with the Data Adequacy Assessment and are working to close national account and financial data gaps. The authorities have requested support from the Fund to assess the compilation of service statistics in the Balance of Payments.

Use of data and/or estimates different from official statistics in the Article IV consultation. Staff have not used data different from official statistics for their analysis.

Other data gaps. Uruguay's provision of data pertaining to climate change, income and gender inequality and digitalization does not constitute a data gap.

Table 2. Uruguay: Data Standards Initiatives

Uruguay subscribes to the Special Data Dissemination Standard (SDDS) since February 2004 and publishes the data on its National Summary Data Page. The latest SDDS Annual Observance Report is available on the Dissemination Standards Bulletin Board (https://dsbb.imf.org/).

Table 3. Uruguay: Table of Common Indicators Required for Surveillance

As of May 9, 2024

	Data Provision to the Fund				Publication under the Data Standards Initiatives through the National Summary Data Page			
	Date of Latest Observation	Date Received	Frequency of Data[6]	Frequency of Reporting[6]	Expected Frequency[6,7]	Uruguay[8]	Expected Timeliness[6,7]	Uruguay[8]
Exchange Rates	May-24	May-24	D	D	D	D	NA	1D
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[1]	May-24	May-24	D	D	M	M	1W	1M
Reserve/Base Money	May-24	May-24	D	D	M	Q	2W	1Q
Broad Money	May-24	May-24	D	D	M	Q	1M	1Q
Central Bank Balance Sheet	Apr-24	May-24	M	M	M	Q	2W	1Q
Consolidated Balance Sheet of the Banking System	Mar-24	Apr-24	M	M	M	Q	1M	1Q
Interest Rates[2]	May-24	May-24	D	D	D	D	NA	1D
Consumer Price Index	Apr-24	May-24	M	M	M	M	1M	1M
Revenue, Expenditure, Balance and Composition of Financing[3]–General Government[4]	Mar-24	Apr-24	M	M	A	Q	2Q	1M
Revenue, Expenditure, Balance and Composition of Financing[3]–Central Government	Mar-24	Apr-24	M	M	M	Q	1M	1M
Stocks of Central Government and Central Government-Guaranteed Debt[5]	Dec-23	Apr-24	Q	Q	Q	Q	1Q	1M
External Current Account Balance	Dec-23	Mar-24	Q	Q	Q	Q	1Q	1Q
Exports and Imports of Goods and Services	Mar-23	Apr-24	M	M	M	Q	8W	1Q
GDP/GNP	Dec-23	Mar-24	Q	Q	Q	Q	1Q	2Q
Gross External Debt	Dec-23	Mar-24	Q	Q	Q	Q	1Q	1Q
International Investment Position	Dec-23	Mar-24	Q	Q	Q	Q	1Q	1Q

[1] Includes reserve assets pledged or otherwise encumbered, as well as 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] Frequency and timeliness: ("D") daily; ("W") weekly or with a lag of no more than one week after the reference date; ("M") monthly or with lag of no more than one month after the reference date; ("Q") quarterly or with lag of no more than one quarter after the reference date; ("A") annual.; ("SA") semiannual; ("I") irregular; ("NA") not available or not applicable; and ("NLT") not later than;.

[7] Encouraged frequency of data and timeliness of reporting under the e-GDDS and required frequency of data and timeliness of reporting under the SDDS and SDDS Plus. Any flexibility options or transition plans used under the SDDS or SDDS Plus are not reflected. For those countries that do not participate in the IMF Data Standards Initiatives, the required frequency and timeliness under the SDDS are shown for New Zealand, and the encouraged frequency and timeliness under the e-GDDS are shown for Eritrea, Nauru, South Sudan, and Turkmenistan.

[8] Based on the information from the Summary of Observance for SDDS and SDDS Plus participants, and the Summary of Dissemination Practices for e-GDDS participants, available from the IMF Dissemination Standards Bulletin Board (https://dsbb.imf.org/). For those countries that do not participate in the Data Standards Initiatives, as well as those that do have a National Data Summary Page, the entries are shown as "..."

INTERNATIONAL MONETARY FUND

URUGUAY

June 14, 2024

STAFF REPORT FOR THE 2024 ARTICLE IV CONSULTATION—INFORMATIONAL ANNEX

Prepared By

Western Hemisphere Department (in consultation with other departments)

CONTENTS

FUND RELATIONS

(As of April 30, 2024)

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)	310.04	72.25
Reserve Tranche Position	119.06	27.75

SDR Department:	**SDR Million**	**%Allocation**
Net cumulative allocation	704.53	100.00
Holdings	634.63	90.08

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				
	2024	2025	2026	2027	2028
Principal					
Charges/Interest	2.15	2.87	2.88	2.88	2.88
Total	2.15	2.87	2.88	2.88	2.88

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 of Uruguay is the Uruguayan peso (UY$). Uruguay's de jure and de facto exchange rate arrangements are classified as floating. As of May 14, 2024, the exchange rate in the official market was UY$38.641 per U.S. dollar. Uruguay accepted the obligations of Article VIII Sections 2(a), 3 and 4 of the IMF's Articles of Agreement, and maintains an exchange rate system free of multiple currency practices and restrictions on payments and transfers for current international transactions.

Article IV Consultation. Uruguay is on the standard 12-month consultation cycle. Discussions for the 2023 Article IV consultation took place during May 15, 2023 (IMF Country Report No. 23/173). Staff discussions for the 2024 Article IV consultation took place April 23–May 3, 2024.

FSAP Participation and ROSCs. A Financial Sector Stability Assessment (FSSA) was considered by the Executive Board on December 16, 2022. A factual statement on the FSAP was published on January 23, 2023, as the authorities need more time to consider possible publication of the FSSA and Technical Notes. Previously, 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 2009–23.

DPT	**Purpose**	**Date of Delivery**
ICD	General Macroeconomic Analysis	April 2022
FAD	Public Financial Management	November 2018
	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	Strengthening the Stress Testing Framework	December 2023
	Strengthening the Cyber Resilience of Financial Market Infrastructures	June 2023
	Strengthening Monetary Policy Communications	November 2021
	Central Bank Transparency Review	September 2021

	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	Monetary and Financial Statistics	February 2020
	Trade Margins and Commercialization Channels	September 2016
	Balance of Payments and International Investment Position Statistics.	April and October 2015
	Data ROSC reassessment	August 2012

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
- Development Bank of Latin America: https://www.caf.com/es/paises/uruguay/