March 2011
IMF Country Report No. 11/62

Uruguay: 2010 Article IV Consultation—Staff Report; Public Information Notice; and Statement by the Executive Director for Uruguay

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of the 2010 Article IV consultation with Uruguay, the following documents have been released and are included in this package:

- The staff report for the 2010 Article IV consultation, prepared by a staff team of the IMF, following discussions that ended on December 13, 2010, with the officials of Uruguay on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on January 12, 2011. The views expressed in the staff report are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF.

- A Public Information Notice (PIN).

- A statement by the Executive Director for Uruguay on behalf of the authorities.

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

Selected Issues Paper

The policy of publication of staff reports and other documents allows for the deletion of market-sensitive information.

Copies of this report are available to the public from

International Monetary Fund • Publication Services
700 19th Street, N.W. • Washington, D.C. 20431
Telephone: (202) 623-7430 • Telefax: (202) 623-7201
E-mail: publications@imf.org Internet: http://www.imf.org

International Monetary Fund
Washington, D.C.

INTERNATIONAL MONETARY FUND

URUGUAY

Staff Report for 2010 Article IV Consultation

Prepared by the Staff Representatives for the 2010 Article IV Consultation

Approved by Rodrigo Valdés and Dominique Desruelle

January 12, 2011

Context: Uruguay's economy is booming with vigorous growth in domestic demand and exports. Unemployment is at record lows, some sectors experience labor shortages, and inflationary pressures are rising, but there are signs of moderation of economic activity. In the context of economy-wide wage negotiations and the budget discussion, political tension has risen.

Main issues: The most immediate macroeconomic policy challenge is to ensure conditions for a smooth transition to more sustainable growth rates and reinforce the economy's resilience to spillovers from global and regional shocks. The medium term challenge is to secure rapid growth with less volatility than in the past. These challenges call for calibrating macroeconomic policies to moderate domestic demand and build policy space to cope with future shocks, and for reforms to tackle infrastructure gaps and labor market shortcomings. Staff welcomed the increase in the monetary policy rate in September and the recently approved budget for 2010–14. Staff supported the budget's focus on reducing public debt, its broad spending priorities, and the creation of a fund to shield the budget from drought-induced costs in the electricity production. Given the outlook and risks, staff recommended a more conservative fiscal policy with slower growth in fiscal spending in 2011–15, cautioned against cutting the top VAT rate in the near term, and thought further normalization of the policy rate was warranted to bring inflation to the mid-point of the official target range. Discussions also covered macro-prudential responses to support fiscal and monetary policy, ideas to enhance the fiscal and monetary policy frameworks further, and reforms to improve the prospects for medium-term growth with lower vulnerability.

Fund relations: (Supplement 1) Uruguay and the Fund have excellent relations. There is a long shared view on broad macroeconomic policy priorities. In recent consultations views have differed slightly on the pace of the withdrawal of policy stimuli with the Fund favoring a somewhat more rapid adjustment and more emphasis on reducing inflation.

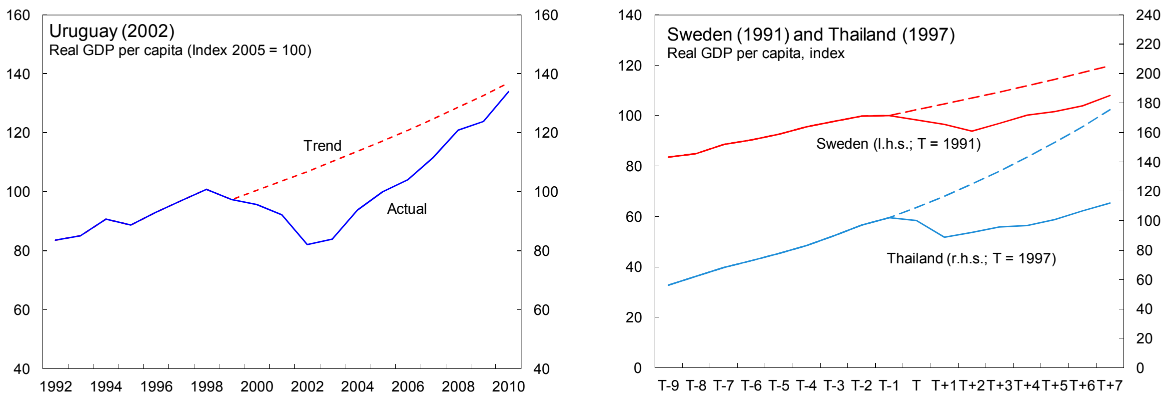
Mission: A staff team comprising U. Erickson von Allmen (head), M. Rosales, H. Zavarce, S. Acosta-Ormaechea (all WHD), T. Wezel (MCM), visited Montevideo November 29–December 13, 2010. M. Gonzalez (Resident Representative) and N. Melgar (the Resident Representative office) assisted the mission. Mr. Valdés (WHD) joined the last part of the mission. Mr. Vogel (OED) participated in the discussions.

Contents Page

I. A BOOMING ECONOMY

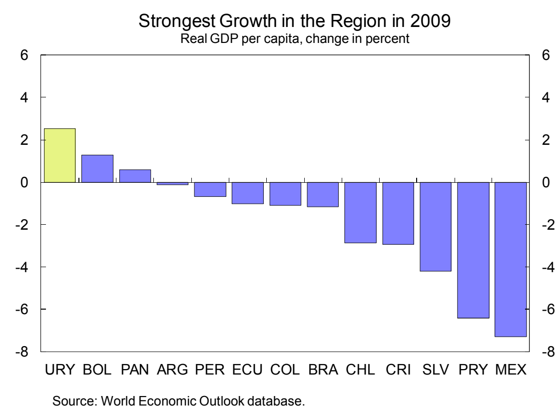
1. **Uruguay's recent economic growth performance has been very strong, capping a remarkable recovery from the country's crisis in 2002**. This recovery has been accompanied in a mutually reinforcing way by significant improvements in public and private sector balance sheets. Large inflows of foreign direct investment (FDI) have spurred big productivity improvements, notably in agriculture, and Uruguay has managed to recover almost all of the output loss (vis-à-vis trend) in about seven years after the crisis.

Uruguay: Output Recovery from Banking Crisis



Source: World Economic Outlook (Sep. 2009 for methodology), and IMF staff calculations.

2. **Though not immune to the global crisis when it hit emerging markets in 2009, Uruguay's rebound has been quick and strong.** A contraction in output in the first quarter of 2009 has been followed by six quarters of growth (Figures 1–6). Although Uruguay avoided a contraction in annual GDP in 2009, the deceleration in growth was nonetheless significant (from 8.5 percent in 2008 to 2.9 in 2009).



3. **The resilience to the global crisis and the quick recovery reflects several factors:**[1]

- ***Growth momentum:*** Uruguay entered the global crisis with significant momentum.
- ***Policy credibility:*** Stead-fast implementation of reforms and prudent policies across governments has generated confidence in Uruguay's policy management.

[1] For analyses of emerging markets' performance in the crisis, see *How Did Emerging Markets Cope in the Crisis,* and *The Global Financial Crisis: Explaining Cross-Country Differences in the Output Impact,* Berkmen et al., (IMF WP/09/280).

- ***Strong and improving fundamentals:*** Years of sizeable primary surpluses and proactive debt management (Annex 1) that have helped to reduce sharply the public debt (a legacy of the 2002 crisis), a strengthened monetary policy framework in the context of a floating exchange rate, substantial international reserves at the Banco Central del Uruguay (BCU), significant improvements in financial sector regulation and supervision, declining (though still high) bank dollarization, little leverage in the economy, and a very liquid and capitalized banking system.

- ***And good fortune:*** Low global interest rates, high commodity prices, and strong growth in partner countries provided a very supportive environment. Also, the comparatively underdeveloped capital market muted the impact of the global crisis.

4. **In 2010 the economy fired on all cylinders with vigorous growth in domestic demand and exports, and inflationary pressures have risen.** The recovery in private consumption—partly pent-up demand for durable goods—was particularly pronounced, boosted by rising employment and real wages, and an uptick in consumer credit. Growth was also helped by the normal rain falls, after droughts in 2008–09. Unemployment has fallen to record lows (6.1 percent in November). Some sectors are experiencing shortages, in particular for skilled labor, that have been aggravated by recent strikes. Headline inflation was 6.9 percent in December, close to the upper end of the current inflation band, despite administrative measures (including delayed adjustment of some tariffs and a temporary freeze on health insurance fees) to contain prices. Staff's estimate of core inflation (which excludes some food items and administratively set prices) has edged up to 7.7 percent. Growth decelerated in the third quarter of 2010 (to 1 percent q/q, s.a.) despite continued strong domestic demand. Staff projects GDP growth at 8–8½ percent for 2010 as a whole.

Uruguay: GDP Growth and Contributions, 2009–10 Q3

	2009				2010		
	Q1	Q2	Q3	Q4	Q1	Q2	Q3
Real GDP, quarter on quarter (S.A)	-1.9	1.4	2.8	2.2	2.1	2.2	1.0
	(Contributions to real GDP growth)						
Real GDP, year-on-year	2.6	1.1	2.8	4.6	8.8	9.8	7.9
Private consumption	-0.1	0.7	1.7	1.8	5.3	7.4	7.4
Public consumption	0.7	0.5	0.6	0.5	0.6	0.4	0.4
Private investment	0.2	-4.6	-0.4	-2.0	1.8	3.0	1.2
Public investment	1.2	1.5	1.5	-0.5	-0.6	-0.3	-1.2
Changes in inventories	-3.1	-4.4	-1.9	2.4	3.2	-1.3	-1.1
Exports	0.2	0.1	0.4	2.1	1.5	5.7	3.3
Imports	3.6	7.4	1.0	0.3	-3.2	-5.3	-2.3

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

5. **Domestic demand has been underpinned by fiscal and monetary policy, but a gradual shift toward more neutral began in the latter part of the year.**

- ***Fiscal policy.*** Fiscal policy, which was countercyclical in the downturn in 2009, became somewhat pro-cyclical in 2010 as growth surprised on the upside. The public sector primary balance has improved thanks to the turnaround in the state-owned electricity company, UTE, following improved weather conditions. Staff projects the public

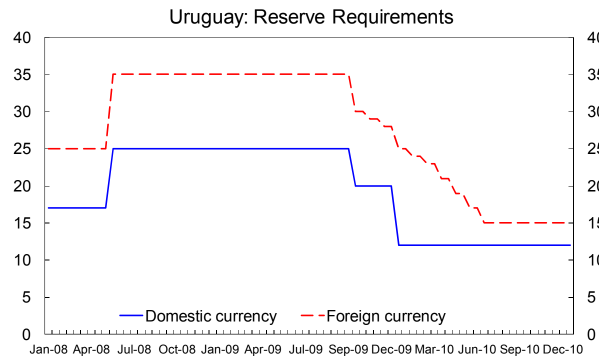
Uruguay: Public Sector Operations, 2008–10
(In percent of annual GDP, unless otherwise noted)

	January–November			Annual	
	2008	2009	2010	2009	2010 Est.
Public sector revenue	23.8	25.1	25.8	26.2	27.7
Of which: Central government	18.4	18.6	18.0	20.4	19.6
Percent change, real terms 1/	6.5	2.8	5.5	3.5	4.4
Public Sector primary spending	21.4	23.6	23.4	27.0	26.5
Percent change, real terms 1/	9.1	11.9	8.2	9.6	6.4
Public sector primary balance	2.7	1.9	2.5	1.1	1.8
General government primary balance 2/	2.7	1.7	1.5	1.2	0.8
Public sector overall balance	-0.1	-0.7	-0.2	-1.7	-1.2

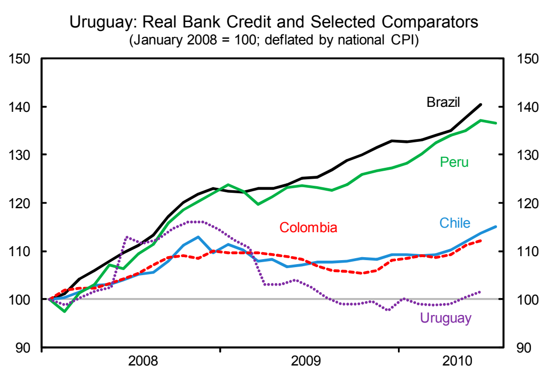
Sources: Ministry of Finance and IMF staff calculations.
1/ Change from same period in previous year.
2/ Defined as central government plus Social Security Bank (BPS).

sector primary surplus to end at 1.8 percent of GDP for 2010 as a whole (from 1.1 percent in 2009).[2] At the same time, despite buoyant activity, the balance of the central government has worsened because of robust real primary spending growth and somewhat sluggish tax revenue, partly the effects of tax exemptions.

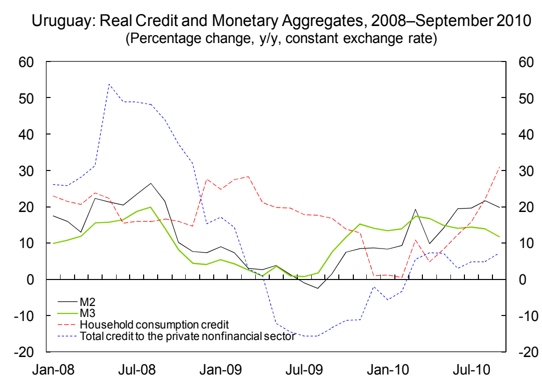
- ***Monetary policy.*** The BCU cut the policy rate by 1¾ percentage points to 6¼ percent in December 2009 (and narrowed the inflation target to 4–6 from 3–7 percent, effective June 2011) and lowered reserve requirements between October 2009 and July 2010. These actions together with buoyant real economic activity and an intensified de-dollarization process (Box 1) have led to a rebound in M2 and local currency credit (albeit from a small base), but the recovery in overall credit has been more tepid (also compared with the region). With inflationary pressures rising and inflation expectations above the new inflation target, the BCU raised its policy rate by 25 basis points in September to 6.5 percent, though at its December 23 monetary policy committee meeting, the BCU left the policy rate on hold.



Source: Banco Central del Uruguay. The chart shows reserve requirements on sight deposits in local currency and sight and savings (1–6 months) deposits in foreign currency residents. Required reserves on other deposits have been similar to these or have remained unchanged.



Source: IMF Regional Economic Outlook-Western Hemisphere, October 2010.

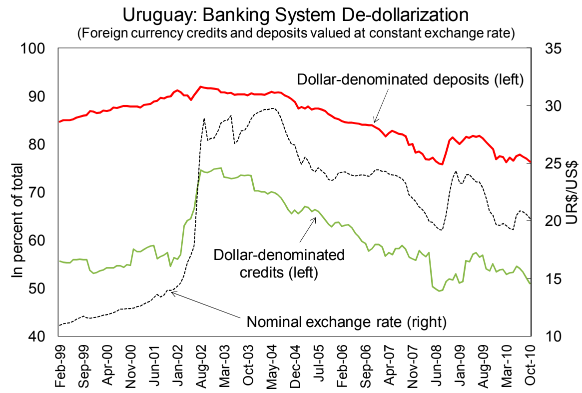


Sources: Banco Central del Uruguay, and IMF staff estimates.

[2] The authorities have put aside US$150 million (equal to 0.4 percent of GDP) of UTE's profits in an Energy Stabilization Fund. The accumulation of resources in the ESF is currently treated as spending, in line with the authorities' accounting. When the guidelines for how the ESF will be used become more concrete, the proper recording of the ESF should also be considered, something the authorities agreed with.

Box 1. Uruguay: De-dollarization Trends

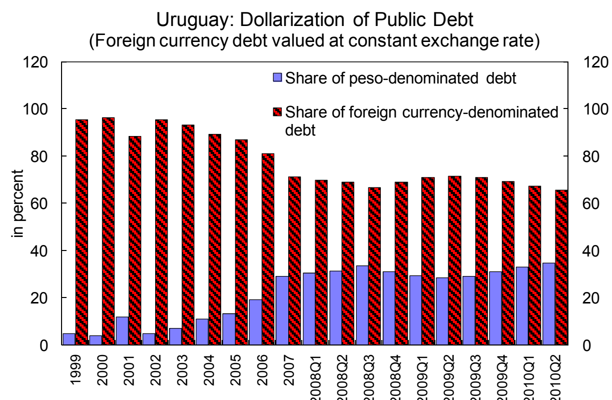
Uruguay has experienced a marked decline in banking sector dollarization since the 2002 crisis. In December 2002—October 2010, deposit and credit dollarization decreased by 15 and 24 percentage points, respectively. In the first ten months of 2010, de-dollarization of credits declined by two percentage points and of deposits by half percentage point.



Sources: Banco Central del Uruguay and IMF staff calculations

De-dollarization is a gradual process, for which macroeconomic stability is a pre-condition. A recent study for Peru identifies the following factors as important: exchange rate appreciation and volatility, prudential measures relating to currency risk, the development of the domestic financial market, and the extension of the yield curve in domestic currency.1/ In Uruguay, in recent years the authorities have introduced prudential regulations to encourage de-dollarization in the banking system, e.g., higher reserve requirements on foreign currency deposits; larger capital requirements for foreign currency loans; limits on banks' foreign currency exposures, and tighter loan provisions for lending in foreign currency to consumers and large corporations. Since March 2009, the BCU is also supporting the development of exchange rate hedges to further foster de-dollarization.

Uruguay's public debt management has achieved a de-dollarization of public debt. (See Annex 1). As a consequence of the increased preference for peso-denominated assets, the share of domestic currency denominated debt rose about 30 percentage points between end-2002 and end-June 2010.



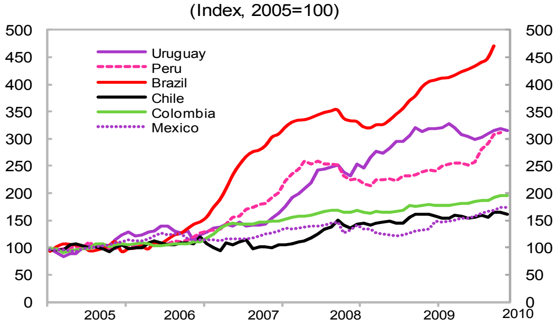
Sources: Banco Central del Uruguay; Ministry of Finance; and IMF staff calculations.

1/ Garcia-Escribano, M. (2010): "Peru: Drivers of De-dollarization." IMF WP/10/169.

6. **Uruguay has so far bucked the typical pattern of booming domestic demand causing an external current account deterioration**. Indeed, the current account surplus increased in the first half of 2010 (to 1.2 percent of projected 2010 GDP), owing to buoyant exports, resilient terms of trade, and a bumper tourism season (mostly regional). The strong exports, reflecting impressive productivity gains in the agricultural sector, in particular, are expected to continue but at a more moderate pace. Nonetheless, a surge in consumer imports is underway (+34 percent in January–November, 2010, y/y) and the current account started to shift to a small deficit in the second half of 2010.

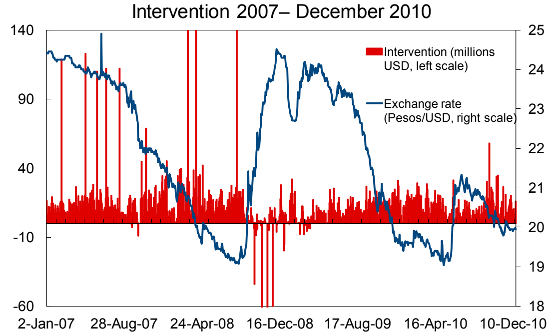
7. **Not surprisingly, with ample global liquidity and booming domestic demand and exports, the currency has appreciated.** The real effective exchange rate appreciated by 17 percent between August 2009 (the last Article IV) and June 2010, while the BCU intervened and bought US$1.4 billion in foreign exchange. In June, concerned about the rapid appreciation, the Ministry of Finance announced it would take an active role in intervention and sterilization which caused an immediate 10 percent depreciation. After clarifications that there is no exchange rate target and that the overriding goal for monetary policy is price stability—later reinforced by the September policy rate increase—the peso has strengthened somewhat against the dollar and also in real effective terms with less active intervention (US$0.5 billion in June–December). The government has taken advantage of external inflows to repay external debt and de-dollarize the public debt and thus absorb some of their impact. The state-owned Banco República has also made foreign exchange purchases to this end.

Reserves Accumulation in Uruguay and Selected Comparators, 2005–10
(Index, 2005=100)



Sources: IMF, *International Financial Statistics*; and IMF staff calculations.

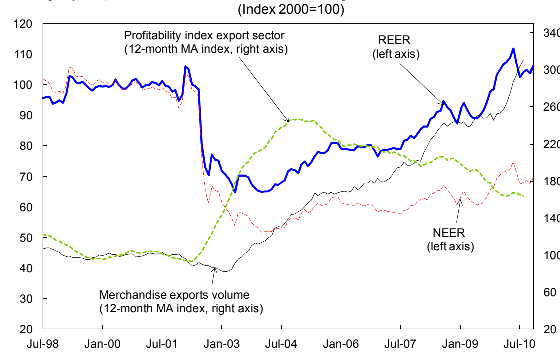
Uruguay: Exchange Rate and Foreign Exchange Intervention 2007– December 2010



Sources: Banco Central del Uruguay and IMF staff calculations.

8. **Still, Uruguay's external position remains strong.** Though the picture is somewhat more mixed than at the time of the 2009 Article IV Consultation—when staff considered the real effective exchange rate in line with its equilibrium—the strength of the currency appears commensurate with Uruguay's position in the economic cycle and not out of line with long-run fundamentals (Box 2). Importantly, the floating exchange rate, the current account surplus, the booming export volume growth, the ample international reserves, and the declining external debt mitigate external stability risks. Since last July, Standard & Poor's and Fitch have raised their ratings of Uruguay's sovereign external debt to two notches below investment grade and Moody's to one below.

Uruguay: Exports, Profits, and Effective Exchange Rates, 1998–November 2010
(Index 2000=100)



Sources: Banco Central del Uruguay; *World Economic Outlook*; and IMF staff calculations.

Uruguay: Selected Financial Soundness Indicators

	2005	2006	2007	2008	2009	2010 Sep.	LAC-5 4/ June 2010
Regulatory capital in percent of risk-weighted assets	24.5	22.7	19.8	18.9	18.4	17.0 2/	17.3
Return on assets	0.8	1.0	1.3	1.0	1.3	0.3 2/	2.1
Return on equity	10.3	11.6	12.8	10.9	15.0	3.3 2/	23.2
Efficiency ratio (net operating costs in percent of net income)	68	72	75	74	82	79	n.a
Liquidity ratio (maturities of up to 30 days)	80.7	69.5	53.9	66.0	64.4	56.9	31.0
Non-performing loans in percent of total loans 1/	5.3	3.6	1.1	0.9	1.0	1.0	2.9
Total loan loss reserves in percent of non-performing loans 3/	221	411	666	807	685	687	128.5
Implict exchange rate risk index 3/	40.0	35.0	35.2	36.2	31.6	31.4	n.a.

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

1/ Loans to the nonfinancial sector.
2/ June data.
3/ Foreign currency credit to the non-tradable sector as a percentage of total credit.
4/ Median of Brazil, Chile, Colombia, Mexico and Peru. The official definition of soundness indicators varies by country.
5/ Excludes Brazil and Colombia.

9. **Macro-financial vulnerabilities remain low at this time despite the international volatility.** Banks rely on deposit funding, maintain substantial liquidity cushions, and carry little leverage. Though on declining trend, capital adequacy ratios still exceed the regulatory minimum (8 percent) by a wide margin and compliance is ensured even under the strong shocks in the BCU's stress tests.[3] Overall loan-loss provisions stand at about six times the historically low level of non-performing loans, partly reflecting the dynamic provisioning. Despite a significant presence of Spanish banks, funding pressures faced by the parent banks have not spilled over to Uruguay, in part because the authorities decided to limit the exposure of the subsidiaries to the parent banks. On December 6, Scotia Bank (Canada) announced it intends to buy Nuevo Banco Commercial, one of the largest private banks. Specific remaining vulnerabilities relate to the high but declining share (31 percent) of credit in foreign currency to the non-tradable sector (primarily households) and the trend decline in banks' profitability. To strengthen systemic supervision the authorities are creating a Financial Risk Committee.

Uruguay: Selected Indicators of the Banking System, end of September 2010
(In percent, unless noted otherwise)

	Share of Liabilities		Share of Assets				In millions of U.S. Dollars			
	Resident deposits 1/	Non resident deposits 1/	Credit 1/	Non performing loans	Return on assets (ROA)	Return on equity (ROE)	Assets	Equity	Results	Leverage 2/
Public Banks	**71**	**4**	**35**	**2.0**	**1.3**	**9.2**	**11,232**	**1,638**	**2142**	**6.9**
Banco Republica (B.R.O.U.)	76	4	31	0.0	1.4	12.4	9,810	1,072	1946	9.2
Banco Hipotecario	19	0	62	13.0	0.9	2.2	1,423	565	196	2.5
Private Banks	**61**	**21**	**31**	**0.0**	**0.4**	**4.0**	**13,222**	**1,221**	**693**	**10.8**
N.B. Comercial	39	1	40	0.0	-0.1	-0.9	1,404	185	-24	7.6
Banco Itau	71	17	31	0.0	0.6	9.9	1,908	118	166	16.2
Banco Santander	76	14	28	0.0	1.6	14.2	4,242	480	945	8.8
Credit Uruguay	73	9	41	0.0	0.3	4.9	1,386	93	65	14.9
B.B.V.A.	63	30	39	0.0	-0.3	-3.6	1,020	76	-40	13.4
Citibank	58	23	16	0.0	1.5	16.9	885	70	166	12.6
Discount Bank	49	41	11	0.0	0.9	11.1	826	71	110	11.6
Lloyds TBS	42	34	29	0.0	-1.2	-14.8	329	27	-63	12.2
HSBC Bank	30	61	39	0.0	-1.4	-25.9	809	40	-142	20.2
Bandes Uruguay	49	9	50	1.0	-15.0	-104.3	174	24	-432	7.3
Banco Surinvest	70	18	3	0.0	-1.7	-11.8	155	22	-41	7.0
Banco Nacion Argentina	10	71	8	0.0	-1.6	-7.6	84	16	-17	5.3
Total	**65**	**14**	**33**	**1.0**	**0.8**	**7**	**24,455**	**2,859**	**2834**	**8.6**

Sources: Banco Central del Uruguay, Financial stability report, third quarter 2010 (available on http://www.bcu.gub.uy/autoriza/sieras/ref.htm); and IMF staff calculations.
1/ Non financial sector.
2/ Assets to equity ratio.

[3] Stress tests involve combined shocks (one adverse and one crisis) to GDP, the exchange rate, international interest rates, country risk, and inflation. In the last Financial Stability Report, the crisis shock includes 31.7 percent depreciation and an 8 percent contraction in GDP. See BCU's website for more details.

Box 2. Quantitative Exchange Rate Assessment

CGER. As of October 2010, the real effective exchange rate (REER) remains broadly in line with fundamentals according to standard CGER approaches. The average of the three approaches suggests a slight overvaluation, in contrast to the assessment at the time of the 2009 Article IV consultation which suggested a moderate undervaluation. The appreciation over the past year is mainly picked up in the equilibrium real exchange rate (ERER), which shows the biggest change from last year.

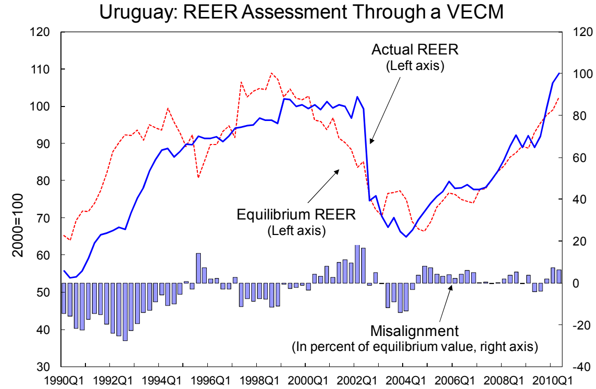
Uruguay: Exchange Rate Assessment

REER deviation from equilibrium (in percent)	2009 Art IV	2010 Art IV
I. Macroeconomic Balance approach	-3.6	-3.3
II. External Sustainability approach	-0.6	0.2
III. Equilibrium Real Exchange Rate approach 1/	-4.6	6.7
IV. Vector Error Correction Model approach 2/	-4.8	6.3
Overall CGER misalignment (average I-III)	-2.9	1.2
Overall REER misalignment (average I-IV)	-3.3	4.4

Sources: *World Economic Outlook* and IMF staff calculations.
1/ Considers the REER as of July 2010.
2/ Considers the average REER as of 2010Q2.

VECM. The results in an estimated vector error correction model (VECM) for Uruguay are close to that under the ERER approach since it also picks up the recent appreciation trend. The VECM estimation uses quarterly data for 1980Q1–2010Q2, and finds one cointegrating relation between the REER, a proxy for the relative productivity of Uruguay vis-à-vis its main trading partners, and the NFA position of the country. According to the model, the REER was 6.3 percent overvalued by mid-2010. Since then the REER has depreciated modestly.

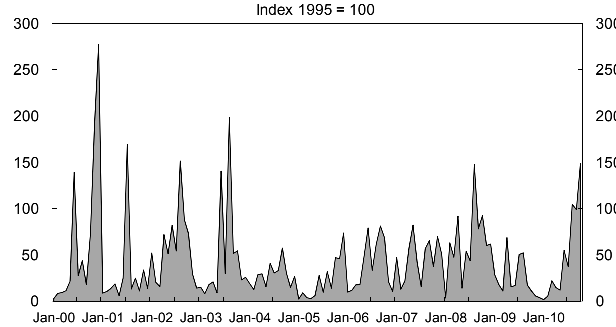
Uruguay: REER Assessment Through a VECM



Source: IMF staff calculations.

10. **The government under President Mujica that took office in March 2010 is advancing on reforms in several important areas.** The election of Mr. Mujica continues the reign of the Frente Amplio coalition, which retained a small majority in both houses. Key initiatives include: a five-year budget aimed at reducing public debt and with an emphasis on infrastructure, education, social outlays, and security; a broader reform agenda, including Public-Private Partnerships (PPPs), to boost investment and improve the business environment, and a reform of the wage setting in the public and private sectors. In the context of budget negotiations and economy-wide wage negotiations, there has been a rise in labor conflicts and political tension, in particular within the Frente Amplio coalition.

Labor Conflicts 1/
Index 1995 = 100



Source: Catholic University of Uruguay.
1/ Index measures the number of working days lost due to labor conflict. For details see:www.ucu.edu.uy.

II. PROSPECTS AND RISKS: 2011–15

11. **The outlook for Uruguay's economy is good, but with challenges.** Continued ample global liquidity and low interest rates, high prices for Uruguay's principal exports, and strong (but slowing) growth in partner countries will challenge Uruguay's absorption capacity. In line with recent indicators and outlook in partner countries, growth is projected to decelerate in 2011–12 toward a more sustainable path. Medium-term growth of 4 percent, as assumed in the budget, is slightly higher than past averages (under 3½ percent), but is not unrealistic in light of recent trends, productivity improvements, and the international outlook. However, given the full employment for skilled labor and the slow growth in the labor force, addressing infrastructure gaps and enhancing the skills of the labor force will be needed to sustain rapid growth. The government's policy agenda reflects these priorities.

Uruguay: International Outlook
(Annual change in percent, unless otherwise specified)

	Average 2000–09	2010	2011	Average 2012–15
Real GDP				
Argentina	3.6	7.5	4.0	3.0
Brazil	3.3	7.5	4.1	4.1
China	10.3	10.5	9.6	9.5
Euro area	1.4	1.7	1.5	1.8
USA	1.8	2.6	2.3	2.8
World	3.6	4.8	4.2	4.6
Commodity prices (U.S. dollars)				
World oil price	16.5	23.3	3.3	2.7
Beef	4.0	22.6	-9.6	-0.7
Soybeans	10.1	-4.6	2.8	-0.3
Wheat	8.8	-3.0	15.3	-3.1
Rice	13.2	-15.6	-1.5	-1.0
Maize	7.9	-1.2	5.1	0.5
World interest rates				
Libor (6 months, in percent)	3.4	0.6	0.8	2.8

Source: World Economic Outlook, Fall 2010.

12. **There are seemingly conflicting risks to this outlook.**

- ***Overheating:*** The most immediate risk is that the pace of domestic demand does not abate as envisaged, because of delayed recalibration of the policy stance, or additional impetus from the expansion in global liquidity and higher commodity prices, or both, causing higher inflation, more appreciation, and a sharper deterioration in the current account—raising the risk of an abrupt end to the boom.

- ***Worse international outlook*:** A worse global or regional outlook would affect Uruguay primarily via lower FDI and export volumes and prices (Figure 6). Effects from volatility in sovereign bond markets would be limited in the short term, at least, by Uruguay's modest external financing needs and BCU's ample reserves. The banking sector's ownership links to Spain could be a conduit for transmitting shocks to Uruguay, though, as mentioned, there a number of mitigating factors.

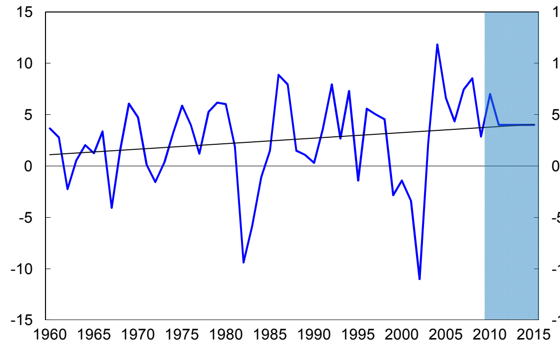
13. **The authorities broadly shared staff's views on the outlook and risks, but were more worried about spillovers from global or regional volatility.** They saw the economy adjusting to a sustainable pace without the need for further policy actions at this stage.

III. POLICY DISCUSSIONS

14. **The discussions focused on how to secure a soft landing and how to achieve strong growth over the medium term with less volatility than in the past.** Uruguay has a history of high output volatility, which can cause abrupt fluctuations in unemployment and poverty and undermine long-term investment. Countries with similar characteristics (small and open, commodity dependent, some dollarized) have achieved important reductions in output volatility. Although Uruguay's volatility is likely to have fallen in recent years, thanks

to the changes in the economic framework, including the floating exchange rate, high-frequency data show still higher output volatility in Uruguay than in comparator countries (but, interestingly, much less volatility in inflation).[4]

Uruguay: Rising Long-term Trend Growth and Volatility
(Annual real GDP growth, in percent)



Sources: International Financial Statistics database, and staff calculations.

Output Volatility in Uruguay and Selected Comparators
(Standard deviation of annual real GDP growth)

	1970–89	1990–09
Uruguay	**4.4**	**5.2**
Chile	6.9	3.3
Costa Rica	4.0	3.0
Peru	6.4	4.3
New Zealand	3.0	2.1
Argentina	4.5	6.0
Brazil	4.8	2.2

Sources: International Financial Statistics database, and IMF staff calculations.

15. **The budget targets primary surpluses of 2.0–2.2 percent of GDP in 2011–14 to reduce the public debt to about 40 percent of GDP in 2015 (60 percent at end-2009).** Since the budget was based on conservative GDP assumptions for 2010, achieving these results should be feasible despite the sluggish revenue observed in 2010. Still, there are downside risks on the revenue side—including from a weakening in the performance of the state-owned fuel import and distribution company, ANCAP, (higher oil prices, delayed tariff adjustments), and the effects of tax exemptions.

16. **In staff's view, more conservative fiscal results would be feasible and warranted to secure a soft landing and reduce the debt faster.** Staff estimates a small positive fiscal impulse in 2011, a year in which output is projected to be above and growing above potential.[5] Also, the budget depends more heavily on the projected performance of public enterprises to achieve the overall fiscal targets than in the past (see chart below). In the context of capital inflows into emerging markets and rapid domestic demand growth, a slower increase in spending would help reduce real appreciation pressures, reinforce the reduction in public debt (allowing the 40 percent target to be achieved earlier), and make the fiscal framework

Uruguay: Public Sector Operations, 2009–15
(In percent of GDP)

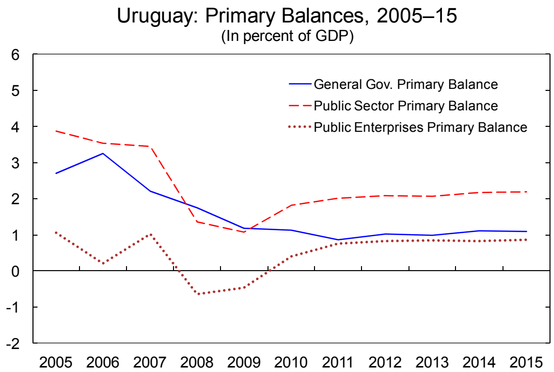
		Est.	Projections				
	2009	2010	2011	2012	2013	2014	2015
Consolidated Public Sector							
Revenues	26.2	27.7	28.0	28.1	28.4	28.4	28.4
Expenditures	27.0	26.5	26.5	26.5	26.5	26.5	26.4
Primary balance	1.1	1.8	2.0	2.1	2.1	2.2	2.2
Overall balance	-1.7	-1.2	-1.1	-1.0	-0.9	-0.8	-0.7
Real revenue growth, in percent	7.8	9.5	5.8	5.4	4.4	4.2	4.1
Real primary spending growth, in percent	9.6	6.3	5.5	4.5	4.4	3.7	4.0
General government 1/							
Primary balance	1.2	0.8	0.7	1.0	1.0	1.1	1.1
Overall balance 1/	-1.6	-1.5	-1.5	-1.2	-1.1	-0.9	-0.9
Real revenue growth, in percent	6.0	6.2	5.3	5.1	4.5	4.5	4.1
Of which: Central government	3.5	4.4	5.0	5.0	4.2	4.0	3.9

Source: Ministry of Finance and IMF staff estimates
1/ Defined as central government plus Social Security Bank (BPS).

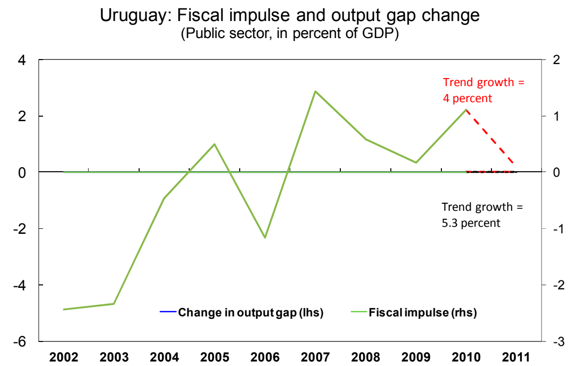
[4] See Selected Issues Paper: *Transmission of Policy Rates in Uruguay—A Cross Country Perspective*.

[5] See Selected Issues Paper: *Assessing the Structural Fiscal Balance in Uruguay*.

less reliant on performance of public enterprises.[6] Given the importance of infrastructure investment for growth, it would be preferable for such a further slowdown in spending growth to focus on central government current expenditure (the wage bill and transfers rise in the budget by 0.6 percentage points of GDP between 2010 and 2014). Staff also encouraged the authorities to save eventual cyclical revenue over-performance. The authorities considered the fiscal stance appropriate to achieve a sound and sustainable economic path as projected. They saw the wage bill growth as key to rectify pay imbalances in certain sectors and to strengthen public services like education and security.



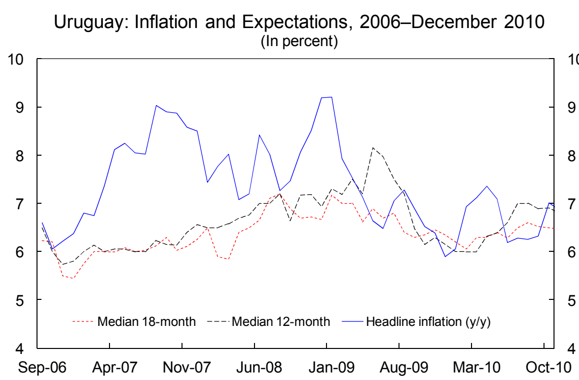
Sources: Ministry of Finance and IMF staff estimates.



Source: IMF staff estimates.

17. **The authorities intend to cut the top VAT rate but staff cautioned that the timing does not seem propitious given the strong domestic demand**. The authorities noted that the reduction in the VAT would be in the context of a significant increase in revenue administration efficiency and reduction in tax evasion and that it would not put the fiscal objectives at risk. Staff worried about adding more fuel to domestic demand and noted that a two percentage point cut in the top rate, as was discussed, would cause a revenue loss equal to 0.7 percent of GDP if applied across the board. This loss would be difficult to offset by efficiency gains, in the short run at least, especially since efficiency is already quite high and tax evasion low (see below).

18. **Staff welcomes the BCU's increase in the policy rate in September but a continued tightening stance is warranted to bring monetary policy to neutral.** Inflation expectations (18-months ahead) were 6.4 percent in December 2010. Booming domestic demand, inflation and inflation expectations at risk of becoming entrenched



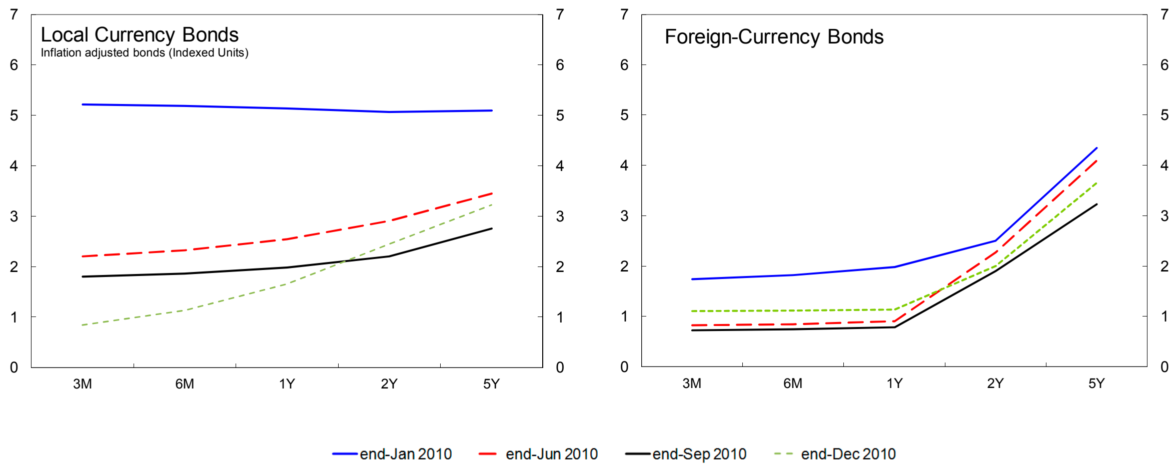
Sources: Uruguayan National Bureau of Statistics; Banco Central del Uruguay; and IMF staff calculations.

---

[6] An increase in government expenditure by 1 percentage point of GDP is associated with an appreciation of the real exchange rate by 1–2½ percent (*World Economic Outlook*, October 2010, and *Regional Economic Outlook—Western Hemisphere*, Spring 2010).

above official targets, and the policy rate barely positive in real ex ante terms call for further normalization of the monetary policy stance. Staff suggested that aiming more clearly for the middle of the inflation target range (5 percent) would create more space for countercyclical monetary policy in the event growth falters. Stability in the target and the band is important for the inflation target's role as an anchor for expectations. The authorities broadly concurred and emphasized their commitment to the inflation targets, noting that the center of the target has been stable.

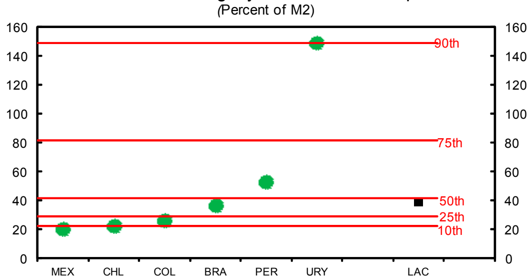
Uruguay: Government Bond Yield Curves, 2010
(In percent)



Sources: BEVSA and IMF staff calculations.

19. **Uruguay will likely continue to see strong external inflows and appreciation pressures.** Most of the inflows reflect the current account surplus and FDI but there is also growing demand for local currency assets, reflected in the fall in local-currency bond yields. Capital inflows will strengthen as Uruguay moves toward investment grade—which many observers see happening within two years—and its local capital markets develop. The challenge is to harness capital flows into productive investments, rather than into consumption or real estate, and to this end advancing on the PPP agenda can help.

Reserves-to-M2 in Uruguay and Selected Comparators 1/
(Percent of M2)



Sources: IMF, *International Financial Statistics*; and IMF staff calculations.
1/ Reserves as of June 2010 or latest available, including gold holdings (national valuation). The red lines present the distribution (in percentiles) of ratios across all emerging market countries. The black box marks the median of the region.

Uruguay: Gross International Reserves
Dec 30, 2010

In billions of U.S. dollars	7.7
In months of imports (2011)	8.6
In percent of:	
GDP	19
Short-term debt	404
ST debt and nonresident deposits	137
M2	141
M3	48

Sources: Banco Central del Uruguay; *World Economic Outlook*; and IMF staff calculations.

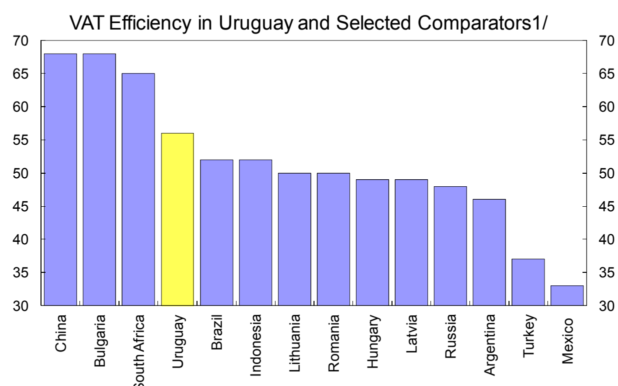
20. **Staff and the authorities agreed on the importance of maintaining a flexible exchange rate.** Given the BCU comfortable reserves, further foreign exchange intervention could be limited. Staff suggested that intervention be subordinated to the inflation target. If appreciation pressures intensify, staff suggested that reducing domestic demand via a further deceleration in government spending be considered. There is also a case for considering relaxing further the limits on investments abroad for pension funds.[7] A macro-prudential response could help contain credit growth if the rapid expansion gains too much strength. The authorities indicated that they would respond to continued inflows with a combination of exchange rate flexibility, debt management, and intervention aimed at reducing volatility.

21. **A well-functioning labor market and prudent wage agreements are essential to maintain a dynamic economy, keep inflation in check, and avoid erosion in export competitiveness.** The rising labor conflicts are a concern since they disrupt production and can deter needed investments. Staff highlighted the importance of a labor market that provides protection without hindering the needed factor reallocation. Staff supports the government's recent guidelines to add a link to productivity growth in the wage setting framework for the private sector (starting in 2010).

Medium Term

22. **The budget for 2010–14 includes improvements to the fiscal framework**. In particular: the anchoring of the budget in a declining gross public debt and the creation of the Energy Stabilization Fund. Staff and the authorities discussed how some aspects of the fiscal framework could be enhanced further.

- ***Tax expenditures.*** Uruguay has achieved significant improvements in tax administration and in cutting down tax evasion.[8] The efficiency of the VAT, for example, compares well internationally. However, these hard-won gains are at risk of being eroded by the use of tax exemptions, mostly for investment promotion. Staff noted the importance of assessing the effectiveness of tax exemptions against alternative uses of tax



Sources: Uruguay Ministry of Finance; *IMF Fiscal Monitor*, November 2010 (Table 5.4); and IMF staff calculations.
1/ Data for comparator countries are from 2006.

---

[7] Pension funds can invest up to 15 percent of their assets in foreign bonds issued by multilaterals, but they are below that limit. The ceiling on investments in government and BCU securities will be reduced gradually from 90 percent to 75 percent by 2015.

[8] A recent TA mission from the Fiscal Affairs Department noted that the tax directorate and the social security institute operate at high international standards but identified weaknesses in the customs administration.

resources, e.g., investment in infrastructure, which are essential for private investment.

- ***The budget***. Staff welcomed the authorities' plan to develop and publish cyclically-adjusted fiscal balances. To strengthen the budget framework further staff encouraged consideration of a more transparent process for mid-year spending adjustments.
- ***Public-Private Partnerships.*** Staff supports the government's plans to use PPPs to help address infrastructure gaps (Box 3). The authorities have received TA from the World Bank, the Inter-American Development Bank, and the Fund's Fiscal Affairs Department. Staff underscored the importance of maintaining a fair balance of risks between the government and the private sector, establishing limits on the stock and flows of the PPP-related liabilities, and ensuring their proper and transparent recording. Staff welcomed that the draft PPP law includes strong safeguards with a key role for the Ministry of Finance in due diligence and assessment of fiscal risks. The authorities agreed on the importance of transparency and are also considering limits on PPP-related liabilities.

23. **With respect to the monetary policy framework, staff welcomed the BCU's strategic plan for 2010–14 and reiterated the importance of improving communications.** The plan touches all aspects of the BCU's activities and includes an ambitious agenda to improve the analytical work on monetary policy. Staff suggested that, in particular, more active and substantive communication by the BCU—at the time of monetary policy decisions and in the quarterly monetary policy report—of the inflation forecast and risks, and how the BCU sees inflation reaching the official targets would help guide inflation expectations and strengthen the transmission mechanism. The BCU plans to strengthen its communications, but also noted that it will be important to have more robust projections of inflation.

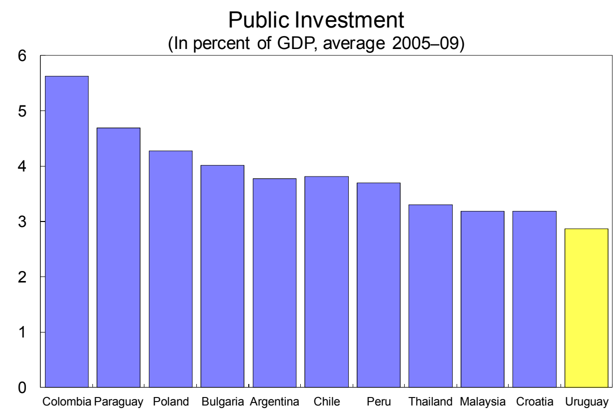
24. **The recapitalization of the BCU is welcome but some of the modalities could make it insufficient.** The recapitalization (October 31, 2010) involves US$2.4 billion worth of government inflation-indexed bonds: US$1.9 billion in perpetual bonds at 3 percent real interest to cover the BCU's operational deficit and US$486 million in 30-year-maturity bonds at 3.5 percent real interest rate. Staff noted two concerns with the recapitalization. First, although the BCU is allowed to use the 30-year bond as collateral in repo operations, this may not be feasible since the bonds are not allowed to be traded in the secondary market. Second, the recapitalization does not seem to include any real cash flow to the BCU since the coupon on the bonds will be paid with 30-year bonds (with the same limitations as above). The authorities noted staff's concern and would consider if further changes were needed.

25. **Enhancing BCU's credibility further would strengthen the monetary policy framework, make it easier to bring down inflation, and reinforce de-dollarization**. Staff suggested that one practical way would be to make clearer the different roles of the BCU's Monetary Policy Committee (which recommends monetary policy decisions to the BCU board) and the Macroeconomic Coordination Committee (a space for macroeconomic

coordination and where the authorities set the inflation target) where the Ministry of Finance is also represented, but which many observers see as the real monetary policy decision body. To this end, a clearer distinction could be made in public communications on monetary policy decisions (as was the case in the December press release) and by delinking their meetings (which is common in international practice). The authorities stressed that the BCU exercises operational independence and they thought the current set up worked well.

Box 3. Uruguay: Public Investment and Public-Private-Partnerships (PPPs)

Public investment in Uruguay is low by international standards, especially when considering the large role played by the public sector in the economy. The 2010–14 budget include an increase in public investment to around 3.5 percent of GDP on average in 2010–14, but this is still below regional levels. To supplement public investment, the government plans to expand the use of PPPs.1/ PPPs are long term contracts under which a private firm finances, builds, maintains, and/or operates infrastructure that provides public services. The main weaknesses of PPP relate to contingent liabilities and risks, and the more limited flexibility to change course when needed.



Source: IMF staff calculations.

The following factors are typically seen as important to reduce the risks with PPPs:

1. A solid institutional framework (including a PPP Law) for the whole PPP process.
2. Trained teams to evaluate PPPs carefully, especially at the Ministry of Finance (MEF).
3. A competitive bidding process to help maximize benefits and reduce costs.
4. A model of risk transfers and sharing with the private sector.
5. A rigorous system for accounting and reporting all PPP liabilities.
6. A limit on the liabilities from PPP. The liabilities should be counted as public debt.

The *Corporación Nacional para el Desarrollo* is responsible for promoting and managing the PPPs in Uruguay, while the MEF has responsibility for due diligence and fiscal risk analysis.

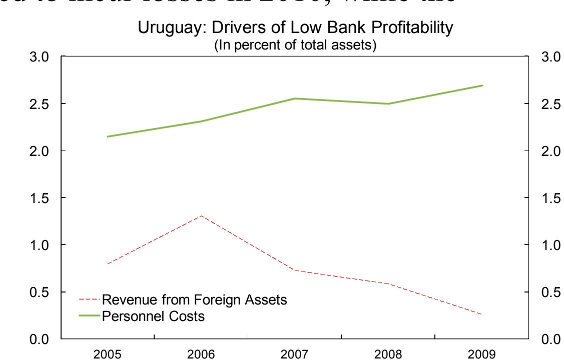
1/ Uruguay has experienced with PPPs. In the 1990s and early 2000s, the government granted more than ten PPP concessions for toll roads, port terminals, airports, gas distribution, and water networks. Most of them are still operated by the private sector, but several are now operated by the public sector.

26. **Bank soundness is good, even by the upcoming Basel III standards, but the profitability remains lackluster notwithstanding low delinquency and recovering credit growth.**

- ***Capital adequacy:*** Banks' common equity (i.e., core Tier 1 capital, or subscribed capital and stock of retained earnings) as a share of assets is well above the minimum required rate of 4.5 percent under the future Basel III regulations. Capital Equity consists exclusively of Tier 1 capital.

- ***Macro-prudential:*** The overall regulatory regime is in line with international best practices, with many measures on credit risk and foreign exchange exposures in place. Uruguay is a pioneer in dynamic loan-loss provisioning, but given the very high provision for NPLs, a review of the parameters of this scheme seems warranted. The authorities noted that they would take this into consideration. Staff supports the creation of a Financial Risk Committee to focus on systemic risk. Credit intermediation is still low (20 percent of GDP) so some trend increase is welcome; however, the strong growth in consumer credit, in particular from less-regulated nonbank institutions, warrants tight supervision. Some of those nonbank institutions that operate without prudential control may have to be brought within the regulatory perimeter. Staff and the authorities also discussed how macro-prudential framework can help keep the incipient credit expansion from turning into a full-fledged credit boom. The authorities follow developments closely and stand ready to adjust the framework if needed. They noted that changing reserve requirements is a tried and tested tool to control liquidity and they stand ready to use this instrument again, but they did not see a need at this time.

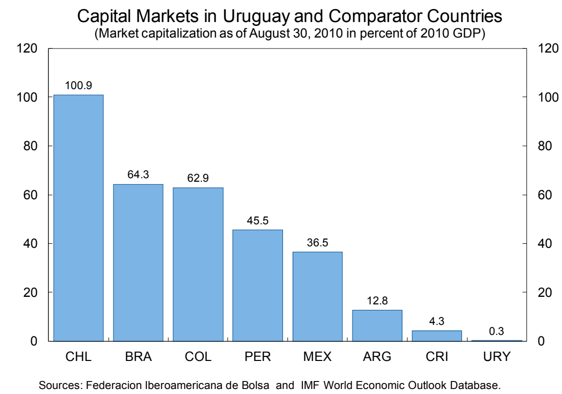
- ***Profits:*** Despite strong growth, a recovery in credit, and record low nonperforming loans, the majority of private banks continued to incur losses in 2010, while the dominant public bank (BROU) remains reasonably profitable. Banks' generally low profitability remains a concern because it can led to greater risk taking and further outsourcing of operations to less regulated nonbank financial institutions. The combination of low returns on the large foreign assets (a structural consequence of high deposits dollarization and limited credit demand from hedged borrowers), rising labor costs, and weak productivity is at the core of private banks' relatively low profitability and calls for efforts to strengthen productivity in the sector.[9]



Sources: Banco Central del Uruguay and IMF staff calculations.

[9] The low profitability is analyzed in detail in the Selected Issues Paper *What explains the low profitability of the Uruguayan banking system*?

27. **Staff welcomes the authorities' efforts to develop the small local capital market.** The authorities are mindful that the lack of a developed and globally integrated capital market helped Uruguay avoid the more nasty effects from the global crisis, but also that broader and deeper corporate funding is important for investment and growth over the long run. Recent steps to develop the capital market include: a bankruptcy law in 2008, a capital market laws in December 2009, and a payments systems law in 2010. The BCU is working on the capital markets regulations. Further, a new project seeks to facilitate access to banking services and strengthen financial literacy and consumer protection.



28. **Staff supports the initiatives to foster investment and productivity growth.** Uruguay ranks 64 out of 139 in the World Economic Forum's *Global Competitiveness Report 2010–11* and 124 out of 183 in the World Bank's *Doing Business 2011*. Key weaknesses relate to rigidities in the labor market, limited local market competition, onerous business regulations, and infrastructure shortcomings (e.g., railroads and relating to foreign trade). The government's agenda tackles many of the weaknesses.

- ***Business environment***. Last May the government launched the "Enterprise in a day" which reduces significantly the time it takes to start a business.
- ***Infrastructure***. The government's infrastructure program focuses on improving the electricity supply, modernizing the railroad and port infrastructure (including through PPPs), and facilitating trade through customs reform.
- ***Public sector***. The Reform of the State agenda is underway. It includes a pilot program for performance-based budgeting in 2011, supported by TA from the Fund. Staff suggested that the planned Inter-American Development Bank/World Bank public expenditure review will provide an opportunity to explore how to make the public more efficient.

29. **The authorities' are making efforts and considerable progress toward meeting international tax standards.** They have signed seven bilateral agreements and five more are underway (12 agreements is a threshold for being considered by the OECD to have "substantially implemented the tax standard"). Also, on December 15, 2010, Parliament approved a law allowing bank secrecy to be lifted in response to requests for information for tax purposes (as per the bilateral agreements). Uruguay has also made significant progress in strengthening AML/CFT, including with TA from the Fund's Legal Department.

IV. Staff Appraisal

30. **Uruguay's growth performance since the country's own crisis in 2002 has been very strong.** Domestic and external factors have contributed to this economic revival, not least the implementation of major reforms (e.g., to financial regulations and supervision, and the tax system) and prudent macroeconomic policies across administrations.

31. **The outlook for the coming years is good, but with challenges.** The most immediate challenge is to secure a soft landing of the economy in the context of ample global liquidity, low interest rates, and high commodity prices. At the same time, there is a risk of spillovers from a worse global or regional outlook. The medium-term macroeconomic challenge is to sustain rapid growth with less volatility than in the past.

32. **The macroeconomic policy requirements to deal with these challenges go in the same direction.** They involve fiscal and monetary policies to temper domestic demand growth to help steer the economy away from a boom/bust path and create policy space (lower debt and inflation) to respond to future shocks. Given the full employment for skilled labor and slow growth in the labor force, sustaining growth at 4 percent over the longer term is feasible but will require efforts to overcome gaps in infrastructure and in the skills of the labor force. The government's policy agenda reflects these challenges and priorities.

33. **The budget for 2010–14 includes many important improvements.** Notably, the focus on reducing the public debt while increasing spending on infrastructure, education, security, and social program, and the creation of the Energy Stabilization Fund. Staff supports the efforts to get a better handle on the costs of tax exemptions, which risk undermining the impressive gains in tax efficiency in recent years. The plan to publish cyclically-adjusted fiscal balances will help improve the budget framework and fiscal policy. Staff suggests more transparent mechanisms for intra-year changes in the budget.

34. **The budget seeks to sustain the fiscal improvement in 2010, but even more ambitious fiscal targets for 2011–14 would be feasible and desirable.** The fiscal position is robust. But more conservative fiscal targets for 2011–14 would better support a soft landing, reduce appreciation pressures, and achieve a faster reduction in the public debt. The fiscal impulse is admittedly difficult to calculate with precision, but this uncertainty together with the state of the cycle and the risks to the outlook reinforce the case to err on the side of caution. This would also include saving cyclical revenue over-performance. Staff cautions against cutting the VAT in the near term. Of course, if growth falters, the more ambitious fiscal targets should be reconsidered so as to allow automatic stabilizers to operate.

35. **The increase in the monetary policy rate last September was a welcome step but a continued tightening is warranted in light of the inflationary pressures.** Strong domestic demand and the risk of inflation expectations becoming stuck above official targets call for a continued measured normalization of the monetary stance. The narrowing of the inflation target band in late 2009 was a welcome signal of commitment to inflation but it also raised the stakes for the BCU. Staff suggests that the BCU aim for the middle of the inflation

target range to ensure space for countercyclical responses. Further, stability in the target band is important for the targets to serve as an anchor for expectations. Finally, staff would caution against using administrative measures to contain inflation.

36. **The recapitalization of the BCU is welcome although two design features could be improved:** ensuring sufficient real cash flow to the BCU and allowing the 30 year bonds to be traded in the secondary market.

37. **There is scope to strengthen the monetary policy framework and its credibility further**. A practical step would be to separate clearly the Monetary Policy Committee from the Macroeconomic Coordination Committee in public communications and by de-linking their meeting schedules. The BCU can also strengthen its influence over inflation and inflation expectations through improved communication of the inflation outlook and risks, and how it sees inflation reaching the official targets.

38. **Staff supports the flexible exchange rate and does not consider the real effective exchange rate to be out of line with long-run fundamentals.** The BCU's level of international reserves is comfortable and further intervention can be limited and subordinated to the inflation target. Continued pro-active debt management is a good way to absorb capital inflows to improve the public debt structure. A further slowdown in government expenditure would be appropriate if appreciation pressures intensify. And the limits on investments abroad for pension funds could be relaxed.

39. **A well-functioning labor market with prudent wage agreements is essential for maintaining a vibrant economy and avoiding erosion in competitiveness.** The reform to take into account sectoral productivity growth in the wage setting framework for the private sector is a welcome step forward.

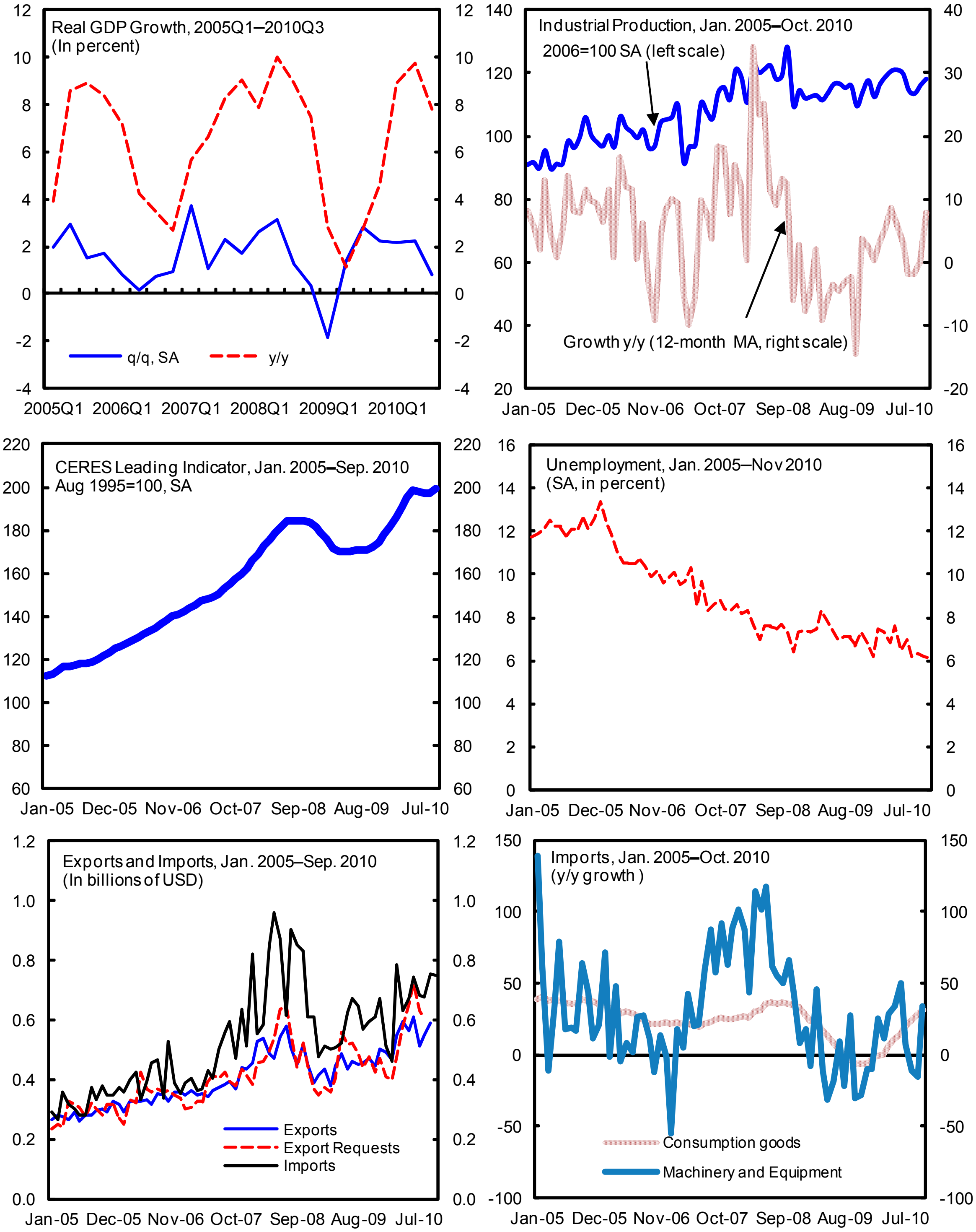
40. **There are no major vulnerabilities in the financial system at this time.** Banks are well-capitalized and highly liquid, and nonperforming loans are at record low. Staff welcomes the extension of the limits on banks' credits to their parent banks and the creation of a Financial Risk Committee to monitor systemic risks. Banks' low profitability remains a concern and calls for efforts to strengthen productivity in the sector. In supervision, the design of the loan-loss provisioning system may need to be modified given the persistently high provisioning of impaired loans. The growing lending by nonbank financial institutions warrants close supervision. Staff welcomes the authorities' readiness to adapt the macro-prudential framework as needed to contain credit growth if the rapid expansion continues unabated.

41. **Staff welcomes the initiatives to boost long-term growth prospects including via PPPs.** It will be important for the PPP framework to ensure an appropriate balance of risk between the private and public sector, establish limits on the liabilities generated by the PPPs, and ensure their appropriate reporting.

42. **Staff proposes that Uruguay remain on the 12-month Article IV cycle.**

Figure 1. Uruguay: Economic Activity

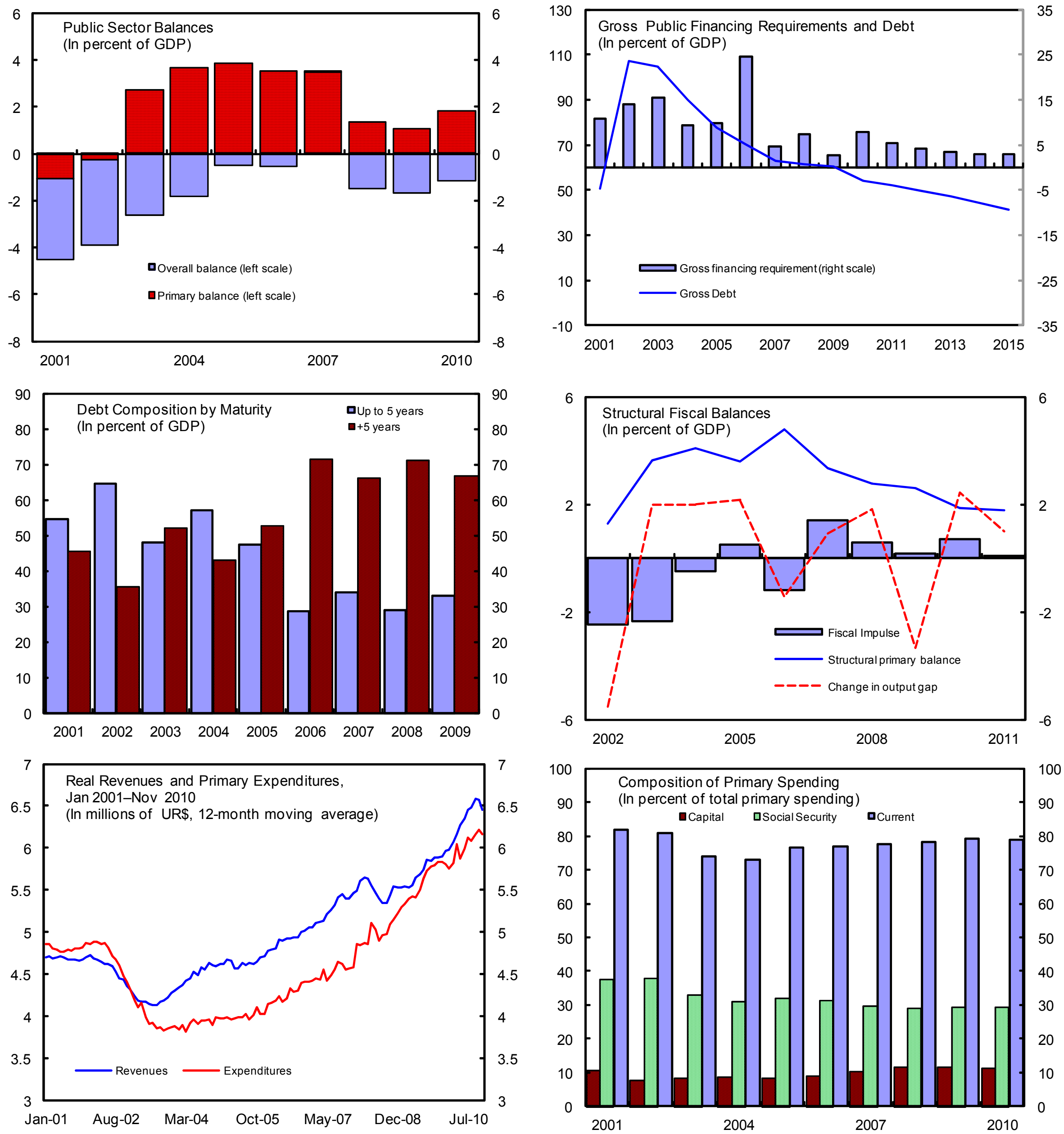
The short lived contraction in output in early 2009 has been followed by six consecutive quarters of growth, with consumption in a leading role. Unemployment has



Sources: Banco Central del Uruguay; Uruguay National Bureau of Statistics; and IMF staff calculations.

Figure 2. Uruguay: Fiscal Developments

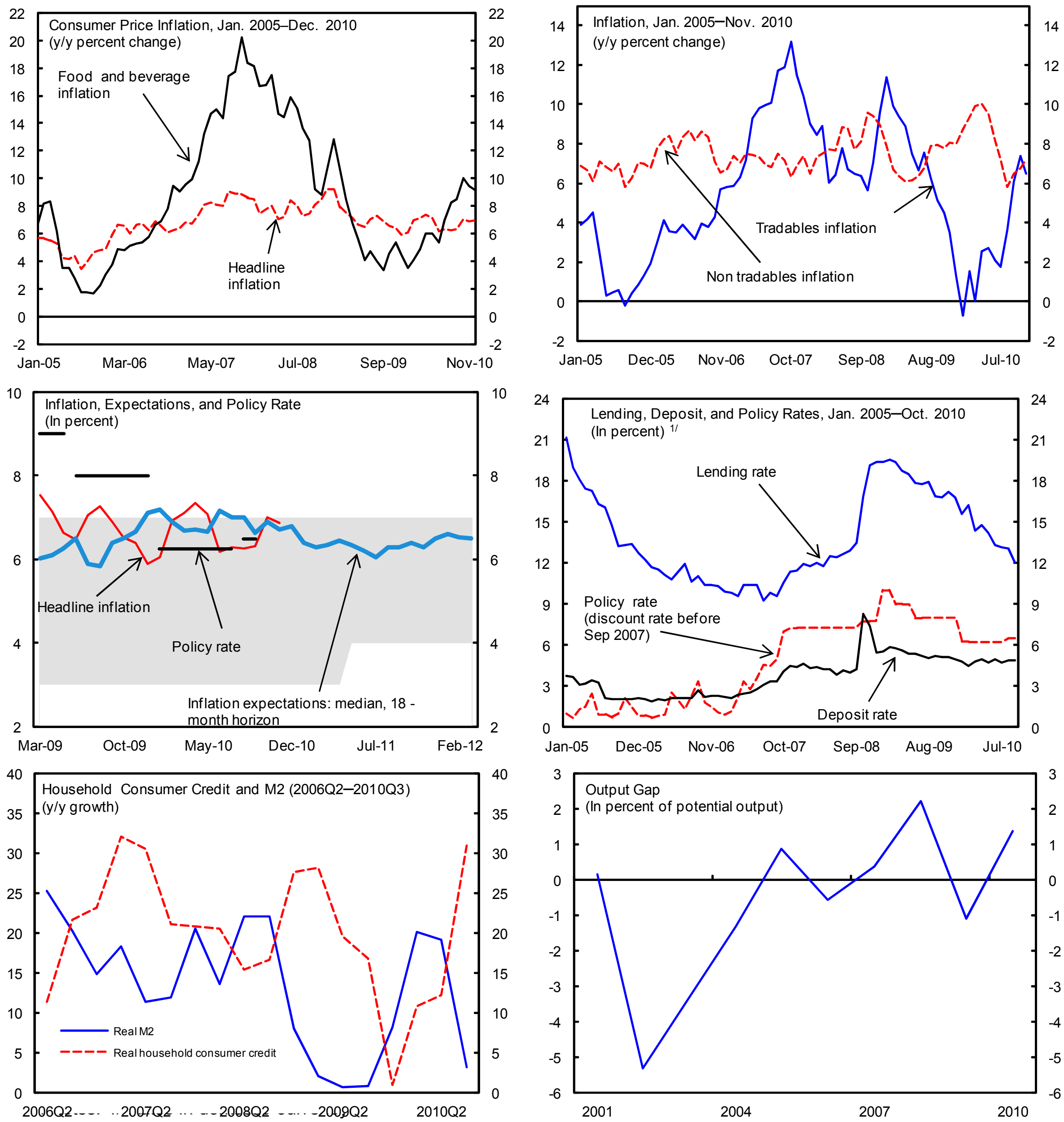
Years of primary surpluses have contributed to a substantial reduction in both public debt and gross public financing requirements with lengthening maturities.



Sources: Banco Central del Uruguay; Ministry of Finance; and IMF staff calculations.

Figure 3. Uruguay: Inflation and Monetary Developments

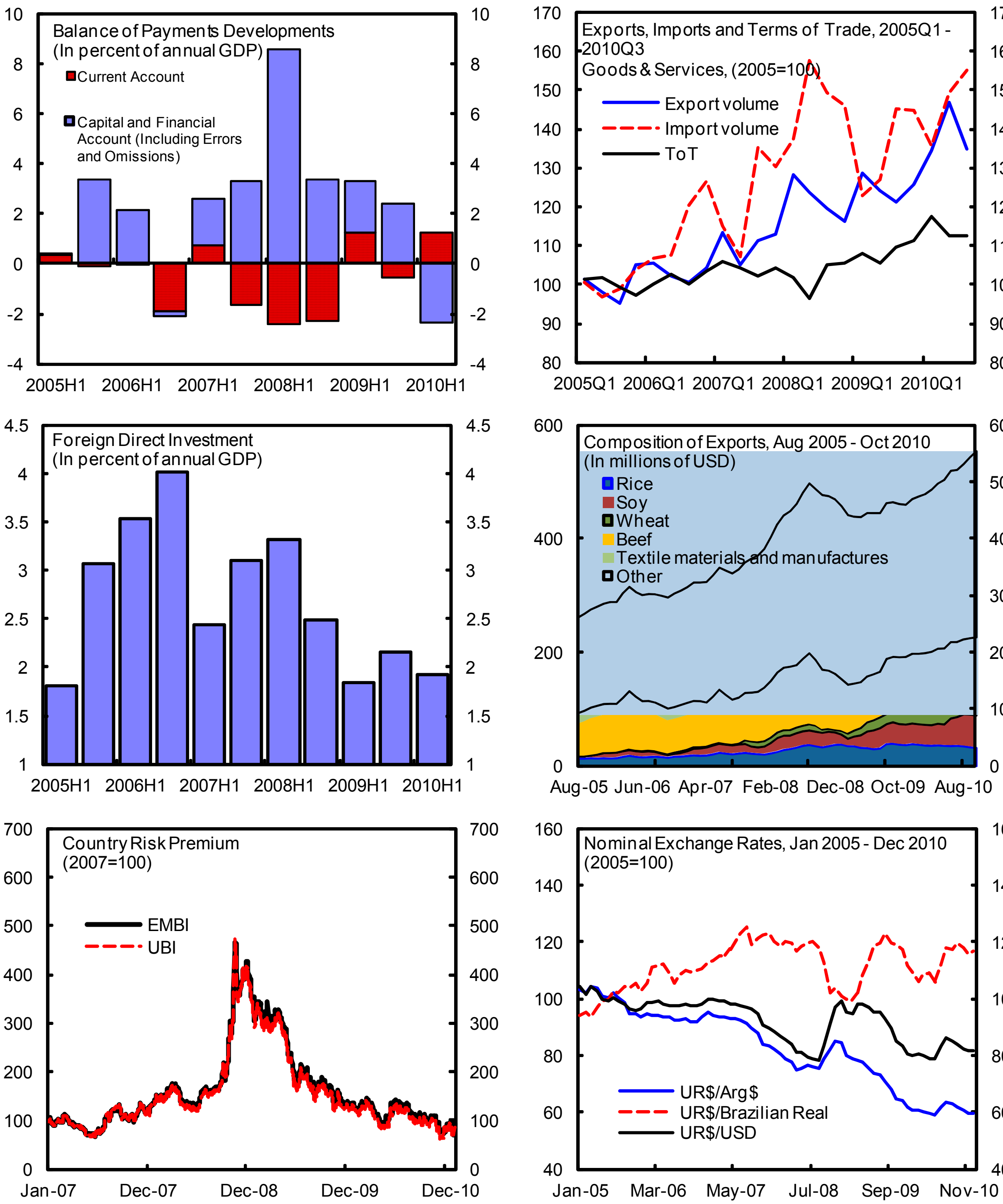
Inflation and inflation expectations have remained at the upper end or above official targets; there are no evident disinflationary pressures going forward.



Sources: Banco Central del Uruguay and IMF staff calculations.
1/ Interest rates in domestic currency.

Figure 4. Uruguay: External Developments

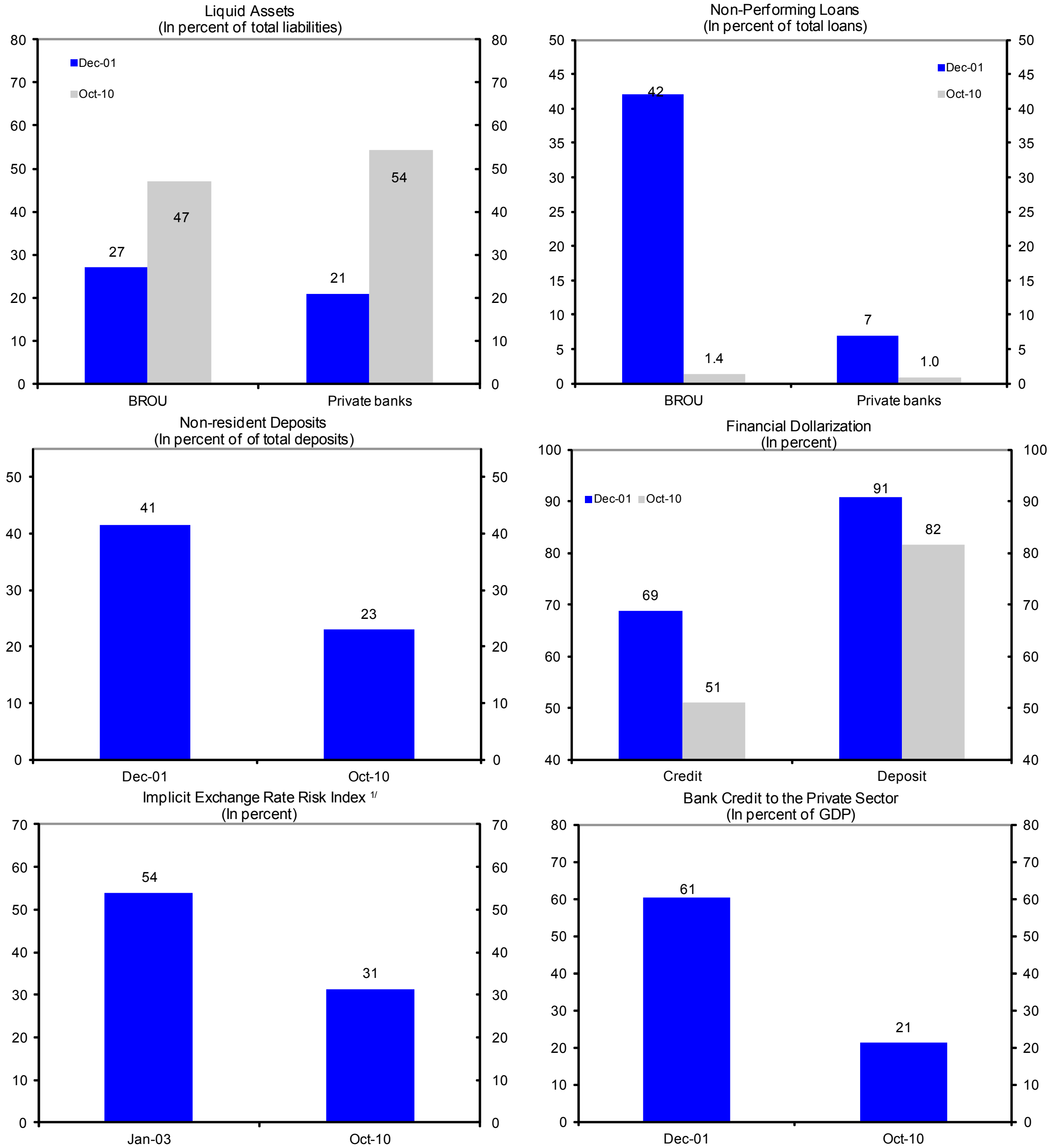
The balance of payments position has remained strong reflecting buoyant exports, resilient terms of trade, a strong tourism season, and substantial FDI inflows.



Sources: Banco Central del Uruguay; IMF World Economic Outlook and IMF staff estimates.

Figure 5. Uruguay: Banking System Indicators

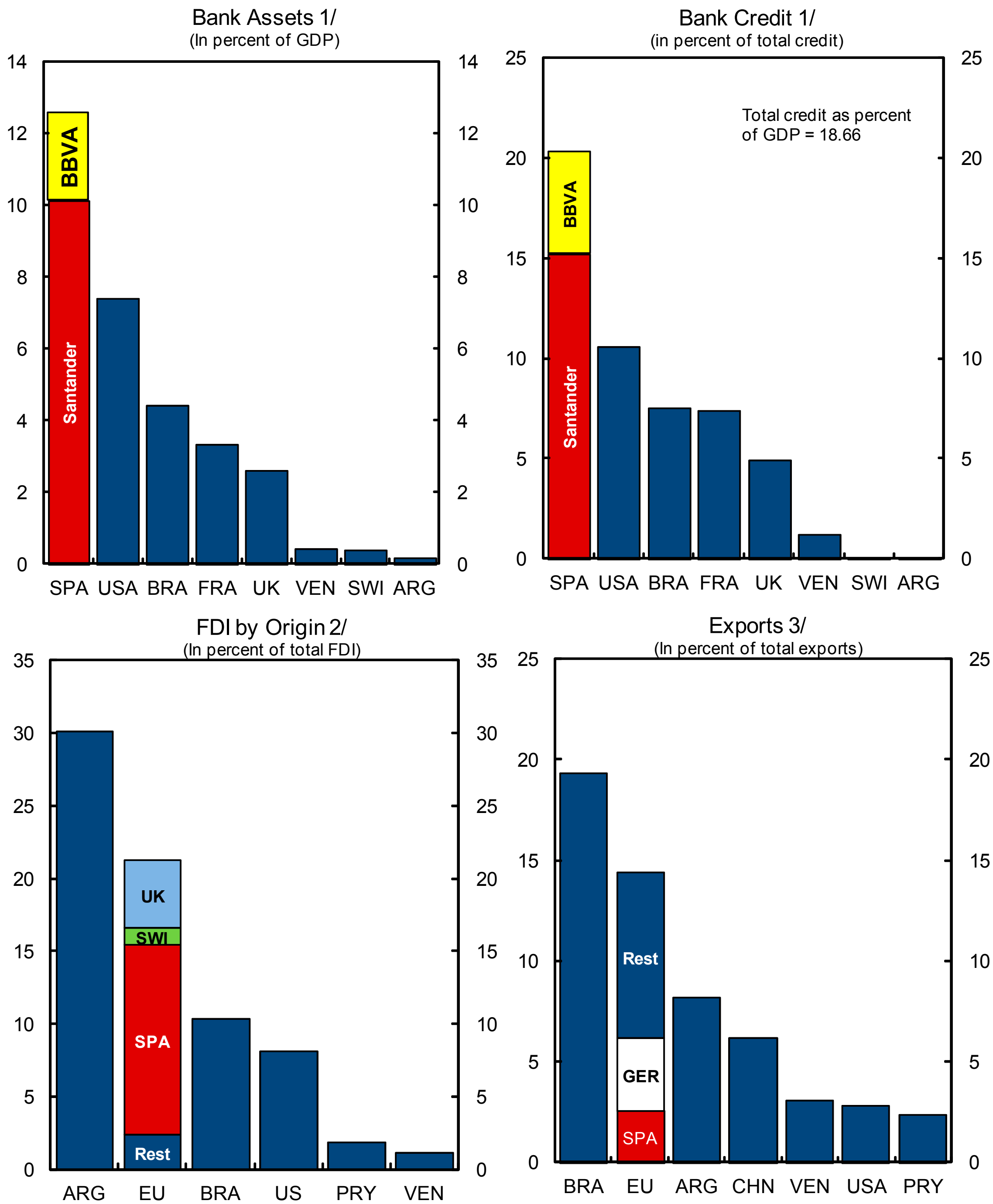
The banking system is highly liquid and well capitalized, NPLs are low, and the share of nonresident deposits is half of what it used to be.



Sources: Banco Central del Uruguay and IMF staff calculations.
1/ Foreign currency credit to the non-tradable sector as a percentage of total credit.

Figure 6. Uruguay: Key Macrofinancial External Linkages

Bank ownership is Uruguay's main economic link to Europe. Exports and FDI inflows are also relevant.



Sources: Banco Central del Uruguay and IMF staff calculations.
1/ BCU Financial Stability Report, second quarter of 2010.
2/ BCU Report on FDI as 2008.
3/ BCU Report on exports as September 2010.

Table 1. Uruguay: Selected Economic and Social Indicators

Latest information available			
Population (estimate for 2009)	3.3	Physicians per 1,000	3.65
		Hospital beds per 1,000	4.4
Life expectancy at birth (years)	75.7		
Crude birth rate (per thousand)	14.9	Access to safe water	
Infant mortality rate (per thousand live births)	12.0	(percent of population)	98.2
Income share held by highest 10 percent of households	n.a.	Adult literacy rate	98
Income share held by lowest 20 percent of households	n.a.	Gross enrollment rate	
Gini coefficient	n.a.	Primary education	113.108
Unemployment rate	6.3	Secondary education	106.944
Poverty rate (2008)	20.5	Tertiary education	41.9919
GDP per capita in 2009 (in US$)	9,426		
Human Development Index Rank (2009 for year 2007)	50 (out of 182)		

						Est.	Projections				
	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015
	(Percent change, unless otherwise specified)										
I. Output, prices, and employment											
Real GDP	6.8	4.3	7.5	8.5	2.9	8.3	5.0	4.2	4.0	4.0	4.0
GDP (US$ billions)	17.4	19.8	24.0	31.2	31.5	41.1	43.7	46.9	50.4	54.2	58.3
GDP deflator	1.3	7.5	9.7	7.0	5.9	7.1	6.8	6.5	6.3	6.1	6.1
CPI inflation (average)	4.7	6.4	8.1	7.9	7.1	6.7	6.6	6.1	6.0	6.0	6.0
CPI inflation (eop)	4.9	6.4	8.5	9.2	5.9	6.9	6.5	6.0	6.0	6.0	6.0
Unemployment (in percent, eop)	12.1	9.1	7.7	6.8	6.3	6.1	6.0	...	...	...	...
II. Monetary indicators 6/											
Base Money (eop)	55.4	10.3	16.4	29.3	6.5	32.3	...	...	...	...	...
M-1	33.5	20.1	29.4	18.6	12.2	29.2	...	...	...	...	...
M-2	26.7	21.7	30.6	17.1	15.0	29.9	...	...	...	...	...
M-3	0.0	11.6	3.8	28.6	-2.6	16.1	...	...	...	...	...
Credit to the private sector (constant exch. rate)	6.3	17.3	22.1	28.0	-7.5	14.1	...	...	...	...	...
	(Percent of GDP, unless otherwise specified)										
III. Public sector operations											
Revenue 1/	28.0	28.0	28.0	26.2	27.7	28.0	28.1	28.4	28.4	28.4	28.4
Non-interest expenditure 1/	24.2	24.6	24.7	25.1	27.0	26.5	26.5	26.5	26.5	26.5	26.4
Primary balance 2/	3.8	3.5	3.4	1.3	1.1	1.8	2.0	2.1	2.1	2.2	2.2
Interest 2/	4.4	4.1	3.4	2.9	2.8	3.0	3.1	3.1	3.0	3.0	2.9
Overall balance 2/	-0.5	-0.5	0.0	-1.5	-1.7	-1.2	-1.1	-1.0	-0.9	-0.8	-0.7
Gross public sector debt	77.6	70.3	63.0	61.6	60.7	54.2	52.3	49.7	47.1	44.6	41.6
IV. Savings and investment											
Gross domestic investment	17.7	19.4	19.4	22.7	17.9	19.3	20.6	21.1	21.4	21.4	21.3
Gross national savings	17.9	17.4	18.4	18.0	18.5	19.8	20.0	19.7	19.5	19.5	19.4
Foreign savings	0.2	-2.0	-0.9	-4.7	0.6	0.5	-0.7	-1.4	-1.9	-1.9	-1.9
V. External indicators											
Merchandise exports, fob (US$ millions)	3,774	4,400	5,100	7,095	6,389	8,098	9,246	9,652	10,395	11,240	12,049
Merchandise imports, fob (US$ millions)	3,753	4,898	5,645	8,810	6,660	8,157	9,929	10,671	11,707	12,599	13,518
Terms of trade (percentage change)	-6.1	1.6	2.3	-1.9	6.6	-0.3	1.1	-0.8	1.4	1.3	1.6
Current account balance	0.2	-2.0	-0.9	-4.7	0.6	0.5	-0.7	-1.4	-1.9	-1.9	-1.9
Foreign direct investment	4.9	7.5	5.6	5.8	4.0	3.2	3.2	3.3	3.3	3.3	3.4
Overall balance of payments (US$ millions)	620	-15	1,005	2,232	1,588	-296	206	211	190	196	198
External debt 4/	63.6	54.3	47.2	44.9	39.1	34.8	34.1	32.9	31.7	30.5	28.7
Of which: External public debt	56.7	47.9	42.8	40.1	35.4	31.9	31.2	30.0	28.8	27.6	25.8
External debt service (percent of exports of goods and services)	40.1	83.6	26.1	19.8	20.2	27.0	17.8	15.8	14.8	14.1	14.5
Gross official reserves (US$ millions) 5/	3,079	3,085	4,124	6,362	8,040	7,744	7,950	8,161	8,351	8,546	8,745
In months of imports of goods and services	6.3	5.5	4.8	9.8	10.1	8.1	7.7	7.2	6.8	6.4	6.4
In percent of short-term debt	137.8	491.2	471.8	797.2	772.3	494.6	586.3	593.1	567.2	553.0	481.5
In percent of short-term debt plus bank non-resident deposits	67.9	101.3	117.2	151.4	162.6	138.3	143.7	139.5	133.2	127.8	119.2

Sources: Data provided by the Uruguayan authorities; and Fund staff estimates.

1/ Non-financial public sector excluding local governments.
2/ Total public sector.
3/ Public sector debt, net of free reserves of the central bank of Uruguay.
4/ Excludes nonresident deposits.
5/ Includes reserve buildup through reserve requirements of resident financial institutions.
6/ October data for 2010.

Table 2. Uruguay: Consolidated Public Sector Operations

(In percent of GDP)

						Est.	Projections				
	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015
Revenues (Non financial public sector) 1/	**28.0**	**28.0**	**28.0**	**26.2**	**27.7**	**28.0**	**28.1**	**28.4**	**28.4**	**28.4**	**28.4**
Central Government	20.9	21.4	20.5	20.0	20.4	19.6	19.5	19.6	19.6	19.6	19.6
Tax revenue	18.9	19.5	18.7	18.5	18.9	18.2	18.1	18.2	18.2	18.2	18.2
DGI	15.9	16.6	16.1	16.6	17.0	16.3	16.3	16.4	16.4	16.4	16.4
IRP	0.8	0.9	0.6	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Public enterprises	1.0	0.7	0.7	0.7	0.9	0.9	0.9	0.9	0.9	0.9	0.9
Foreign trade	1.2	1.3	1.3	1.1	1.0	1.0	0.9	0.9	0.9	0.9	0.9
Non tax revenue	1.9	1.9	1.8	1.6	1.5	1.4	1.4	1.4	1.4	1.4	1.4
Pension Security Bank (BPS)	5.0	5.3	5.1	5.3	6.0	6.2	6.3	6.4	6.4	6.5	6.6
Current surplus of public enterprises	2.1	1.4	2.4	0.8	1.3	2.2	2.3	2.4	2.4	2.3	2.3
Expenditures (Non financial public sector) 1/	**24.2**	**24.6**	**24.7**	**25.1**	**27.0**	**26.5**	**26.5**	**26.5**	**26.5**	**26.5**	**26.4**
Current Expenditure	21.9	22.0	21.9	21.8	23.7	23.2	23.2	23.2	23.2	23.3	23.3
Wages	4.6	4.6	4.5	4.5	5.0	4.8	4.9	4.9	5.0	5.0	5.1
Goods and services	4.0	4.2	4.1	3.7	3.6	3.6	3.6	3.5	3.4	3.4	3.2
Social security benefits	9.1	8.9	8.3	8.1	8.7	8.6	8.6	8.6	8.5	8.4	8.4
Other transfers	4.2	4.3	5.0	5.6	6.4	6.2	6.2	6.2	6.3	6.5	6.5
Capital Expenditure	2.3	2.6	2.9	3.2	3.4	3.3	3.3	3.3	3.3	3.2	3.2
Primary Balance (Local governments)	0.2	0.4	0.2	0.1	0.3	0.2	0.3	0.2	0.2	0.2	0.2
Primary Balance (BSE)	0.1	-0.1	0.2	0.2	0.1	0.1	0.2	0.1	0.1	0.1	0.1
Primary Balance (Non financial public sector)	4.0	3.7	3.6	1.5	1.2	1.9	2.1	2.2	2.1	2.2	2.3
Primary Balance (BCU)	-0.2	-0.2	-0.1	-0.1	-0.1	0.0	-0.1	-0.1	-0.1	-0.1	-0.1
Primary Balance (Public Sector)	**3.9**	**3.5**	**3.4**	**1.4**	**1.1**	**1.8**	**2.0**	**2.1**	**2.1**	**2.2**	**2.2**
Interest payments	4.4	4.1	3.4	2.9	2.8	3.0	3.1	3.1	3.0	3.0	2.9
Overall balance (Public Sector)	**-0.5**	**-0.5**	**0.0**	**-1.5**	**-1.7**	**-1.2**	**-1.1**	**-1.0**	**-0.9**	**-0.8**	**-0.7**

Sources: Data provided by the Uruguayan authorities; and Fund staff estimates and projections.

1/ Excludes local governments.

Table 3. Uruguay: Consolidated Public Sector Operations

(In millions of pesos)

						Est.	Projections				
	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015
Revenues (Non financial public sector) 1/	**118,924**	**133,714**	**157,132**	**170,943**	**197,234**	**230,672**	**260,093**	**290,718**	**321,467**	**354,993**	**391,812**
					1,441						
Central Government	88,734	101,982	115,289	130,751	144,875	161,426	180,635	201,179	222,014	244,801	269,824
Tax revenue	80,487	92,955	105,054	120,560	134,334	149,867	167,675	186,798	206,127	227,268	250,477
DGI	67,585	79,103	90,564	108,731	120,933	134,255	150,725	168,295	185,800	205,061	226,412
IRP	3,285	4,401	3,519		0	0	0	0	0	0	0
Public enterprises	4,423	3,455	3,894	4,727	6,359	7,370	8,263	9,169	10,129	11,179	12,335
Foreign trade	5,195	5,995	7,077	7,103	7,042	8,242	8,688	9,335	10,198	11,028	11,729
Non tax revenue	8,247	9,028	10,234	10,190	10,541	11,559	12,960	14,381	15,887	17,534	19,347
Pension Security Bank (BPS)	21,425	25,155	28,473	34,778	42,922	51,251	58,205	65,135	72,718	81,686	90,397
Current surplus of public enterprises	8,766	6,577	13,370	5,414	9,438	17,995	21,253	24,404	26,734	28,505	31,591
Expenditures (Non financial public sector) 1/	**102,946**	**117,229**	**138,955**	**163,714**	**192,167**	**218,126**	**245,217**	**271,939**	**300,686**	**330,767**	**364,810**
Current Expenditure	93,166	105,009	122,836	142,593	168,187	191,258	214,723	237,794	262,847	290,760	321,079
Wages	19,415	21,790	25,291	29,220	35,470	39,231	45,279	50,244	56,527	62,693	70,217
Goods and services	16,955	20,182	22,870	24,404	25,911	29,814	32,883	35,888	38,976	41,974	44,696
Social security benefits	38,871	42,446	46,579	52,638	61,633	71,066	79,084	87,743	95,902	105,405	116,443
Other transfers	17,926	20,591	28,095	36,330	45,173	51,147	57,477	63,919	71,443	80,688	89,723
Capital Expenditure	9,780	12,220	16,119	21,121	23,980	26,868	30,494	34,145	37,840	40,007	43,731
Central Government	5,521	6,626	8,515	11,572	11,212	12,198	16,171	18,149	20,677	21,879	24,141
Public Enterprises	4,259	5,594	7,604	9,550	12,768	14,670	14,323	15,996	17,163	18,128	19,589
Primary Balance (Local Government)	750	1,726	1,053	925	2,132	1,729	2,648	2,085	2,215	2,350	2,593
Primary Balance (BSE)	392	-668	869	1,549	1,061	987	1,825	1,207	1,282	1,361	1,501
Primary Balance (Non financial public sector)	17,120	17,543	20,099	9,702	8,261	15,262	19,350	22,071	24,277	27,936	31,097
Primary Balance (BCU)	-712	-743	-723	-863	-653	-264	-733	-783	-831	-882	-973
Primary Balance (Public Sector)	**16,408**	**16,801**	**19,376**	**8,839**	**7,608**	**14,998**	**18,616**	**21,288**	**23,446**	**27,054**	**30,123**
Interest payments	18,608	19,356	19,317	18,630	19,808	24,578	28,594	31,540	33,609	37,282	39,939
Overall balance (Public Sector)	**-2,200**	**-2,555**	**58**	**-9,791**	**-12,200**	**-9,580**	**-9,978**	**-10,251**	**-10,163**	**-10,228**	**-9,816**

Sources: Data provided by the Uruguayan authorities; and Fund staff estimates and projections.

1/ Excludes local governments.

Table 4. Uruguay: Summary Accounts of the Banking System
(In millions of U.S. dollars)

	2005	2006	2007	2008	2009	2010 4/
			1. Banco Central del Uruguay			
Net foreign assets	1,269	3,282	5,208	7,034	8,255	8,326
Net international reserves 1/	775	3,085	4,124	6,362	8,040	8,022
Gross international reserves	3,079	3,085	4,124	6,362	8,040	8,022
Reserve liabilities 1/	2,304	0	0	0	0	0
Other net foreign assets	501	198	1,086	674	217	303
Net domestic assets	77	-1,769	-3,263	-4,858	-5,473	-5,580
Net credit to the public sector	2,164	931	-55	1,512	991	1,768
Net credit to the financial system	-1,636	-1,735	-1,799	-3,314	-2,695	-1,658
Credit to the private sector	15	15	15	14	15	14
Securities issued by the BCU	-960	-1,443	-2,564	-2,545	-4,431	-5,911
Other	494	464	1,140	-526	647	208
Peso monetary liabilities	1,346	1,513	1,945	2,176	2,782	2,746
			2. Public and Private Banks 2/			
Net foreign assets	1,969	2,162	2,345	1,722	2,790	5,385
Net domestic assets	5,924	6,522	7,706	9,856	10,922	10,379
Net credit to the public sector	347	317	142	-1	1,222	985
Net credit to the financial system	2,681	2,907	3,352	4,858	5,129	4,755
Credit to the private sector	3,949	4,612	5,968	7,260	7,456	8,346
Other	-1,052	-1,313	-1,756	-2,261	-2,885	-3,707
Liabilities to the private sector (residents)	7,893	8,684	10,051	11,578	13,712	15,764
Public banks	4,244	4,643	5,367	5,978	6,981	7,859
Local currency	873	1,140	1,618	1,751	2,352	2,685
Foreign currency	3,371	3,503	3,749	4,227	4,629	5,174
Private banks	3,649	4,041	4,684	5,599	6,731	7,905
Local currency	607	702	1,122	1,226	1,808	2,079
Foreign currency	3,042	3,338	3,562	4,373	4,923	5,826
			3. Banking System			
Net foreign assets	3,238	5,444	7,552	8,756	11,044	13,710
Net domestic assets	4,748	3,362	2,822	2,501	3,179	2,550
Credit to the public sector	2,511	1,248	87	1,511	2,213	2,753
Credit to the rest of financial system	-208	-220	-67	-953	164	846
Credit to the private sector	3,964	4,626	5,983	7,274	7,471	8,360
Other	-1,518	-2,293	-3,180	-5,331	-6,669	-9,410
Broad money (M3)	7,986	8,806	10,375	11,257	14,224	16,260
			(Percentage change, otherwise indicated)			
Memorandum items (in pesos):						
Base money (end-of-period)	55.4	10.3	16.4	29.3	6.5	32.3
Currency issued	22.0	27.7	11.6	14.8	13.2	18.5
M-1	33.5	20.1	29.4	18.6	12.2	29.2
M-2	26.7	21.7	30.6	17.1	15.0	29.9
M-3	0.0	11.6	3.8	28.6	-2.6	16.1
Credit to private sector (constant exchange rate)	6.3	17.3	22.1	28.0	-7.5	14.1
"Free" international reserves (in millions of US$) 3/	898	899	1,847	2,615	4,882	6,204

Source: Central Bank of Uruguay.

1/ Includes all outstanding liabilities to the IMF, but excludes liabilities to resident financial institutions.

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

3/ Net of liabilities to resident financial institutions.

4/ October data.

Table 5. Uruguay: Balance of Payments and External Sector Indicators

(In millions of U.S. dollars, unless otherwise stated)

					Prel.	Est.	Projections				
	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015
					1. Balance of Payments						
Current account	**42**	**-392**	**-220**	**-1,480**	**178**	**201**	**-291**	**-670**	**-957**	**-1,029**	**-1,100**
Trade balance	21	-499	-545	-1,714	-271	-58	-683	-1,019	-1,312	-1,359	-1,469
Exports, f.o.b.	3,774	4,400	5,100	7,095	6,389	8,098	9,246	9,652	10,395	11,240	12,049
Imports, f.o.b.	3,753	4,898	5,645	8,810	6,660	8,157	9,929	10,671	11,707	12,599	13,518
Of which: Fuel products	865	1,138	1,148	2,504	1,354	1,533	1,912	2,062	2,219	2,411	2,669
Services	372	409	703	822	987	1,128	1,207	1,260	1,299	1,290	1,321
Exports, f.o.b.	1,311	1,387	1,833	2,277	2,121	2,497	2,768	2,998	3,246	3,479	3,729
Imports, f.o.b.	939	979	1,130	1,455	1,134	1,369	1,561	1,738	1,947	2,189	2,408
Income (net)	-494	-428	-516	-736	-678	-1,014	-966	-1,066	-1,103	-1,122	-1,118
Transfers (net)	144	126	137	148	140	145	151	155	159	163	166
Financial and capital account	**752**	**528**	**1,505**	**2,801**	**432**	**-497**	**497**	**881**	**1,148**	**1,224**	**1,298**
Foreign direct investment	847	1,493	1,329	1,809	1,258	1,308	1,417	1,538	1,670	1,813	1,967
Portfolio investment	806	1,686	1,151	-558	-710	-1,266	-1,037	-1,205	-1,349	-1,376	-1,513
Other capital flows (net)	-95	-965	176	992	-826	-1,804	-921	-657	-522	-589	-668
Portfolio investment (net)	806	1,686	1,151	-558	-710	-1,266	…	…	…	…	…
Loans (net)	-144	-549	422	667	1,071	-604	…	…	…	…	…
Deposits (net)	-586	222	-1,595	1,316	-1,673	-1,914	…	…	…	…	…
Other flows, net	-143	-2,339	281	-445	488	1,981	-261	118	450	419	752
Unidentified Financing	-32	8	-86	11	-1	-2	-2	-2	-2	-2	-2
Errors and omissions	-174	-152	-279	911	978	0	0	0	0	0	0
Reserve assets (- increase)	**-620**	**15**	**-1,005**	**-2,232**	**-1,588**	**296**	**-206**	**-211**	**-190**	**-196**	**-198**
					2. Reserve Adequacy and External Indicators						
Gross official reserves (stock)	**3,079**	**3,085**	**4,124**	**6,362**	**8,040**	**7,744**	**7,950**	**8,161**	**8,351**	**8,546**	**8,745**
In months of next year's imports of goods and services	6.3	5.5	4.8	9.8	10.1	8.1	7.7	7.2	6.8	6.4	6.4
In percent of short-term debt	137.8	491.2	471.8	797.2	772.3	494.6	586.3	593.1	567.2	553.0	481.5
					(As percent of GDP)						
Exports of goods	21.7	22.2	21.3	22.8	20.3	19.7	21.2	20.6	20.6	20.7	20.7
Imports of goods	21.6	24.7	23.6	28.3	21.1	19.8	22.7	22.8	23.2	23.2	23.2
Current account	0.2	-2.0	-0.9	-4.7	0.6	0.5	-0.7	-1.4	-1.9	-1.9	-1.9
Financial and capital account	4.3	2.7	6.3	9.0	1.4	-1.2	1.1	1.9	2.3	2.3	2.2
Of which: Foreign direct investment (net)	4.9	7.5	5.6	5.8	4.0	3.2	3.2	3.3	3.3	3.3	3.4
Other capital flows (net)	-0.5	-4.9	0.7	3.2	-2.6	-4.4	-2.1	-1.4	-1.0	-1.1	-1.1
Changes in GIR	-3.6	0.1	-4.2	-7.2	-5.0	0.7	-0.5	-0.4	-0.4	-0.4	-0.3
Total external debt	63.6	54.3	47.2	44.9	39.1	34.8	34.1	32.9	31.7	30.5	28.7
Short-term debt (residual maturity)	12.9	3.2	3.6	2.6	3.3	3.8	3.1	2.9	2.9	2.9	3.1
External public debt	56.7	47.9	42.8	40.1	35.4	31.9	31.2	30.0	28.8	27.6	25.8
Total external debt + NR deposits	76.4	66.7	57.4	57.6	49.9	44.6	43.7	42.4	41.2	40.0	38.2
					(As percent of annual exports of goods and services)						
Total external debt	224.9	182.8	176.5	128.4	165.6	135.6	124.1	122.0	117.2	112.3	106.0
Total external debt (including nonresidential deposits)	270.1	224.6	214.6	164.7	211.5	173.7	158.8	157.3	152.3	147.3	141.0
Debt service	40.1	83.6	26.1	19.8	20.2	27.0	17.8	15.8	14.8	14.1	14.5
Of which: Interest payments	16.2	15.7	12.5	8.9	9.4	8.0	6.9	7.0	6.5	5.8	5.1
					(Annual percent changes)						
Exports of goods (merchandise)	20.0	16.6	15.9	39.1	-10.0	26.8	14.2	4.4	7.7	8.1	7.2
Imports of goods (merchandise)	25.4	30.5	15.2	56.1	-24.4	22.5	21.7	7.5	9.7	7.6	7.3
Export prices in US$ (year-on-year percent change)	5.2	10.3	11.6	22.8	-11.4	9.8	5.7	-0.4	2.0	2.2	2.5
Import prices in US$ (year-on-year percent change)	12.1	8.6	9.0	25.2	-16.9	10.2	4.6	0.4	0.6	1.0	0.9
Terms of trade	-6.1	1.6	2.3	-1.9	6.6	-0.3	1.1	-0.8	1.4	1.3	1.6
Export volume	12.7	3.2	7.4	10.1	2.5	13.4	7.3	5.7	5.7	5.6	4.6
Import volume	10.0	15.3	5.7	21.0	-8.6	10.9	15.4	7.6	9.3	7.3	6.8

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

ANNEX 1. URUGUAY'S EXPERIENCE WITH PROACTIVE DEBT MANAGEMENT

1. ***The origin***. One consequence of the 2002 financial crisis was a rise in the indebtedness of the public sector from 40 percent of GDP in 2000 to 107 percent in 2002 as a result of the large fall in output, the currency depreciation, the fiscal cost of rescuing the banking system, and the substantial fiscal deficits. The increase in debt created sizeable debt service payments and financing requirements over the subsequent five years.

2. ***The response***. The government tackled the debt and financing challenges through actions on several fronts. In addition to major fiscal adjustment, in 2003 the government completed a comprehensive, voluntary debt exchange (which included all foreign currency denominated bonds) that helped smooth the 2003–05 financing needs. Financial support from the Fund and other international institutions also helped overcome the large financing requirements. And in December 2005, the government created a Debt Management Unit in the Ministry of Finance that has undertaken proactive debt management operations.

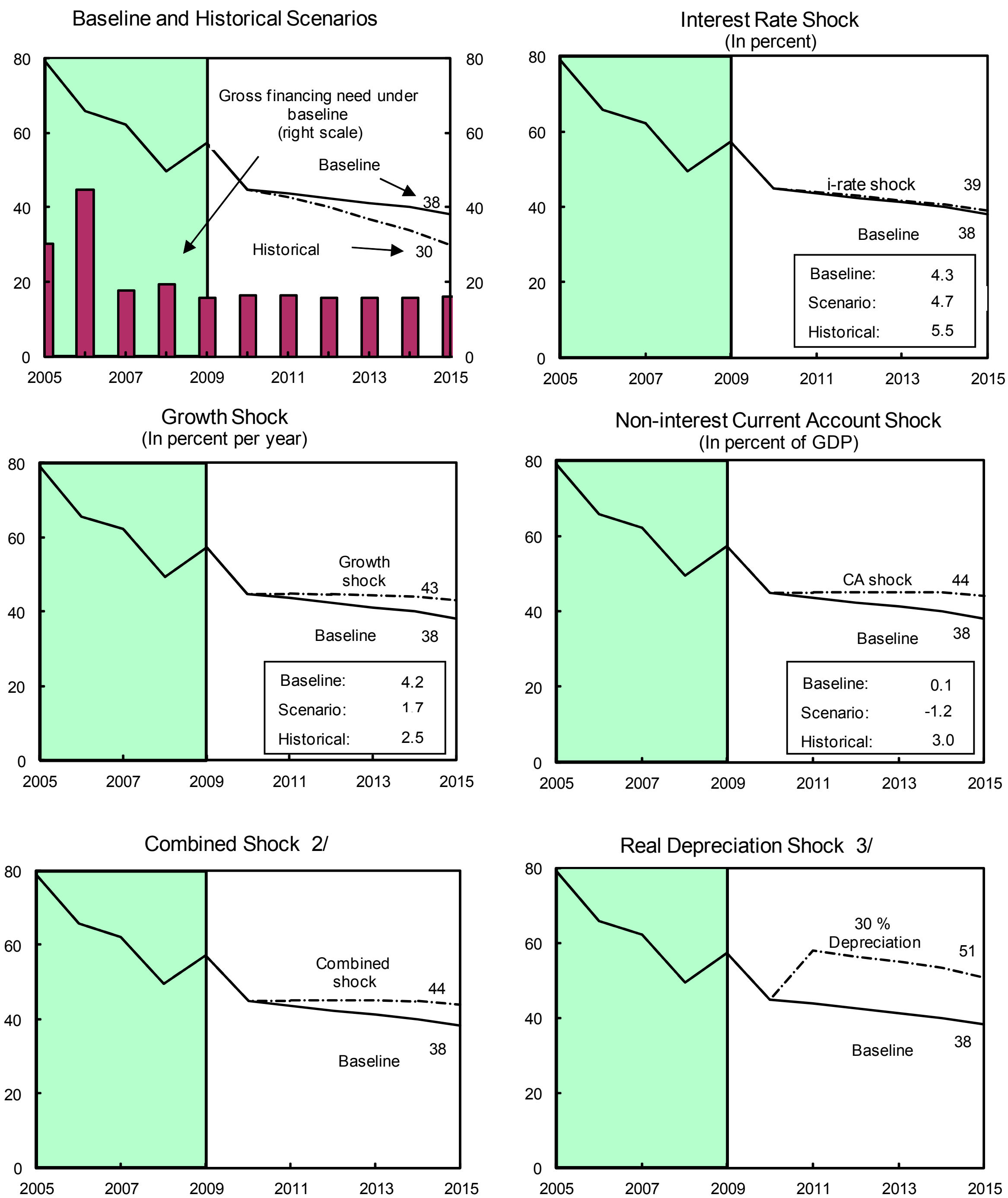
3. ***The result.*** These actions together with strong economic growth and a substantial real exchange appreciation reduced the public debt to 53 percent of GDP in June 2010, improved the debt structure, and strengthened the government's liquidity buffers.

4. ***Debt management operations.*** In 2006–09, the Debt Management Unit took advantage of favorable conditions in the capital markets to improve liquidity buffers, and to reduce roll-over, interest rate, and exchange rate risks. Key operations include:

- ***Liquidity buffers:*** The government used contingent credit lines and an active prefunding policy. At the end of 2009, the central government had built up about $1.5 billion in deposits at the BCU, more than enough to finance the 2010 budget.
- ***Roll-over-risk:*** The government prepaid or bought back about $3.6 billion of short and medium-term debt, issued $6.5 billion in long-term Global Bonds (10–30 year), and contracted loans with multilaterals (average maturity of 17 years). The duration of the debt increased from 4.6 years by the end of 2004 to 10.3 years by end-2009.
- ***Interest rate risk:*** The government issued Global Bonds at fixed interest rates, and changed the floating rate loans with the IADB to fixed-rate loans. By end-2009 only 10 percent of debt was at floating rates, down from 23 percent in 2004.
- ***Exchange rate risk:*** The government has increased the funding in domestic currency. In 2010, it increased the issuance of debt in indexed units with five and ten year maturities. At the end of June 2010, foreign currency denominated debt, though still high, had been reduced to 65 percent of total debt from almost 90 percent in 2004.

ANNEX 2. URUGUAY'S FISCAL AND EXTERNAL DEBT SUSTAINABILITY ANALYSIS

Figure A.1. Uruguay: External Debt Sustainability: Bound Tests 1/
(External debt in percent of GDP)



Sources: International Monetary Fund, Country desk data, and staff estimates.
1/ Shaded areas represent actual data. Individual shocks are permanent one-half standard deviation shocks. Figures in the boxes represent average projections for the respective variables in the baseline and scenario being presented. Ten-year historical average for the variable is also shown.
2/ Permanent 1/4 standard deviation shocks applied to real interest rate, growth rate, and current account balance.
3/ One-time real depreciation of 30 percent occurs in 2010.

Table A.1. Uruguay: External Debt Sustainability Framework, 2005-2015

(In percent of GDP, unless otherwise indicated)

	Actual					Projections						
	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	Debt-stabilizing non-interest current account 6/
Baseline: External debt	**79.1**	**65.6**	**62.1**	**49.5**	**57.1**	**44.8**	**43.7**	**42.4**	**41.2**	**40.0**	**38.2**	**-3.4**
Change in external debt	-23.8	-13.5	-3.5	-12.6	7.6	-12.3	-1.1	-1.2	-1.2	-1.2	-1.8	
Identified external debt-creating flows (4+8+9)	-24.1	-12.1	-13.4	-10.3	-4.1	-5.7	-2.9	-1.9	-1.3	-1.3	-1.2	
Current account deficit, excluding interest payments	-5.0	-2.6	-2.7	2.1	-3.1	-2.6	-1.2	-0.5	0.1	0.3	0.5	
Deficit in balance of goods and services	-2.3	0.5	-0.7	2.9	-2.3	-2.6	-1.2	-0.5	0.0	0.1	0.3	
Exports	29.3	29.2	28.9	30.1	27.0	25.8	27.5	27.0	27.1	27.2	27.1	
Imports	27.0	29.7	28.3	32.9	24.7	23.2	26.3	26.5	27.1	27.3	27.3	
Net non-debt creating capital inflows (negative)	-3.5	-4.5	-3.3	-2.5	-1.9	-1.6	-1.5	-1.6	-1.6	-1.6	-1.6	
Automatic debt dynamics 1/	-15.6	-5.0	-7.5	-9.9	0.9	-1.5	-0.2	0.2	0.2	0.0	-0.1	
Contribution from nominal interest rate	4.7	4.6	3.6	2.7	2.6	2.1	1.9	1.9	1.7	1.6	1.4	
Contribution from real GDP growth	-5.5	-3.0	-4.0	-4.1	-1.4	-3.6	-2.1	-1.7	-1.6	-1.5	-1.5	
Contribution from price and exchange rate changes 2/	-14.8	-6.6	-7.0	-8.5	-0.2	...	...	...	...	...	...	
Residual, incl. change in gross foreign assets (2-3) 3/	0.3	-1.4	9.9	-2.3	11.8	-6.6	1.8	0.7	0.1	0.0	-0.6	
External debt-to-exports ratio (in percent)	270.1	224.6	214.6	164.7	211.5	173.7	158.8	157.3	152.3	147.3	141.0	
Gross external financing need (in billions of US dollars) 4/	**5.3**	**8.9**	**4.2**	**6.0**	**4.9**	**6.8**	**7.2**	**7.3**	**7.9**	**8.5**	**9.3**	
In percent of GDP	30.2	44.7	17.6	19.3	15.7	16.4	16.5	15.6	15.7	15.7	15.9	
Scenario with key variables at their historical averages 5/						**44.8**	**42.6**	**39.9**	**36.8**	**33.7**	**29.9**	**-2.2**
Key Macroeconomic Assumptions Underlying Baseline												
Real GDP growth (in percent)	6.8	4.3	7.5	8.5	2.9	8.3	5.0	4.2	4.0	4.0	4.0	
GDP deflator in US dollars (change in percent)	18.8	9.3	12.6	19.9	-1.7	20.5	1.2	3.0	3.4	3.3	3.5	
Nominal external interest rate (in percent)	5.9	6.6	6.7	5.6	5.2	4.7	4.5	4.7	4.4	4.1	3.7	
Growth of exports (US dollar terms, in percent)	19.5	13.8	19.8	35.2	-9.2	24.5	13.4	5.3	7.8	7.9	7.2	
Growth of imports (US dollar terms, in percent)	24.2	25.2	15.3	51.5	-24.1	22.2	20.6	8.0	10.0	8.3	7.7	
Current account balance, excluding interest payments	5.0	2.6	2.7	-2.1	3.1	2.6	1.2	0.5	-0.1	-0.3	-0.5	
Net non-debt creating capital inflows	3.5	4.5	3.3	2.5	1.9	1.6	1.5	1.6	1.6	1.6	1.6	

1/ Derived as $[r - g - \rho(1+g) + \varepsilon\alpha(1+r)]/(1+g+\rho+g\rho)$ times previous period debt stock, with r = nominal effective interest rate on external debt; ρ = change in domestic GDP deflator in US dollar terms, g = real GDP growth rate, ε = nominal appreciation (increase in dollar value of domestic currency), and α = share of domestic-currency denominated debt in total external debt.

2/ The contribution from price and exchange rate changes is defined as $[-\rho(1+g) + \varepsilon\alpha(1+r)]/(1+g+\rho+g\rho)$ times previous period debt stock. ρ increases with an appreciating domestic currency ($\varepsilon > 0$) and rising inflation (based on GDP deflator).

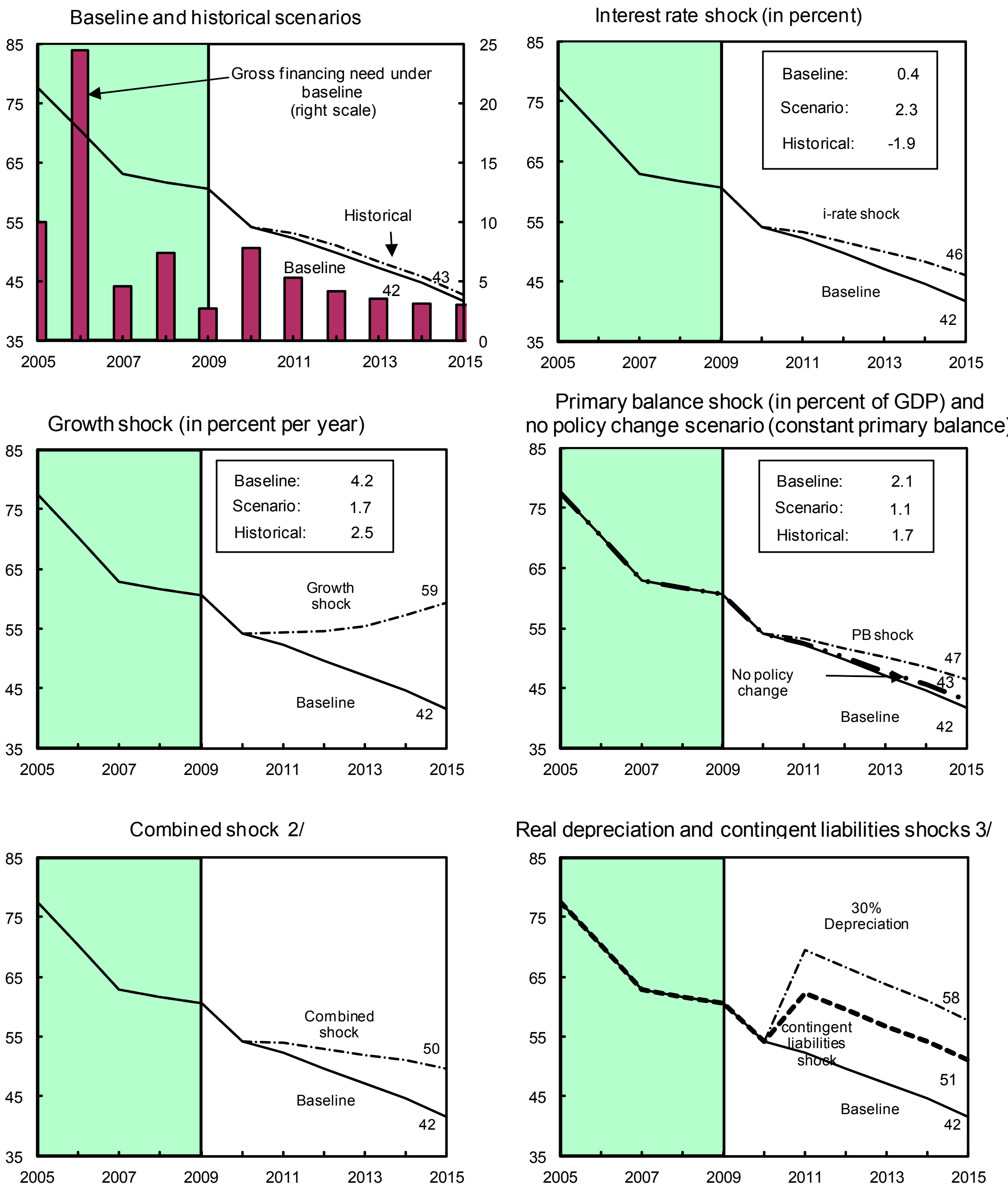
3/ For projection, line includes the impact of price and exchange rate changes.

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

5/ 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.

6/ 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 A.2. Uruguay: Public Debt Sustainability: Bound Tests 1/
(Public debt in percent of GDP)



Sources: International Monetary Fund, country desk data, and staff estimates.

1/ Shaded areas represent actual data. Individual shocks are permanent one-half standard deviation shocks. Figures in the boxes represent average projections for the respective variables in the baseline and scenario being presented. Ten-year historical average for the variable is also shown.

2/ Constant primary balance.

3/ Permanent 1/4 standard deviation shocks applied to real interest rate, growth rate, and primary balance.

4/ One-time real depreciation of 30 percent and 10 percent of GDP shock to contingent liabilities occur in 2010, with real depreciation defined as nominal depreciation (measured by percentage fall in dollar value of local currency) minus domestic inflation (based on GDP deflator).

Table A.2. Uruguay: Public Sector Debt Sustainability Framework, 2005-2015
(In percent of GDP, unless otherwise indicated)

	Actual					Projections						
	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	Debt-stabilizing primary balance 9/
Baseline: Public sector debt 1/	**77.6**	**70.3**	**63.0**	**61.6**	**60.7**	**54.2**	**52.3**	**49.7**	**47.1**	**44.7**	**41.6**	**-0.6**
Of which: Foreign-currency denominated	67.7	57.4	43.7	43.0	39.6	34.9	33.8	32.0	29.9	28.0	25.5	
Change in public sector debt	-12.5	-7.3	-7.4	-1.3	-1.0	-6.5	-1.9	-2.6	-2.6	-2.5	-3.0	
Identified debt-creating flows (4+7+12)	-14.9	-5.7	-16.5	-2.4	-11.3	-7.2	-4.8	-4.2	-3.8	-3.6	-3.5	
Primary deficit	-3.8	-3.5	-3.4	-1.3	-1.1	-1.8	-2.0	-2.1	-2.1	-2.2	-2.2	
Revenue and grants	30.8	31.0	30.7	28.9	30.4	30.7	30.8	31.0	31.0	31.0	31.0	
Primary (noninterest) expenditure	26.9	27.5	27.3	27.6	29.3	28.8	28.8	28.9	29.0	28.9	28.8	
Automatic debt dynamics 2/	-11.1	-2.2	-13.0	-1.0	-10.2	-5.3	-2.8	-2.1	-1.7	-1.4	-1.3	
Contribution from interest rate/growth differential 3/	-2.4	-4.4	-7.3	-5.9	-2.2	-5.3	-2.8	-2.1	-1.7	-1.4	-1.3	
Of which: Contribution from real interest rate	3.2	-1.4	-2.8	-1.3	-0.6	-1.0	-0.3	-0.1	0.0	0.3	0.3	
Contribution from real GDP growth	-5.7	-3.0	-4.5	-4.6	-1.6	-4.3	-2.4	-2.0	-1.8	-1.7	-1.6	
Contribution from exchange rate depreciation 4/	-8.6	2.2	-5.8	4.9	-8.0	...	...	...	...	...	...	
Other identified debt-creating flows	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Privatization receipts (negative)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Recognition of implicit or contingent liabilities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Other (specify, e.g. bank recapitalization)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Residual, including asset changes (2-3) 5/	2.4	-1.5	9.1	1.1	10.3	0.7	2.9	1.6	1.3	1.1	0.5	
Public sector debt-to-revenue ratio 1/	252.4	226.7	204.8	213.1	199.7	176.7	169.6	160.3	151.9	143.9	134.2	
Gross financing need 6/	**10.0**	**24.5**	**4.6**	**7.3**	**2.7**	**7.8**	**5.3**	**4.2**	**3.5**	**3.1**	**3.0**	
in billions of U.S. dollars	1.7	4.8	1.1	2.3	0.8	3.2	2.3	2.0	1.8	1.7	1.7	
Scenario with key variables at their historical averages 7/						**54.2**	**53.2**	**50.9**	**48.4**	**45.8**	**42.7**	**-1.1**
Scenario with no policy change (constant primary balance) in 2010-2015						**54.2**	**52.4**	**50.1**	**47.8**	**45.6**	**43.0**	**-0.6**
Key Macroeconomic and Fiscal Assumptions Underlying Baseline												
Real GDP growth (in percent)	6.8	4.3	7.5	8.5	2.9	8.3	5.0	4.2	4.0	4.0	4.0	
Average nominal interest rate on public debt (in percent) 8/	5.3	5.9	5.8	5.3	4.9	5.7	6.4	6.5	6.6	7.0	7.2	
Average real interest rate (nominal rate minus change in GDP deflator, in percent)	4.0	-1.6	-4.0	-1.8	-0.9	-1.4	-0.4	0.0	0.3	0.9	1.1	
Nominal appreciation (increase in US dollar value of local currency, in percent)	12.4	-3.3	12.7	-10.9	23.6	...	...	...	...	...	...	
Inflation rate (GDP deflator, in percent)	1.3	7.5	9.7	7.0	5.9	7.1	6.8	6.5	6.3	6.1	6.1	
Growth of real primary spending (deflated by GDP deflator, in percent)	9.1	6.6	6.7	9.7	9.2	6.5	4.9	4.6	4.0	3.7	3.9	
Primary deficit	-3.8	-3.5	-3.4	-1.3	-1.1	-1.8	-2.0	-2.1	-2.1	-2.2	-2.2	

1/ Indicate coverage of public sector, e.g., general government or nonfinancial public sector. Also whether net or gross debt is used.

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

3/ The real interest rate contribution is derived from the denominator in footnote 2/ as $r - \pi(1+g)$ and the real growth contribution as -g.

4/ The exchange rate contribution is derived from the numerator in footnote 2/ as $\alpha\varepsilon(1+r)$.

5/ For projections, this line includes exchange rate changes.

6/ Defined as public sector deficit, plus amortization of medium and long-term public sector debt, plus short-term debt at end of previous period.

7/ The key variables include real GDP growth; real interest rate; and primary balance in percent of GDP.

8/ Derived as nominal interest expenditure divided by previous period debt stock.

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

INTERNATIONAL MONETARY FUND

URUGUAY

Staff Report for the 2010 Article IV Consultation—Informational Annex

Prepared by the Staff Representatives for the 2010 Article IV
Consultation with Uruguay

Approved by Rodrigo Valdés and Dominique Desruelle

January 12, 2011

Contents Page

ANNEX 1. FUND RELATIONS
(As of December 31, 2010)

I. Membership Status: Joined: March 11, 1946 — Article VIII

II. General Resources Account:	**SDR Million**	**% Quota**
Quota	306.50	100.00
Fund holdings of currency	243.49	79.44
Reserve Tranche Position	63.02	20.56

III. SDR Department:	**SDR Million**	**% Allocation**
Net cumulative allocation	293.26	100.00
Holdings	245.59	83.75

IV. Outstanding Purchases and Loans: None

V. Latest Financial Arrangements:

Type	Date of Arrangement	Expiration Date	Amount Approved (SDR Million)	Amount Drawn (SDR Million)
Stand-By	Jun 08, 2005	Dec 27, 2006	766.25	263.59
Stand-By	Apr 01, 2002	Mar 31, 2005	1,988.50	1,988.50
Of which: SRF	Jun 25, 2002	Aug 08, 2002	128.70	128.70
Stand-By	May 31, 2000	Mar 31, 2002	150.00	150.00

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

	Forthcoming				
	2010	2011	2012	2013	2014
Principal					
Charges/Interest	0.04	0.15	0.15	0.15	0.15
Total	0.04	0.15	0.15	0.15	0.15

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.

VII. Exchange Rate Arrangement. The currency is the Uruguayan peso (Ur$). Uruguay has followed an independently floating exchange rate regime since July 29, 2002. Since September 2007, monetary policy uses the policy rate, and no longer monetary targets, as intermediate instrument. In 2008, Uruguay's de facto exchange rate regime was reclassified from a managed float with no predetermined path for the exchange rate to a floating exchange rate regime. On December 21, 2010, the exchange rate in the official market was Ur$ 19.95 per US dollar. Uruguay's exchange system is free of restrictions on payments and transfers for current international transactions.

VIII. **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).

IX. **FSAP participation and ROSCs**. The Financial Sector Stability Assessment (FSSA) was considered by the Executive Board on June 28, 2006 (Country Report No. 06/187). The ROSC-module on fiscal transparency was published on March 5, 2001. A ROSC-module on data dissemination practices was published on October 18, 2001. The ROSC on Anti-Money Laundering and Combating the Financing of Terrorism (AML/CFT) was published on December 2006 (Country Report No. 06/435)

X. **Technical Assistance 2007–10**

DPT	**Purpose**	**Date of Delivery**
FAD	Private public partnership	May 2010
	Tax, customs, and social security administration	September 2010 and February 2007
	Resident advisor on social security administration, 1 year	July 2006 to June 2007
LEG	TA to assist the authorities on the elaboration of a risk-based national strategy enhancing the AML/CFT regime	December 2010
	TA to conduct a money laundering/terrorist financing country risk assessment consistent with the objectives of the national AML/CFT strategy	January, April, and July 2009
	TA to develop a framework to elaborate and implement a national AML/CFT strategy consistent with the recommendations of the Fund's 2005 AML/CFT assessment report	February 2007
MCM	Strengthening the formulation and conduct of monetary and exchange rate policies	May 2007
STA	Monetary and financial statistics	November 2007
	Government Finance Statistics, to assist in improving the quality of public debt data	February 2008

XI. **Resident Representative**. Mrs. Maria Gonzalez. The Resident Representative covers Uruguay from the Buenos Aires' office.

ANNEX 2. RELATIONS WITH THE WORLD BANK UNDER JMAP

Title	Products	Provisional timing of Missions	Expected delivery date*
1. Bank work program	**A. Lending** 1. Programmatic Public Sector (DPL) 2. Integrated Agricultural Development and Natural Resources Management Loan 3. OSE APL III 4. Improvement of Primary Education Loan 5. Sustainable Industrial Development Project		September 2010 September 2011 September 2011 September 2011 September 2011
	B. ESW 1. Health Reform Assessment 2. One Laptop per Child Program Evaluation 3. Social Sector Expenditure Review 4. Monitoring Social Policies with the Human Opportunity Index 5. Review of housing policy reform options 6. Mitigation and adaptation to climate change effects in the rural sector 7. Investment Climate Assessment		August 2010 March 2011 TBD June 2011 June 2011 June 2011 July 2011
	C. Technical Assistance 1. Integration of Public Policies on risk management for threats of water origin 2. Infrastructure Railways 3. South-South Collaboration		December 2010 TBD TBD
2. Fund work program	2010 Art IV Consultation Staff visit	December 2010 May 2011	Staff report January 2011
3. Joint work program	Bank's country representative will join the IMF's Article IV Consultation discussions		December 2010

*Delivery date refers to the Board date in lending projects, and to delivery to client in case of AAA.

ANNEX 3. RELATIONS WITH THE INTER-AMERICAN DEVELOPMENT BANK

(As of November 11, 2010)

The Inter- American Development Bank is preparing its new Country Strategy with Uruguay (2011-2015), which is expected to be approved by the Board of Directors at the beginning of 2011. Lending under the new program is expected to reach approximately US$ 1.9 billion. The program will also include additional non reimbursable financing for technical assistance and analytical work. Under the new Strategy, it is expected that the IADB will continue to support the development of productive infrastructure, particularly transportation and energy, as well as human capital investments, particularly in secondary education and targeted social programs, such as INFAMILIA, aimed at improving living conditions and social inclusion of disadvantaged children, adolescents and their families.

The Bank's current Country Strategy, approved in March 2006, supports the Government's policy, which seeks to consolidate growth and improve the population's social welfare. In support of this longer-term goal, the Strategy focuses on the following priority areas: (i) improving public sector management, to increase its efficiency and efficacy, while supporting fiscal and debt sustainability; (ii) enhancing regional and international competitiveness of domestic output and encouraging private investment in order to promote sustainable growth; and (iii) reducing poverty and increasing social inclusion.

The Bank's strategy proposed an original lending scenario of about US$ 1.2 billion for the five-year period 2005–09, which was considered to be consistent with Uruguay's five year budget plan, annual amendments approved by Congress, and the maintenance of a relatively neutral net flow of Bank resources (during this period of concentrated external-IFI maturities). Between 2005 and 2009, 34 loans were approved, adding US$ 1,297 million. This program included lending to support the Government in the key policy areas of competitiveness (17 loans adding US$ 437 MM and representing 34% of the approved amounts), the social sectors and poverty reduction (6 loans adding US$ 490 MM, representing 38% of the approved amounts), and public sector management (11 loans, adding US$ 371 MM; 29% of the approved amounts).

Highlights from 2009 and 2010 lending program include: within the area of competitiveness, additional financing for modernizing the Port of Montevideo approved in November 2009 (US$ 20 million) as well as an investment loan approved in September 2009 (US$ 10.5 million) aimed at improving public administration within the agricultural sector.

In support of the Government's social policy aimed at reducing poverty and social exclusion, the Bank approved in December 2009, a US$ 6 million investment loan to support *Plan Ceibal* (one laptop per child enrolled in primary and secondary public schools), as well as a US $40 million, approved in September 2010, to support the implementation of the National Strategy for Childhood and Adolescence. Another investment loan (US$ 48 million) in support of secondary education is under preparation and expected to be approved in December 2010.

Within the public sector management, a second programmatic operation was approved in April 2009 for US$ 285 million aimed at the modernization of the tax administration system and improving public expenditure; and in December 2009, the Bank approved a US$ 4 million operation in support of institutional strengthening of the Central Bank's supervision of financial services.

As of November, 2010 the Bank's current portfolio in Uruguay includes loans for the financing of 36 projects; two of which are to the private sector without sovereign guarantee. The lending portfolio, aligned to the administration's priorities and consistent with the Bank's Country Strategy, amounts to US$ 1,137.3 million, of which US$ 562.7 million are pending disbursement. Portfolio performance related to investment loans in 2010 is relatively normal and disbursements will total US$ 121.8 million in 2010.

FINANCIAL RELATIONS WITH THE INTER-AMERICAN DEVELOPMENT BANK [1]

(In millions of U.S. dollars)

Total outstanding loans: US$2,268.8 (As of September 30, 2010)

Loan transactions:

	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010p
Disbursements	214.2	558.6	367.2	53.1	242.3	114.8	112.9	337.2	477.3	82.6
Amortization	60.7	73.1	103.7	113.3	220.0	519.6	133.8	138.7	162.0	166.5
Net Loan Flows	**153.5**	**485.5**	**263.6**	**-60.2**	**22.3**	**-404.8**	**-20.9**	**198.5**	**328.8**	**-83.94**

Source: Inter-American Development Bank.

[1] As of November 11, 2010.

[2] IDB staff projection.

ANNEX 4. STATISTICAL ISSUES

As of November 1, 2010

I. Assessment of Data Adequacy for Surveillance
General: Data provision has some shortcomings, but broadly adequate for surveillance. Most affected area is national accounts.
National Accounts: In 2009, the Uruguayan authorities completed a revision of national accounts statistics, in which they updated the benchmark year (from 1983 to 1997 and 2005) and adopted the *System of National Accounts 1993 (SNA93)*. However, national accounts statistics still have a number of shortcomings, limited coverage of the enterprise survey, long publication lags, inadequate information on the informal economy, and incomplete quarterly accounts. The central bank (BCU) compiles and disseminates annual GDP estimates in current and at previous year prices by the production and expenditure approaches, as well as quarterly constant price GDP estimates by the production and expenditure approaches. Gross national income, gross disposable income and gross savings are also available annually.
Consumer prices: Both the consumer and wholesale price indices are reported on a regular and timely basis for publication in the *IFS*. The consumer price index has a base period of March 1997 = 100, and the base of the wholesale price index has been updated to 2001. Coverage of the CPI is limited to the capital city. In 2011, the CPI will have national coverage, a more detailed basket, updated weights, and a base period of 2006=100. Fifty thousand price quotations will be included in the index. Producer price indices (March 2010 =100) for national products were recently disseminated. The authorities do not provide trade price and volume indices for publication in the *International Financial Statistics (IFS)*.
Government finance statistics: Official data on the central administration, the state enterprises and the social security system are complete and current, but there are problems with the timeliness of the data on local governments. There are also problems with the timeliness of financing and debt data reported for inclusion in the Fund's statistical publications. Information on a monthly and quarterly basis for financing and debt data respectively, are disseminated on the BCU website from 1999 onwards for the central government and total public sector, but no information is reported for publication in the *International Financial Statistics*. The information reported for publication in the *Government Finance Statistics Yearbook* covers transactions on revenue and expense for the consolidated central government (data on revenue and expense for local governments have not been reported since 1994), and the general government's operations on financial assets and liabilities, both in terms of flows (financing) and stocks (debt).
Monetary and financial statistics: Monetary and financial statistics are prepared in accordance with the IMF's *Monetary and Financial Statistics Manual (2000).* Authorities report monetary data for the central bank, other depository corporations, and other financial corporations (OFCs) using the standardized reporting forms (SRFs). However, data for the

OFCs are limited to off-shore financial institutions. A mission could be fielded in FY 2012 to expand the institutional coverage of the OFCs and compile the SRF for OFCs with full institutional coverage. Authorities reported Financial Soundness Indicators (FSI) for 2008, but the historical series and updates have not been submitted.	
External sector statistics: Balance of payments statements are compiled and published on a quarterly basis. Data are compiled following the recommendations of the fifth edition of the *Balance of Payments Manual*. Uruguay compiles and reports to STA quarterly data on balance of payments and annual data on the international investment position (IIP) for publication in the *IFS* and the *Balance of Payments Statistics Yearbook*. New surveys are allowing for improved coverage of the private sector in the IIP. Uruguay started disseminating the international reserves and foreign currency liquidity data template on the Fund's external website in 2005. The BCU also disseminates quarterly external debt statistics on its website, although not in the format envisaged by the SDDS.	
II. Data Standards and Quality	
Uruguay subscribed to the SDDS in February 2004 and is in observance.	Data ROSC published on October 1, 2001.
III. Reporting to STA (Optional)	
No data are currently reported to STA for publication in the *Government Finance Statistics* or in the *International Financial Statistics*.	

URUGUAY: COMMON INDICATORS REQUIRED FOR SURVEILLANCE
(As of November 30, 2010)

	Date of latest observation	Date received	Frequency of Data 6/	Frequency of Reporting 6/	Frequency of Publication 6/
Exchange Rates	Nov 29, 2010	11/30/10	D	D	D
International Reserve Assets and Reserve Liabilities of the Monetary Authorities 1	Oct. 2010	11/09/10	M	M	M
Reserve/Base Money	Oct. 2010	11/09/10	M	M	M
Broad Money	Sep. 2010	11/09/10	M	M	M
Central Bank Balance Sheet	Oct. 2010	11/09/10	M	M	M
Consolidated Balance Sheet of the Banking System	Sep. 2010	11/09/10	M	M	M
Interest Rates 2/	Nov 29, 2010	11/30/10	D	D	D
Consumer Price Index	Oct. 2010	11/03/10	M	M	M
Revenue, Expenditure, Balance and Composition of Financing 3/– Central Government	Oct. 2010	11/30/10	M	M	M
Stocks of Central Government and Central Government-Guaranteed Debt 5/	Q2/10	9/30/10	Q	Q	Q
External Current Account Balance	Q2/10	9/30/10	Q	Q	Q
Exports and Imports of Goods and Services	Q2/10	9/30/10	Q	Q	Q
GDP/GNP	Q2/10	9/15/10	Q	Q	Q
Gross External Debt	Q2/10	9/30/10	Q	Q	Q

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/ Daily (D); weekly (W); monthly (M); quarterly (Q); annually (A); irregular (I); and not available (NA).

INTERNATIONAL MONETARY FUND
Public Information Notice
EXTERNAL RELATIONS DEPARTMENT

Public Information Notice (PIN) No. 11/20
FOR IMMEDIATE RELEASE
February 4, 2011

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

IMF Executive Board Concludes 2010 Article IV Consultation with Uruguay

On January 28, 2011, the Executive Board of the International Monetary Fund (IMF) concluded the 2010 Article IV consultation with Uruguay, and considered and endorsed the staff appraisal without a meeting.[1]

Background

Uruguay's growth performance over the last seven years has been very strong. Domestic and external factors have contributed to this economic revival, not least the consistent implementation of important reforms and prudent policies across administrations. Though not immune to the global crisis when it hit emerging markets in 2009, Uruguay's rebound has been quick and robust. In 2010, Uruguay's economy has been booming with vigorous growth in domestic demand and exports in the context of strong growth in partner countries, high commodity prices, ample global liquidity, and low international interest rates. The banking sector is well-capitalized and highly liquid, and nonperforming loans are record low under a regulatory regime in line with international best practices.

Unemployment has fallen to record lows, and inflationary pressures have risen. Headline inflation was 6.9 percent in December, close to the upper end of the current inflation band. Staff's estimate of core inflation (which excludes some food items and administratively set prices) has been edging up and was 7.7 percent. Some sectors are experiencing shortages, in particular for skilled labor. The external current account remained in surplus on the back of buoyant exports, resilient terms of trade, and a bumper tourism season. Economic activity slowed in the third quarter of 2010 and the economy is expected to growth 8–8.5 percent in

[1] Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board. At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities. An explanation of any qualifiers used in summings up can be found here: http://www.imf.org/external/np/sec/misc/qualifiers.htm.

2010 as a whole. In 2011, a continued moderation of the economic activity rate is expected, with growth performing around 5 percent.

The authorities' policy response has sought to balance different tradeoffs. Concerns about the real effective exchange rate appreciation amid external inflows and buoyant demand conditions led to intervention and sterilization operations. The risk of inflation above the target range triggered a policy rate increase in late September, but the rate was left on hold in December.

On fiscal policy, the budget for 2010–14 aims to reduce the level of debt while focusing outlays on infrastructure, education, security, and social programs. Also, the government has taken advantage of external inflows to continue de-dollarize the public debt helping to moderate their impact. Staff projects the public sector primary surplus to improve to 1.8 percent of GDP (from 1.1 percent in 2009) owing to the rebound in the state electricity company's performance following normalization of weather conditions. Despite strong economic growth, there was some worsening in the balance of the central government (reflecting robust growth in real primary expenditures and somewhat sluggish tax revenue).

Executive Board Assessment

In concluding the 2010 Article IV consultation with Uruguay, Executive Directors endorsed staff's appraisal, as follows:

Uruguay's growth performance since the country's own crisis in 2002 has been very strong. Domestic and external factors have contributed to this economic revival, not least the implementation of major reforms (e.g., to financial regulations and supervision, and the tax system) and prudent macroeconomic policies across administrations.

The outlook for the coming years is good, but with challenges. The most immediate challenge is to secure a soft landing of the economy in the context of ample global liquidity, low interest rates, and high commodity prices. At the same time, there is a risk of spillovers from a worse global or regional outlook. The medium-term macroeconomic challenge is to sustain rapid growth with less volatility than in the past.

The macroeconomic policy requirements to deal with these challenges go in the same direction. They involve fiscal and monetary policies to temper domestic demand growth to help steer the economy away from a boom/bust path and create policy space (lower debt and inflation) to respond to future shocks. Given the full employment for skilled labor and slow growth in the labor force, sustaining growth at 4 percent over the longer term is feasible but will require efforts to overcome gaps in infrastructure and in the skills of the labor force. The government's policy agenda reflects these challenges and priorities.

The budget for 2010–14 includes many important improvements. Notably: the focus on reducing the public debt while increasing spending on infrastructure, education, security, and social program, and the creation of the Energy Stabilization Fund. Staff supports the efforts to get a better handle on the costs of tax exemptions, which risk undermining the impressive gains in tax efficiency in recent years. The plan to publish cyclically-adjusted fiscal balances will help improve the budget framework and fiscal policy. Staff suggests more transparent mechanisms for intra-year changes in the budget.

The budget seeks to sustain the fiscal improvement in 2010, but even more ambitious fiscal targets for 2011–14 would be feasible and desirable. The fiscal position is robust. But more conservative fiscal targets for 2011–P14 would better support a soft landing, reduce appreciation pressures, and achieve a faster reduction in the public debt. The fiscal impulse is admittedly difficult to calculate with precision, but this uncertainty together with the state of the cycle and the risks to the outlook reinforce the case to err on the side of caution. This would also include saving cyclical revenue over-performance. Staff cautions against cutting the Value Added Tax (VAT) in the near term. Of course, if growth falters, the more ambitious fiscal targets should be reconsidered so as to allow automatic stabilizers to operate.

The increase in the monetary policy rate last September was a welcome step but a continued tightening is warranted in light of the inflationary pressures. Strong domestic demand and the risk of inflation expectations becoming stuck above official targets call for a continued measured normalization of the monetary stance. The narrowing of the inflation target band in late 2009 was a welcome signal of commitment to inflation but it also raised the stakes for the Central Bank of Uruguay (BCU). Staff suggests that the BCU aim for the middle of the inflation target range to ensure space for countercyclical responses. Further, stability in the target band is important for the targets to serve as an anchor for expectations. Finally, staff would caution against using administrative measures to contain inflation.

The recapitalization of the BCU is welcome although two design features could be improved: ensuring sufficient real cash flow to the BCU and allowing the 30 year bonds to be traded in the secondary market.

There is scope to strengthen the monetary policy framework and its credibility further. A practical step would be to separate clearly the Monetary Policy Committee from the Macroeconomic Coordination Committee in public communications and by de-linking their meeting schedules. The BCU can also strengthen its influence over inflation and inflation expectations through improved communication of the inflation outlook and risks, and how it sees inflation reaching the official targets.

Staff supports the flexible exchange rate and does not consider the real effective exchange rate to be out of line with long-run fundamentals. The BCU's level of international reserves is comfortable and further intervention can be limited and subordinated to the inflation target. Continued pro-active debt management is a good way to absorb capital inflows to improve the public debt structure. A further slowdown in government expenditure would be appropriate if appreciation pressures intensify. And the limits on investments abroad for pension funds could be relaxed.

A well-functioning labor market with prudent wage agreements is essential for maintaining a vibrant economy and avoiding erosion in competitiveness. The reform to take into account sectoral productivity growth in the wage setting framework for the private sector is a welcome step forward.

There are no major vulnerabilities in the financial system at this time. Banks are well-capitalized and highly liquid, and nonperforming loans are at record low. Staff welcomes the extension of the limits on banks' credits to their parent banks and the creation of a Financial Risk Committee to monitor systemic risks. Banks' low profitability remains a concern and calls for efforts to strengthen productivity in the sector. In supervision, the design of the loan-loss provisioning system may need to be modified given the persistently high provisioning of impaired loans. The growing lending by nonbank financial institutions warrants close supervision. Staff welcomes the authorities' readiness to adapt the macro-prudential framework as needed to contain credit growth if the rapid expansion continues unabated.

Staff welcomes the initiatives to boost long-term growth prospects including via Public-Private Partnerships (PPPs). It will be important for the PPP framework to ensure an appropriate balance of risk between the private and public sector, establish limits on the liabilities generated by the PPPs, and ensure their appropriate reporting.

Uruguay: Basic Data

	2005	2006	2007	2008	Prel. 2009	Est. 2010	Proj. 2011
(Annual percent change, unless otherwise specified)							
Real GDP	6.8	4.3	7.5	8.5	2.9	8.3	5.0
Real consumption	5.2	5.9	7.1	8.1	2.0	6.3	7.0
Real investment	4.2	16.8	6.3	27.5	-10.7	12.4	9.7
Prices							
CPI inflation (average)	4.7	6.4	8.1	7.9	7.1	6.7	6.6
CPI inflation (eop)	4.9	6.4	8.5	9.2	5.9	6.9	6.5
Terms of trade	-6.1	1.6	2.3	-1.9	6.6	-0.3	1.1
(In percent of GDP)							
Public sector finances							
Total revenues	28.0	28.0	28.0	26.2	27.7	28.0	28.1
Non-interest expenditure	24.2	24.6	24.7	25.1	27.0	26.5	26.5
Primary balance	3.8	3.5	3.4	1.3	1.1	1.8	2.0
Overall balance	-0.5	-0.5	0.0	-1.5	-1.7	-1.2	1.1
Gross public sector debt	77.6	70.3	63.0	61.6	60.7	54.2	52.3
Of Which: Public external debt	56.7	47.9	42.8	40.1	35.4	31.9	31.2
Annual percent change, unless otherwise specified)							
Money and Credit 1/							
Base Money (eop)	55.4	10.3	16.4	29.3	6.5	32.3	…
M-1	33.5	20.1	29.4	18.6	12.2	29.2	…
M-2	26.7	21.7	30.6	17.1	15.0	29.9	…
M-3	0.0	11.6	3.8	28.6	-2.6	16.1	…
Credit to the private sector (constant exchange rate)	6.3	17.3	22.1	28.0	-7.5	14.1	…
(In percent of GDP, unless otherwise indicated)							
Balance of payments							
Current account balance	0.2	-2.0	-0.9	-4.7	0.6	0.5	-0.7
Merchandise exports, fob	21.7	22.2	21.3	22.8	20.3	19.7	21.2
Merchandise imports, fob	21.6	24.7	23.6	28.3	21.1	19.8	22.7
Services, income, and transfers (net)	2.1	2.1	2.9	2.6	3.1	2.7	2.8
Capital and financial account	4.3	2.7	6.3	9.0	1.4	-1.2	1.1
Foreign direct investment	4.9	7.5	5.6	5.8	4.0	3.2	3.2
Overall balance of payments (In millions of U.S. dollars)	620.3	-15.4	1,005.4	2,232.4	1,588.3	-295.8	206.0
Gross official reserves (In millions of U.S. dollars) 2/	3,079	3,085	4,124	6,362	8,040	7,744	7,950
In percent of short-term debt	137.8	491.2	471.8	797.2	772.3	494.6	586.3
In percent of short-term debt and FX deposits	67.9	101.3	117.2	151.4	162.6	138.3	143.7
Outstanding external debt	63.6	54.3	47.2	44.9	39.1	34.8	34.1
External debt service (percent of exports of goods and services)	40.1	83.6	26.1	19.8	20.2	27.0	17.8

Sources: Data provided by the Uruguayan authorities and IMF staff estimates.
1/ October data for 2010.
2/ Includes reserves buildup through reserve requirements of resident financial institutions.

Uruguay: Document Containing the Authorities' Views
Prepared by the Chair Representing Uruguay at the IMF Executive Board
February 16, 2011

Uruguay's Economy: Another Remarkable Year

After enduring 2009, a difficult year for the region and the world, with positive economic growth –though substantially lower than the average of the past years-, Uruguay exhibited another year of vigorous economic activity in 2010. This was accompanied by a constant decline in the unemployment rate (which is currently the lowest on record), and a prudent increase in real salaries. The latter, together with transparent and well-targeted social policies, have allowed Uruguay to present a significant decline in poverty rates and meaningful progress towards reducing inequality. These developments, once again, clearly demonstrate the strong linkages between economic stability and social achievements. The sustainability of policies and reforms critically relies on a fair distribution of their benefits among the whole society. At the same time, social improvements must be based on sound policies, which tend to generate conditions and resources to promote and sustain those improvements.

Robust and Broad-Based Economic Growth

Exports are exhibiting a notable performance. External sales of goods reveal a considerable diversification in markets (e.g., Mercosur: 32 percent of total external sales; the rest of the Americas: 15 percent; Europe: 23 percent; China: 6 percent) and products. Meanwhile, tourism is flourishing, following a virtuous cycle with estate and hotel developments in the main tourist destinations of the country. Private consumption also presents a robust dynamic in the context of a sound path of credit growth. Investment continues to indicate the attractiveness of Uruguay as a regional investment center and, in this regard, it is worth noting the outstanding increase in foreign direct investment (FDI) in recent years, a trend which has been reinforced by announcements over the last few months related to the set up of huge foreign investment projects.

The Five-Year Budget: Reinforced Economic Stability; Higher Social Expenditures; and Renewed Efforts to Increase Value of Spending

The recently approved five-year Budget perfectly mirrors the authorities' commitment to reinforce economic stability while devoting more resources to social spending. On the latter, the authorities are fully aware that devoting resources is not a sufficient condition to increase the value of public spending, thus the above-referred budget, as well as further policies, will redouble efforts aimed at increasing this value, for instance, by systematically assessing the quality of the programs and the fulfillment of their envisaged results.

The Uruguayan authorities believe that social expenditure is the key instrument in achieving their social objectives and, in this regard, education is the government's key priority. Health and housing are other areas that the authorities have given particular consideration to in the budget, together with the country's considerable infrastructure needs. Precisely, considering the imperious necessity for an important amount of resources, the coexistence with other priorities, and the advantages of undertaking some projects jointly with the private sector, the authorities will reinforce the use of Public-Private Partnerships (PPPs) for which they are progressing in setting up a solid legal, institutional and managerial framework in line with the best international practices.

Meanwhile, the budget establishes a gradual decline in the overall fiscal deficit from the current 1.2 percent of GDP—an outstanding figure these days in the world economy—to 0.7 percent in 2015, which will drive the public debt-to-GDP ratio to 40 percent by that year.

Public Revenues: Reaping the Fruits of Years of Reforms

Five years ago, Uruguay implemented bold reforms in its tax system and revenue administration. Admittedly, when these changes were planned and first established, the envisaged results could have been regarded as too optimistic. However, the authorities' strong commitment to the reforms, together with the substantial efforts from the revenue administrations (DGI and BPS), has obtained notable results. The fact that tax evasion decreased 17 percentage points, from 32 percent in 2004 to 15 percent in 2009, and the significant efficiency gains speak for themselves on the implication of the changes. Nonetheless, perhaps even more important than figures is the reinforcement among the Uruguayan population of the tax compliance culture, which involves a long-term facet in a country. Furthermore, once again, public revenues in 2010 have shown a very satisfactory performance.

In the meantime, the Uruguayan authorities have repeatedly emphasized that any decision on taxes will be established in the context of additional revenue efficiency gains and, as usual, fully verifying the coherence of measures relative to the tax system's pillars and their consistency with the government's synergetic objectives of economic stability, promoting investment, and social improvements.

Public Debt: Deepening Trends

In recent years, the gross public sector debt-to-GDP ratio has substantially decreased, which has been accompanied with a crucial transformation in Uruguay's debt structure. In this respect, it is worth underlining the sizeable extension of the debt average maturity—stretching out to 12 years—the ample decrease of its de-dollarization—debt denominated in domestic currency and indexed units (Unidades Indexadas, linked to CPI) increased to 40 percent, very close to the authorities' target of 45 percent envisaged for 2015—and the fact that most of the debt is at fixed rates. These trends have been deepened with the successful debt operation carried out a few weeks ago, when the central government issued notes denominated in local currency and indexed units, which was mostly acquired with debt already issued by the central bank with a shorter maturity; as summarized by the Uruguayan authorities, "urgencies have been vanishing, while certainties consolidating".

Credit rating agencies have continued to upgrade Uruguay's debt; the most recent was Moody's, raising Uruguay's debt to one notch below investment grade. It is interesting to note that Uruguay's sovereign spreads are around 152 basis points (data as of end-January of this year), which is within a range of 30 basis points observed for Brazil, Colombia, Mexico, Peru and Uruguay) and below sovereign spreads in many advanced economies. Perhaps, once again, credit ratings are somewhat behind developments in countries and markets.

Monetary Policies: Clear Objectives to Face Global Challenges

As in many emerging countries around the world, and particularly in the region, the Central Bank of Uruguay has to deal with challenges stemming from the substantial pick up in commodity prices worldwide, and the accommodative monetary policy stance observed in advanced economies. Admittedly, some factors can temporarily deviate inflation figures from the target range, but this system should be seen with an appropriate perspective and, in this regard, the central bank has reiterated its strong commitment to the overriding objective of maintaining low and stable inflation rates, and will continue to act consistently.

Of course, in a context of a floating exchange rate system, the authorities are closely following developments in the exchange market in order to smooth volatility and movements that could hurt competitiveness in the short term. The authorities have taken advantage of the international financial conditions to accumulate a considerable amount of international reserves which, according to the staff report, is at a comfortable level, although downside risks still observed in the global economy merit a cautious approach in this regard.

Sound Prudential Framework and Governance as the Basis of a Healthy and Dynamic Financial System

Uruguay's financial system has experienced critical reforms over the past years, and their results have been noticeably observed, especially during this global financial crisis. Among the structural changes in the system, it is worth noting the significant transformation in the governance of BROU and BHU and, consequently, their incentives, functioning, and performance; a very efficient regulation and supervision framework (including some innovative aspects as the dynamic provisioning system); and a strengthened structure of the system as a whole. As also mentioned in the staff report, the banking system is highly liquid and well-capitalized and non-performing loans are at very low levels (about 1 percent). The banking system's relatively low profitability may be seen, to some extent, as the other side of the coin. However, the adaptation of the banks to the current global market conditions—particularly low international interest rates—the fact that the credit intermediation in Uruguay is still low compared to regional and international benchmarks, as well as the positive perspectives offered by the Uruguayan economy and its investment climate, lead to infer that the system's profitability will continue to improve. The authorities consider that the sound prudential framework, which, if needed, could be subject to further adjustments, establishes a sound basis for healthy and profitable developments in the financial system.

Meanwhile, the authorities have underscored the importance of enhancing financial inclusiveness as a way to keep increasing formal economy and to facilitate access to financial services to individuals, as well as small and medium-sized businesses—the lack of its access frequently constitutes an important constraint to enhance the population's opportunities.

Conclusions: Significant Achievements but also Sizeable Challenges

Uruguay is facing a positive period based on prudent economic policies and structural reforms, which is supported by a favorable external environment. Policies and reforms together with Uruguay's sound institutions, political maturity, and social values have critically contributed to promoting economic stability, attracting investment, creating genuine employment, and increasing the population's real income. Consequently, considerable social achievements have been made. Beyond these achievements, much remains to be done. The authorities are fully aware of the challenges posed by the current global economic situation and the country's positive cycle. Commodity prices are increasing, generating inflationary pressures worldwide, particularly in emerging and low-income countries; capital inflows will likely persist or even deepen in the short term, although the low level of interest rates will not last indefinitely. At the same time, envisaged economic and social objectives give rise to the need to address some considerable shortfalls (for instance, in education and infrastructure), and the government is committed to dedicating high amounts of resources and efforts in this regard. The authorities firmly believe that this positive period constitutes an historic opportunity to critically heighten Uruguay's economy and society in a sustainable manner and are fully encouraged to achieve it.