INTERNATIONAL MONETARY FUND

IMF Country Report No. 23/178

URUGUAY

May 2023

2023 ARTICLE IV CONSULTATION—PRESS RELEASE; STAFF REPORT; AND STATEMENT BY THE EXECUTIVE DIRECTOR FOR URUGUAY

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of the 2023 Article IV consultation with, the following documents have been released and are included in this package:

- A **Press Release** summarizing the views of the Executive Board as expressed during its May 15, 2023, consideration of the staff report that concluded the Article IV consultation with Uruguay.
- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on May 15, 2023, following discussions that ended on March 17, 2023, 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 April 26, 2023.
- An **Informational Annex** prepared by the IMF staff.
- A **Statement by the Executive Director** for Uruguay.

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

Selected Issues

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

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International Monetary Fund
Washington, D.C.

IMF Executive Board Concludes 2023 Article IV Consultation with Uruguay

FOR IMMEDIATE RELEASE

Washington, DC – **May 17, 2023:** The Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation[1] with Uruguay on May 15, 2023.

After reaching pre-pandemic levels in mid-2021, real GDP grew by 4.9 percent in 2022 mainly driven by strong commodity exports and the service sector, including tourism. However, the economy decelerated in the second half of the year due to adverse external conditions and the effects of the most severe drought in forty years. Inflation remained above the target range in 2022 but, after peaking in September 2022 at 9.95 percent, it started to decline towards the end of the year, reaching 7.3 percent in March 2023.

In response to increased inflationary pressures, the Banco Central del Uruguay (BCU) appropriately tightened monetary policy during 2022. The BCU markedly raised the policy rate from 5.75 percent in December 2021 to 11.5 percent in December 2022. The BCU implemented an interest rate cut of 25 basis points in its April 2023 meeting, citing declining inflationary pressures. The fiscal deficit and government debt declined substantially over the last two years, reflecting the authorities' efforts to stay within the targets of the fiscal rule, while protecting the most vulnerable. After peaking at 68.1 percent of GDP in 2020, gross non-financial public sector (NFPS) debt reached 59.3 percent of GDP at the end of 2022, below its pre-pandemic level amid historically low sovereign spreads. The health of the financial sector remains sound, and banks have weathered the pandemic well.

The economy is expected to decelerate in 2023, with real GDP growth projected at 2 percent. Despite external headwinds, tighter financial conditions, and the impact of the drought, growth would be supported by a strong tourism season, increased cellulose production and exports, and robust private consumption as real wages recover. The growth outlook after 2023 is positive, but subject to external and domestic risks. Main macroeconomic risks are derived from a worsening of external financial conditions, deterioration of international geopolitical tensions, and the impact of the drought. Inflation is expected to decline to 7 percent in 2023 and fall within the target range in 2024. The authorities' strong track record of implementing sound macroeconomic policies in a challenging environment has improved the country's resilience to shocks. Overall fiscal risks are low.

Executive Board Assessment[2]

Executive Directors commended Uruguay's robust institutions and sound policies, which have supported the economy's resilience to shocks. Directors noted that the outlook, while positive,

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[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.

[2] At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities. An explanation of any qualifiers used in summings up can be found here: http://www.IMF.org/external/np/sec/misc/qualifiers.htm.

is subject to downside risks, including related to the current drought. They emphasized the need to consolidate progress made in upgrading the fiscal, monetary, and financial frameworks and continue with ambitious structural reforms to maintain Uruguay's strong resilience and support sustainable and inclusive growth.

Directors commended the authorities for meeting the fiscal rule targets for three consecutive years despite a challenging economic environment and concurred that the fiscal framework has strengthened policy credibility. They emphasized that continued strong compliance with the current fiscal rule is the priority in the current juncture. At the same time, many Directors considered that a more explicit debt objective could be a useful component of a medium-term fiscal strategy.

Directors agreed that a modest fiscal impulse is appropriate in 2023 and encouraged measures to put the debt on a downward path once the effect of the drought abates. They recommended measures to further rationalize tax expenditures, improve the targeting of subsidies, and reduce the wage bill, while continuing to take steps to preserve social cohesion. Directors also welcomed the recently approved pension reform, which should help to stabilize long-term pension spending.

Directors emphasized the need to maintain a tight monetary stance until price pressures and inflation expectations converge to the target band. They highlighted that this along with efforts to strengthen de jure central bank independence would help to further strengthen monetary policy credibility and support efforts to reduce dollarization. Directors agreed that the exchange rate should continue to act as a shock absorber and that FX interventions should be limited to responding to disorderly market conditions.

Directors welcomed that the financial sector remains resilient and healthy. They indicated that efforts to further enhance financial supervision are essential to bolster resilience to shocks and improve confidence in the financial system. Directors also encouraged steps to promote domestic capital market development and encouraged continued progress in implementing the recent FSAP recommendations and toward creating a comprehensive AML/CFT national plan.

Directors noted that structural reforms remain critical to improve productivity and reinvigorate growth. They welcomed the recent reforms in the education system and indicated the need for further efforts to address long-standing human capital erosion and skill gaps. Directors also supported efforts to improve the efficiency and productivity of state-owned enterprises and enhance trade integration.

Directors commended Uruguay's leadership in climate change policy and recognized the authorities' efforts to integrate climate policies into their overall policy agenda, noting the successful issuance of a Sovereign Sustainability-Linked Bond. They recognized the significant progress in reducing greenhouse gas emissions intensity and encouraged the authorities to continue their efforts to transform Uruguay into a climate-resilient, green, and sustainable economy.

Uruguay: Selected Economic Indicators

			Projections	
	2021	2022	2023	2024
Output, prices, and employment				
Real GDP (percent change)	5.3	4.9	2.0	3.0
GDP (US$ billions)	61.4	71.2	76.5	80.5
Unemployment (in percent, pa)	9.4	7.9	8.2	8.1
Output gap (percent of potential output)	-2.0	-0.4	-0.6	-0.2
CPI inflation (in percent, end of period))	8.0	8.3	7.0	5.7
	(Percent change, unless otherwise specified)			
Monetary and banking indicators 1/				
Base money	9.1	1.7	...	...
M2	16.2	1.7	...	...
Growth of credit to households (in real pesos)	4.4	6.4	...	...
Growth of credit to firms (in US$)	7.0	19.1	...	...
Bank assets (in percent of GDP)	74.2	67.1	...	...
Private credit (in percent of GDP) 2/	27.0	26.1	...	...
	(Percent of GDP, unless otherwise specified)			
Fiscal sector indicators 3/				
Revenue CG-BPS (A)	27.0	27.1	26.1	26.5
excluding *cincuentones*	26.7	27.0	26.1	26.5
Primary expenditure CG-BPS (B)	27.9	27.8	27.3	27.5
Primary balance of local governments (C)	0.1	0.1	0.1	0.1
Primary balance of BSE (D)	0.1	0.0	0.2	0.2
Primary balance NFPS (A-B+C+D)	-0.6	-0.5	-1.0	-0.7
excluding *cincuentones* 4/	-0.9	-0.6	-1.0	-0.7
Interest NFPS	2.0	2.0	1.9	2.0
Overall balance NFPS	-2.6	-2.5	-2.9	-2.7
excluding *cincuentones* 4/	-3.0	-2.7	-3.0	-2.8
Gross debt NFPS	63.4	59.3	61.6	61.9
Net debt NFPS	53.3	50.5	52.9	53.3
External indicators				
Merchandise exports, fob (US$ billions)	15.7	17.2	15.5	16.6
Merchandise imports, fob (US$ billions)	11.2	13.6	13.3	14.5
Terms of trade (percent change)	1.9	-4.7	1.0	0.7
Current account balance	-2.5	-3.2	-3.2	-3.0
Total external debt + non-resident deposits	79.4	78.0	79.1	77.4
Of which: External public debt	34.7	29.1	33.6	32.4
External debt service (in percent of exports of g&s)	57.7	53.7	61.8	52.7
Gross official reserves (US$ billions)	17.0	15.1	16.1	16.3
In months of imports of goods and services	13.7	9.7	10.4	9.8
In percent of:				
Short-term external (STE) debt	221	169	221	215
STE debt plus banks' non-resident deposits	298	265	249	243

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

INTERNATIONAL MONETARY FUND

URUGUAY

STAFF REPORT FOR THE 2023 ARTICLE IV CONSULTATION

April 26, 2023

KEY ISSUES

Context. Uruguay showed strong resilience during the Covid-19 pandemic, owing to its high institutional quality, strong governance, and the authorities' policy responses. Scarring effects in real activity and the labor market were mitigated somewhat by the authorities' well-targeted responses. The authorities' strong track record of implementing sound macroeconomic policies in a challenging environment has improved the country's resilience to shocks. Since September 2022, the country is undergoing the most severe drought in forty years.

Recent Developments. After reaching pre-pandemic levels in mid-2021, real GDP grew at a healthy pace in the first half of 2022, but due to the drought and adverse external conditions, growth turned negative in the second half. Russia's war in Ukraine had a limited direct impact due to small trade links, but agricultural exports benefited from increased demand and global prices. Inflation remained above the target range in 2022. In response, the Banco Central del Uruguay (BCU) appropriately tightened monetary policy, while the peso appreciated. The fiscal deficit and government debt declined substantially over the last two years, reflecting the authorities' efforts to stay within the targets of the fiscal rule, while protecting the most vulnerable.

Outlook and Risks. The economy is expected to decelerate in 2023. Despite external headwinds, tighter financial conditions, and the impact of the drought, growth would be supported by a strong tourism season, increased cellulose production and exports, and robust private consumption as real wages recover. The growth outlook after 2023 is positive, but subject to external and domestic risks. Overall fiscal risks are low. Near-term fiscal risks appear limited as maturities are long, liquidity buffers are adequate and market access remains at favorable terms, while medium-term risks are moderate.

Policy Issues. Fiscal policy plans are appropriate for 2023. After the effect of the drought abates, additional fiscal efforts would be needed to put debt on a firm downward path and rebuild policy space. The tight monetary policy stance is appropriate and should be maintained until inflation and inflation expectations have converged to the target range in a sustained manner. The exchange rate should continue to act as a shock absorber with FX interventions limited to respond to disorderly market conditions.

Approved By
Patricia Alonso-Gamo (WHD) and Anna Ilyina (SPR)

Discussions took place in Montevideo during March 6-17, 2023. The staff team comprised Pau Rabanal (head), Jean François Clevy, Chiara Fratto, and M. Belén Sbrancia (all WHD), and Ivo Krznar (MCM). Patricia Alonso-Gamo (WHD) attended the concluding meetings. Mauricio Vargas (WHD) provided analytical support from headquarters, and Jesús Sánchez (WHD) provided research assistance. Inés Bustillo (OED) attended key meetings. Staff met with Minister of Economy and Finance Arbeleche, Central Bank President Labat, Minister of Labor Mieres, Minister of Industry Paganini, Minister of Environment Bouvier, Director of the Office of Planning and Budget Alfie, other senior government officials, as well as representatives of state-owned enterprises, labor unions, the private sector, academia, and political leaders.

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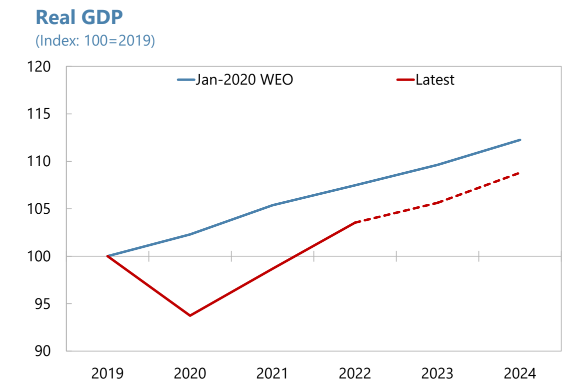
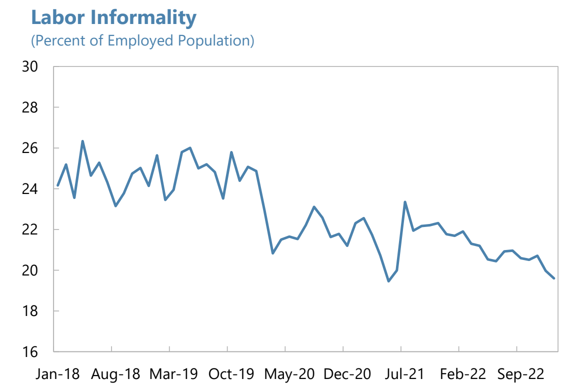
CONTEXT

1. **Uruguay showed strong resilience during the Covid-19 pandemic, owing to its high institutional quality, strong governance, and the authorities' policy responses.** Thanks to its robust institutions and adequate social safety net, Uruguay was able to provide a highly effective response to the health emergency triggered by the Covid-19 pandemic. After two severe infection waves in 2021, containment measures were subsequently relaxed and mobility indicators returned to pre-pandemic levels in mid-2022, supported by highly effective vaccination campaigns, including for boosters. Scarring effects in real activity and the labor market were somewhat mitigated by the authorities' well-targeted responses. Labor market informality declined during the pandemic and has remained at a lower level.



Sources: IMF WEO and staff calculations.



Sources: Uruguayan authorities and IMF staff calculations.

2. **The authorities' strong track record of implementing sound macroeconomic policies in a challenging environment has improved the country's resilience to shocks.** Uruguay has maintained favorable market access and enjoys historically low spreads despite the succession of unfavorable shocks. Progress made since 2020 on the fiscal framework, including a solid track record of achieving the fiscal rule targets and the creation of the Fiscal Council, strengthened the credibility on the authorities' commitment to fiscal prudence. Improvements to the monetary policy framework should enhance the transmission channels of monetary policy, while helping reduce dollarization overtime. The government's reform agenda gained momentum following a positive vote in the referendum called on the "*Ley de Urgente Consideración*" in March 2022.[1] Consolidating these gains should be an important priority, as they place the country in a more favorable position to address external risks.

3. **Since September 2022, the country is undergoing the most severe drought in forty years.** The average rainfall in the summer of 2022-23 was about 64 percent lower than the historical average (see Box 1). The drought has impacted most agricultural production, including soybean and cattle farming, which altogether account for almost 40 percent of goods export value. According to data from the Ministry of Agriculture, as of January 2023, soybean cultivated areas suffered a 26

[1] Law of Urgent Consideration: see IMF Country Report 22/16 for more details.

percent loss in yield when compared to its historical average. Livestock has been impacted by weight loss and lower calving rate with potential long-lasting effects.

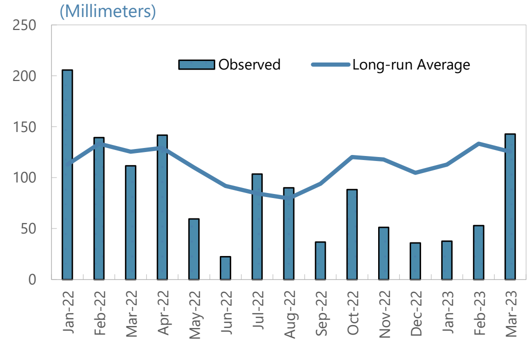
Box 1. Impact of the Drought

Since September 2022, Uruguay is experiencing the most severe drought in the last forty years. With precipitations 64 percent below the historical average and temperatures about 1.4°C above the historical average, the 2022-2023 summer season was the driest and the second hottest in the last 42 years.[1]

The agricultural sector has been severely affected, with a significant negative impact in production and exports. The drought mostly affected soybean production and cattle farming, reduced cattle livestock and increased the cost of foraging. Other affected products include milk, corn, wine, fruit, and forestry. As of end-January, the Ministry of Agriculture estimated that preliminary direct losses amounted to almost US$1 billion or 1.4 percent of 2022 GDP.

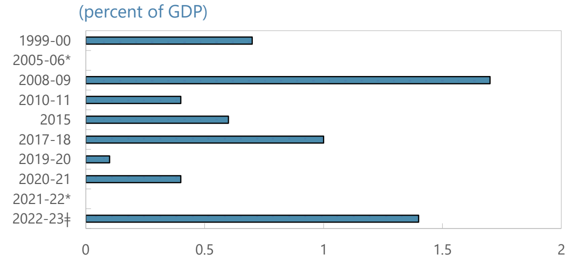
The effects of the drought may spill to the rest of the economy and be long-lasting. The drought is likely to also have indirect effects and reduce economic activity in sectors linked to agriculture, including transportation and food processing. The impact on cattle livestock could extend beyond this year, due to weight loss and reduced calving rate. The drought may also decrease the productivity of the soil in heavily affected areas.

Cumulated Rainfall
(Millimeters)



Source: INUMET, IMF staff calculations.

Economic Impact of Droughts
(percent of GDP)



Sources: OPYPA, IMF staff calculations.
Note: * Not Available. ‡ Estimate as of Jan 2023

The authorities quickly deployed temporary measures to bring relief to producers impacted by the drought. The National Guarantee System was activated to facilitate access to working capital loans for micro, small and medium-sized firms in the affected sectors, while the BCU has allowed banks to grant loan extensions up to 180 days without impacting debtor credit quality. Other measures include energy subsidies for producers.

1/ https://www.inumet.gub.uy/sala-de-prensa/noticias/informe-sequia-meteorologica-2020-2023
Source: INUMET.

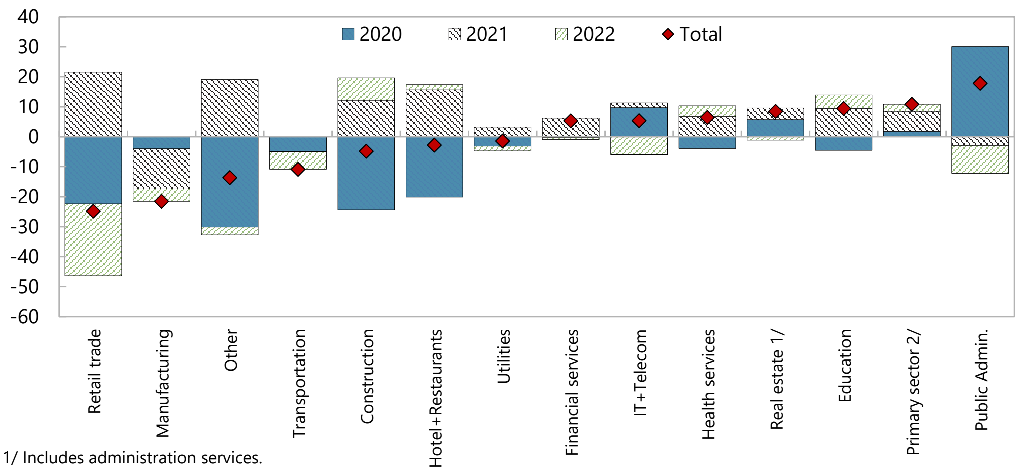
RECENT DEVELOPMENTS

4. **After reaching pre-pandemic levels in mid-2021, real GDP grew at a healthy pace in the first half of 2022, but due to the drought and adverse external conditions, growth turned negative in the second half of the year.** Growth was 4.9 percent in 2022, driven by continued strong exports of agricultural products and recovering service sectors, including tourism. Russia's war in Ukraine had a limited direct impact due to small trade links, but agricultural exports benefited from increased demand and global prices. The economy contracted in the second half of the year, driven by the global slowdown and the effects of the drought. Employment creation rebounded in 2022 with 40,000 new jobs created on average while unemployment has hovered around 8 percent.

The employment recovery has been uneven across sectors: services employment exhibited strong growth, but other sectors lagged. Poverty declined to 9.1 percent in 2022H2 from 11 percent in 2021H2.

Change in Employment

(In thousands)

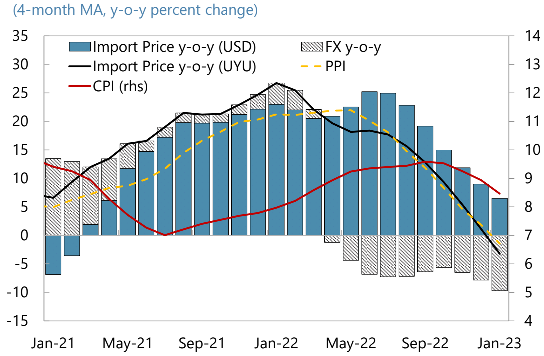


1/ Includes administration services.
2/ Includes agriculture, fishing and mining.
Sources: Uruguayan authorities and IMF staff calculations

5. Inflation remained above the target range in 2022 but started to decline towards the end of the year. Inflation reached about 8 percent (year-on-year) by end-2021, peaked at 9.95 percent in September 2022, and declined to 7.3 percent in March 2023. The increase in inflation was less pronounced than in other countries, owing to a strong monetary policy response, the appreciation of the Uruguayan peso, and the limited increase in administered prices, which helped contain inflationary pressures from high commodity prices, global supply chain bottlenecks, and strong demand. Meanwhile, the authorities' commitment to restoring real wages to their pre-pandemic levels, could put pressure on inflation going forward.[2]

Imported Inflation

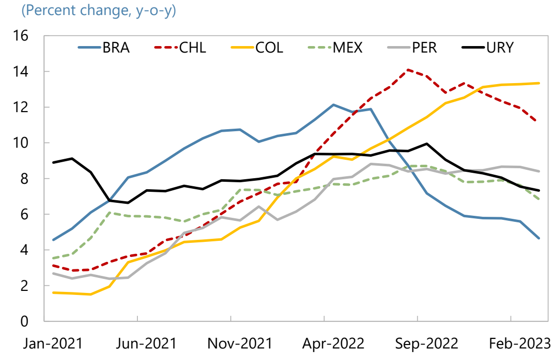
(4-month MA, y-o-y percent change)



Sources: Uruguayan authorities and IMF staff calculations.

CPI Inflation

(Percent change, y-o-y)

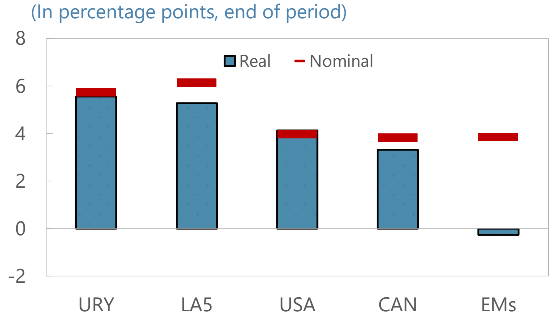


Sources: Haver.

[2] The central administration has agreed to an additional increase in real wages through 2024 conditional on economic performance, which could reach 3 percent.

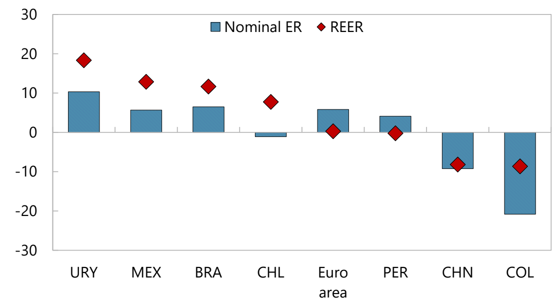
6. In response to increased inflationary pressures, the Banco Central del Uruguay (BCU) appropriately tightened monetary policy during 2022, while the peso appreciated. The BCU markedly raised the policy rate from 5.75 percent in December 2021 to 11.5 percent in December 2022. As previously announced, the BCU lowered the ceiling of the target range from 7 to 6 percent effective September 2022. Inflation expectations remained outside the target band in 2022 but have recently declined, particularly two-year ahead expectations. The peso appreciated by about 10 percent against the US dollar in nominal terms, and by 18 percent in real effective terms in 2022, driven by interest rate differentials, favorable terms of trade, and increased US dollar liquidity. The authorities have not intervened in the foreign exchange market.

Change in Monetary Policy Rates: 2021-2022 1/
(In percentage points, end of period)



Source: Haver, BCU, Consensus Forecast.
1/ 12-month ahead inflation expectations is used to compute real rates.

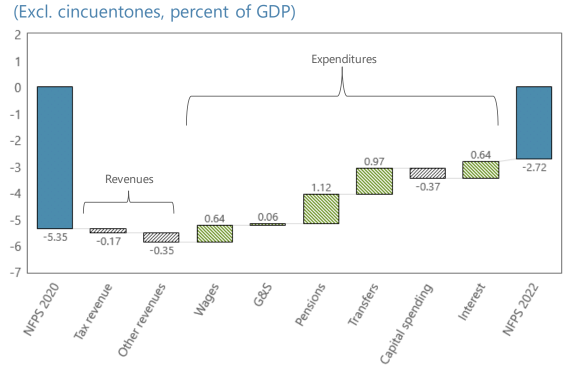
Exchange Rate Change: 2021-2022
(In percent)



Sources: Country authorities, IMF International Financial Statistics (IFS) and staff calculations.
Notes: Increase indicates appreciation, decrease indicates depreciation.

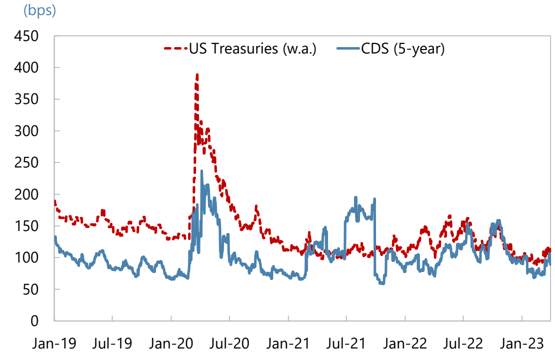
7. The fiscal deficit and government debt declined substantially over the last two years, reflecting the authorities' efforts to stay within the targets of the fiscal rule, while protecting the most vulnerable. The overall deficit of the non-financial public sector (NFPS), excluding *cincuentones*, reached 2.7 percent of GDP in 2022, compared to 3.0 percent in 2021.[3] While COVID-related spending was gradually unwound, the authorities deployed funds to protect vulnerable groups from high food and energy prices (see Box 2). After peaking at 68.1 percent of GDP in 2020, gross NFPS debt reached 59.3 percent of GDP at the end of 2022, below its pre-pandemic level,

Change in Overall NFPS Balance: 2020-2022
(Excl. cincuentones, percent of GDP)



Source: Urguayan authorities and IMF staff calculations.

Sovereign Bond Spreads
(bps)



Sources: Bloomberg and IMF staff calculations

[3] Temporary proceeds through 2022 from the pension reform that allowed certain workers to voluntarily move back to the public pension system.

amid historically low sovereign spreads. The improvement since 2020 reflects the authorities' efforts, which are key to preserve macroeconomic and financial stability and favorable market access, as well as the effect of higher-than-expected GDP growth and inflation, and the peso appreciation. Staff's assessment is that there is some fiscal space available to respond to shocks without jeopardizing market access.

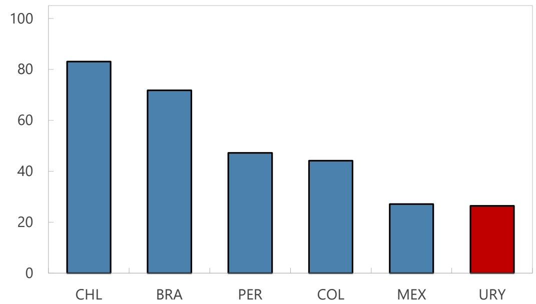
Box 2. Measures to Mitigate the Impact of High Food and Energy Prices on Vulnerable Groups

	US$ million	percent of GDP
Bringing forward increase in wages and pensions	120	0.17
Increase in social transfers	40	0.06
Freeze on price of propane tank	90	0.13
Additional measures:	10	0.01
Reduction in VAT of certain products	5	0.01
Reduction of import taxes for certain products	5	0.01
Streamlining import control	n.a.	
Subsidy for new hires 30-44 years-old	n.a.	
Total	**260**	**0.4**

8. **The current account deficit increased to 3.2 percent of GDP, while the external position was broadly in line with fundamentals and desirable policies in 2022 (Annex I).** Amidst higher international prices, Uruguay's nominal and real exports grew by 17 and 11 percent respectively in 2022. Strong soybeans and meat exports offset lower electricity exports, tourism exports still below pre-pandemic levels, higher freight costs, and higher energy imports. The trade balance is positive but is offset by a widening primary income balance deficit, driven by the high share of FDI liabilities (Annex II). Meanwhile, risks to external sustainability are limited (Annex III).

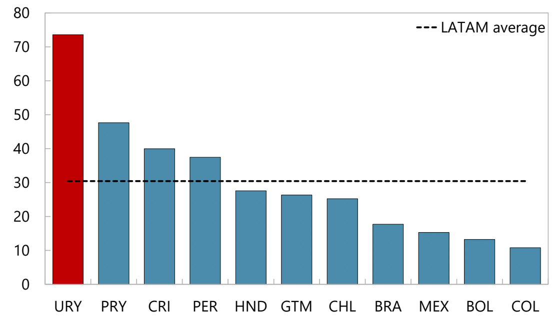
9. **The health of the financial sector remains sound, amid low financial intermediation and high dollarization.** Banks have weathered the pandemic well. So far, pandemic-related measures have expired without visible signs of increased stress, reflected in low and stable non-performing loan ratios, high profitability, and strong liquidity indicators. Ample liquidity buffers allow banks to sustain severe funding pressures while contagion risks appear limited. Profitability declined in 2022 due to the appreciation of the exchange rate and banks' positive FX net open position. Financial intermediation is low with a credit-to-GDP ratio of 26 percent, and dollarization is high at about 75 percent for deposits and 50 percent for loans. Dollarization hampers the effectiveness of the monetary policy transmission mechanism and aggravates FX credit and systemic liquidity risks. Moreover, about 75 percent of corporate sector debt is denominated in foreign currency. State-owned banks have stronger capital ratios than private banks and high liquidity buffers, but due to their large presence in the financial system, special attention should be given to maintaining competition.

Credit to Private Sector, end-2022 1/
(In percent of GDP)



Source: IMF International Financial Statistics (IFS) and staff calculations.
1/ Latest data available for Peru is for end-2021.

Foreign Currency Deposits 1/
(Percent of Total Deposits)



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

OUTLOOK AND RISKS

10. The economy is expected to decelerate in 2023, but the growth outlook over the projection period is positive. Real GDP growth is projected at 2 percent in 2023 amid high uncertainty due to the impact of the current drought. Despite external headwinds, tighter financial conditions, and the effects of the drought, growth would be supported by a strong tourism season, increased cellulose production and exports, and robust private consumption as real wages recover. Growth is expected to rebound to 3 percent in 2024 and gradually converge to the potential growth rate of 2.2 percent by 2028. Inflation is expected to decline to 7 percent in 2023 and fall within the target range in 2024. Main macroeconomic risks are derived from a worsening of external financial conditions, deterioration of international geopolitical tensions, and the severity and duration of the current drought (Annex IV).

11. Overall fiscal risks are low. Near-term fiscal risks appear limited as maturities are long, liquidity buffers are adequate and market access remains at favorable terms, while medium-term risks are moderate. Moreover, the active debt management of the Ministry of Finance has been key to maintain the investor grade credit rating and mitigate debt dynamic risks. Meanwhile, the high share of FX debt and non-residents holdings are key vulnerabilities which could amplify shocks in a context of more restrictive global financial conditions and slowing growth. The findings of the SFDSA (Annex V) confirm this assessment.

Authorities' Views

12. The authorities broadly concurred with the outlook and the balance of risks. They emphasized that the main local short-term risk is how the intensity and duration of the drought will continue to impact economic activity. On inflation, the authorities agreed that inflation would continue to gradually converge towards the target.

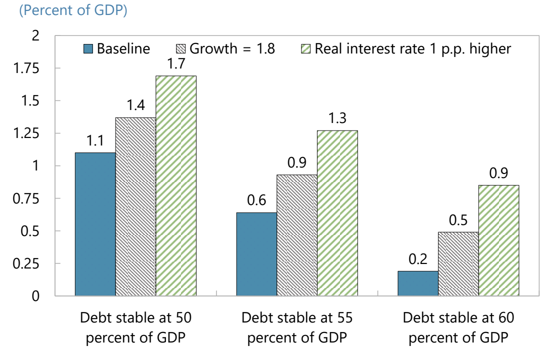
POLICY DISCUSSIONS

A. Fiscal Policy: Rebuilding Buffers While Maintaining Social Cohesion

13. Following a strong fiscal consolidation since 2020, fiscal policy plans are appropriate for 2023. In the near term, the authorities' plan is consistent with achieving the targets of the fiscal rule while safeguarding social cohesion. The NFPS fiscal deficit is projected at 3 percent of GDP in 2023, while social spending remains a large fraction of total spending. Current fiscal plans would keep NFPS debt largely stable. The recently announced tax cut (0.2 percent of GDP) represents a structural reduction in revenues which will require real spending to grow at a slower pace, as already contemplated in the authorities' plan.[4] Beyond fiscal sustainability considerations, maintaining a prudent fiscal policy will also support the central bank's disinflationary efforts.

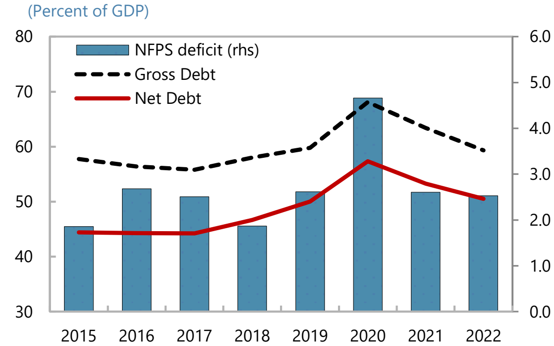
14. After the effect of the drought abates, additional fiscal efforts would be needed to put debt on a firm downward path and rebuild policy space. The authorities' successful efforts to reduce debt in the aftermath of the pandemic amid difficult external conditions are commendable, but the debt-to-GDP ratio is at historically high levels. IMF staff estimates that bringing NFPS debt to a range between 50-55 percent of GDP over the medium term would provide large enough buffers to respond to shocks. A constant primary surplus of 0.6 would allow to reach a debt to GDP ratio of 55 percent by 2032, while a primary surplus of 1.1 percent of GDP would allow to reach a debt to GDP ratio of 50 percent (see Selected Issues Paper). Within the current framework, the annual fiscal reports to Parliament ("*Rendición de Cuentas y Exposición de Motivos*") could incorporate more explicitly the link between the calibration of the three pillars of the fiscal rule and the authorities' stated efforts to stabilize the debt-to-GDP ratio over the forecasting horizon. Going forward, in line with past IMF staff recommendations, a well-calibrated explicit debt anchor would help stabilize the debt-to-GDP ratio at a lower level over the medium term.

Primary Balance Required to Stabilize Debt by 2032
(Percent of GDP)



Sources: IMF staff calculations.

Government Debt and Fiscal Balance
(Percent of GDP)



Source: Uruguayan authorities and IMF staff calculations.

[4] The tax cuts were implemented as increased deductions for personal income taxes (IRPF) and social security tax (IASS), and tax cuts for micro and small businesses.

15. Relatively high tax rates and high spending rigidities limit available options for consolidation. As a result, a combination of measures would be needed to generate the necessary savings to bring the debt-to-GDP ratio to a lower level over the medium term. Some policies that could be considered include rationalizing tax expenditures, a reduction of the wage bill through attrition of public employment, better targeting of subsidies (in particular LNG), and increasing the efficiency of state-owned enterprises. Uruguay is already making progress with personalized VAT for recipients of social plans: continuing with these efforts would help reducing the regressivity of VAT while increasing revenues. Recent initiatives to reduce absenteeism of public employees and improve the efficiency of disability insurance could allow for a better allocation of resources. Capital spending and social programs, which are largely well-targeted, should be preserved.

Authorities' Views

16. The authorities reiterated their resolute commitment to conducting prudent fiscal policy and adhering to the targets of the fiscal rule while protecting the most vulnerable. They underscored that the recently announced tax cuts had been incorporated in last year's fiscal report to Parliament (*"Rendición de Cuentas"*). The authorities stressed their compliance with the three pillars of the fiscal rule for a third year in a row and restoring fiscal credibility, as reflected in the lowest EMBI spreads in Latin America. They did not share the view that it is necessary to amend the existing fiscal rule with an explicit debt anchor arguing that the current rule was deliberately designed to target a specific debt-to-GDP ratio. It was precisely the compliance with such a rule that enabled to reduce debt even under very testing circumstances, including the pandemic, outperforming the initial objective of stabilizing the debt-to-GDP ratio at 2020 levels. While agreeing on the need to continue assessing alternative medium-term debt-to-GDP objectives, their current focus is on building a strong compliance track record with the targets of the current rule, which they view as ambitious, and maintaining their objective of keeping the debt-to-GDP ratio stable.

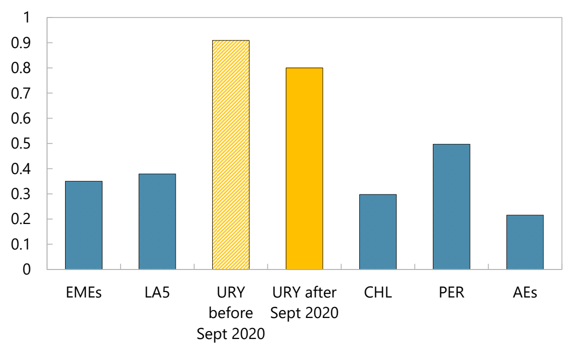
B. Monetary and Exchange Rate Policies: Strengthening Credibility and Reducing Dollarization

17. The tight monetary policy stance is appropriate and should be maintained until inflation and inflation expectations have converged to the target range in a sustained manner. With 12-month ahead inflation expectations at around 7 percent, ex-ante real policy rates are about 4.25 percent, significantly above the neutral rate of 2 percent, making the monetary policy stance contractionary. The BCU should closely monitor the evolution of inflationary pressures and make sure that any further monetary easing is conditional on a firm convergence of inflation and inflation expectations to the target range, which will be crucial for building monetary policy credibility and supporting de-dollarization efforts. If additional inflationary shocks materialize, the BCU should stand ready to tighten monetary policy.

18. Recent enhancements to the monetary policy framework increased the effectiveness of monetary policy, but additional steps are needed to further strengthen central bank

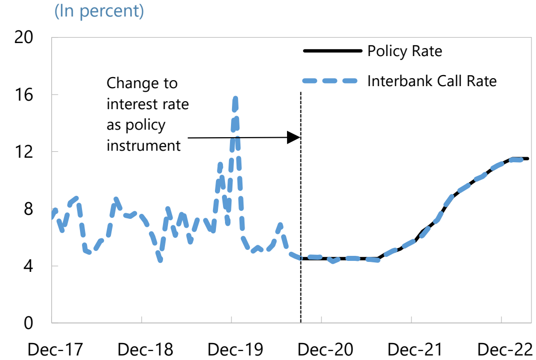
independence. Since 2020, the BCU has significantly improved the monetary framework, including by adopting the short-term interest rate as monetary policy instrument, which helped provide reference interest rates to market participants and reduced the volatility of benchmark interest rates. Additional improvements to the BCU communication strategy have more recently facilitated the convergence of inflation expectations to the target band. However, inflation expectations remain anchored outside the target range (see Annex VI). Strengthening *de jure* central bank independence would further improve credibility and support policy continuity. BCU Board members should have fixed and staggered terms (not overlapping with the general electoral cycle) and reasons for dismissal during their term be clearly outlined in the law, to insulate monetary policy decision making from the political cycle.

Probability of Inflation Outside Target Range
(Average, 2008-2022)



Sources: Consensus Economics and IMF staff calculations.

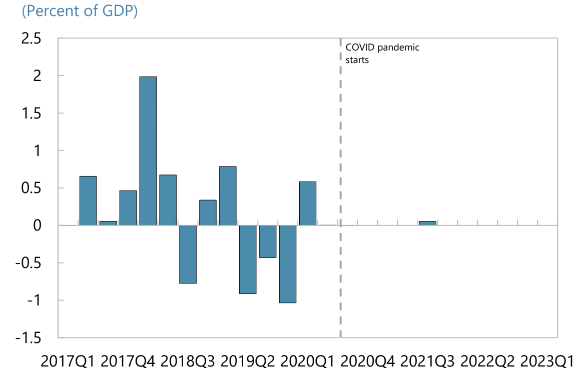
Interbank Call Rate and Monetary Policy Instrument
(In percent)



Source: Uruguayan authorities.

19. The exchange rate should continue to act as a shock absorber with FX interventions limited to respond to disorderly market conditions. To support its overall upgrading of the monetary policy framework, the BCU has not intervened in the foreign exchange market, which has helped provide clarity on the objectives of monetary policy. The peso has been allowed to float and act as a shock absorber. In an analysis based on the Integrated Policy Framework (IPF), staff finds that the costs of conducting FXI outweigh benefits, because improving monetary policy credibility and communication should remain the highest priority.

Net FX Purchases by the BCU
(Percent of GDP)



Sources: Uruguayan authorities and IMF staff calculations

20. Addressing high dollarization, a long-standing challenge, would increase the effectiveness of monetary policy and strengthen the inflation targeting regime. High dollarization levels increase FX credit risk for banks, government, and unhedged corporates, while also hampering the effectiveness of the monetary policy transmission mechanism. In 2021, the BCU presented its strategy to de-dollarize the economy, which included, among others, improving the monetary policy framework to reach low and stable inflation and developing local currency debt markets. Additional policies can complement these efforts. Staff analysis finds that higher dollarization levels are associated to structural factors such as lower financial development, lower credibility of monetary policy and prudential policies. Thus, recalibrating macro-prudential policies and continuing the implementation of financial sector development measures would also strengthen the authorities' plans. Differential reserve requirements for domestic and foreign currency deposits have shown to be particularly helpful in reducing deposit dollarization as suggested by the successful de-dollarization experiences of other countries in the region (see Selected Issues Paper). Staff analysis also finds that, in addition to improving the monetary policy framework and lowering inflation, continued exchange rate flexibility would contribute to the de-dollarization strategy, especially when the exchange rate is allowed to appreciate.

Authorities' Views

21. The authorities agreed that the monetary policy stance is appropriate, and that inflation will converge to the target range. They reaffirmed their commitment to bringing down inflation and emphasized that the moderation of the international inflationary pressures would contribute to the slowdown in domestic inflation. The authorities concur that the exchange rate should be allowed to act as a shock absorber and to limit FX intervention to addressing disorderly market conditions. The authorities noted progress in their de-dollarization strategy and highlighted their commitment to continue implementing its key elements that include: (i) strengthening the monetary policy framework to ensure low and stable inflation, (ii) developing the peso capital market, (iii) addressing cultural dollarization (such as pricing in US dollars in real estate markets and for durable goods) and (iv) recalibrating existing prudential and fiscal tools.

C. Financial Sector Policies: Improving Resilience

22. The authorities have made progress in strengthening financial sector supervision in recent years, but further efforts are needed to buttress the resilience of the financial sector, in line with the recent FSAP recommendations (see Annex VII). The authorities have updated the supervisory framework in line with international initiatives and implemented a broad range of macroprudential tools, strengthening the resilience of the banking sector and reducing dollarization risks. Further enhancing the macroprudential framework is an important priority, particularly expanding the current toolkit to cover the household sector. Corporate sector vulnerability to shocks requires close monitoring. Closing large data gaps is needed to assess system-wide FX liquidity risk and recalibrate current de-dollarization measures.[5] Enhanced solvency stress tests should be incorporated into risk-based supervision and their results linked to supervisory actions. Solvency risks for some private banks should be addressed by Pillar 2 capital add-ons and restrictions on dividend distribution. Moreover, redesigning the bank wealth tax would incentivize private banks to raise additional capital. The crisis management framework should be updated by overhauling the

[5] This includes finalizing cross-sectoral datasets with information on interlinkages and exposures, as well as more granular data on household indebtedness and the extent of unhedged corporate FX loans.

role of the government in funding bank resolution, developing a recovery and resolution planning framework, and an emergency liquidity provision facility.

23. According to the Financial Action Task Force of Latin America (GAFILAT)'s 2020 Mutual Evaluation Report (MER), Uruguay was assessed as having a moderately effective AML/CFT system.[6] The MER highlighted the vulnerability of the financial sector to illicit capital placement, including from tax crimes from neighboring countries, and the real estate and construction sector which receives significant investments by non-resident clients, sometimes involving misuse of legal persons and arrangements. Money laundering related to proceeds from organized crime, particularly drug trafficking, should be closely monitored. The authorities are expected to conclude and publish a National Risk Assessment (NRA) by the end of April, which will consider new risks such as virtual assets/virtual asset service providers (VA/VASPs). The NRA report will serve as the basis for an AML/CFT national action plan. Additionally, the recent "*Rendición de Cuentas*" established a Special Prosecutor's office for ML/TF. Finally, the proposed Law of Virtual Assets (an amendment of the Organic Law of the Central Bank and the Securities Law) is pending approval by Congress.

Authorities' Views

24. The authorities underscored that the financial sector remains sound and resilient. They emphasized that the banking system's profitability remains high, with strong liquidity indicators and low and stable non-performing loans. They welcomed the FSAP's acknowledgement of the progress made in strengthening financial sector oversight in recent years and generally concurred with the importance of further enhancing supervision and regulation. The development of a resolution planning framework and an emergency liquidity provision facility will be incorporated into BCU's and SSF's workplans. The authorities highlighted that they are constantly reviewing the macroprudential framework, including its mandate and transparency. With respect to creating incentives for private banks to raise additional capital through a redesign of the bank wealth tax, they noted that it requires a careful calibration to avoid impacting tax revenues negatively. The authorities noted the significant progress made in strengthening the AML/CFT framework and their commitment to implementing recommendations from the 2020 GAFILAT MER and FSAP reports. They are confident that the Special Prosecutor's office will become a valuable tool in the fight against ML/TF.

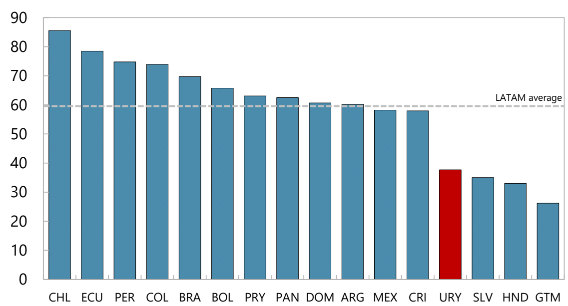
D. Structural Policies: Boosting Sustainable Growth

25. Structural reforms remain critical to increase productivity, educational attainment, investment, and growth. Boosting potential growth is essential to sustain the welfare state and the social safety net. The authorities' efforts are focused on the following areas:

[6] See the 2020 GAFILAT Mutual Evaluation Report (MER). For technical compliance the 2020 MER rated Uruguay largely compliant on the majority of the FATF recommendations.

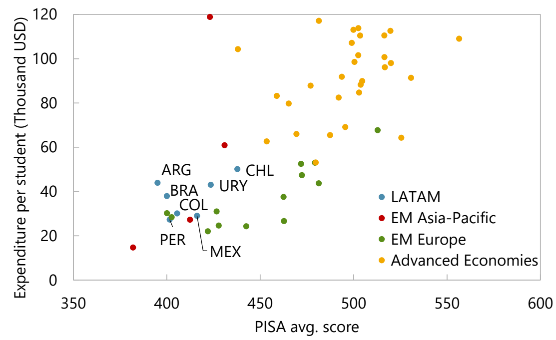
- **Education and Innovation**. Uruguay has high dropout rates and one of the lowest secondary graduation rates in the region, while test scores compare unfavorably with OECD economies. Youth unemployment remains high. The initial phase of the new education reform mostly affects primary education, but a significant upgrade in secondary education and human capital is needed to increase the supply of high-skilled workers, including in the ICT sector where shortages have become apparent (see Box 3). In the short-term, drawing on the successful implementation of on-demand training programs, coordinated public-private initiatives should be prioritized to bridge the skills gap. The recently launched Innovation Hub could help in attracting international startups, as well as encouraging the installation of open laboratories, which would bolster the national ecosystem by accessing technology.

Secondary School Completion Rate 1/
(Percent)



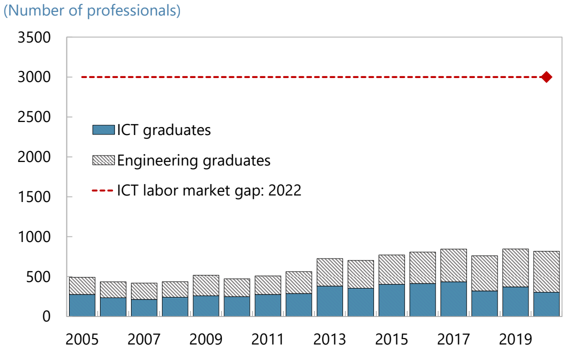
1/ Year of latest observation difffers accross countries. Data for Uruguay corresponds to 2019.
Sources: UNICEF and Uruguayan authorities.

PISA Scores and Education Expenditure 1/



1/ Education expenditure accounts for Purchasing Power Parities (PPP).
Sources: OECD and IMF staff calculations.

Skilled Labor Gap: ICT and Engineering 1/
(Number of professionals)



1/ ICT: Information and Communication Technology.
Sources: Uruguayan authorities, CUTI.

Box 3. Education Reform

Under the name "*Transformación Educativa*" (Educational Transformation), the authorities have launched a dynamic process to improve the education system and tackle long-standing challenges. The five pillars of the reform are centered around: (i) improving governance and coordination across the different institutions that design and implement the education policy, (ii) reduce inequality in the system by which students in poorer households have significantly worse education outcomes, (iii) increase retention of students by improving the management of educational centers, (iv) modernize curriculums, and (v) improve teacher training programs.

An initial outcome of this process has been the redesign of lower education levels "Educación Básica Inicial" for children aged 4 to 14. The new regime limits repetition of grades to only some years and shifts to a grading system based on 10 competencies. The key aspects of the new regime are articulated in the national curriculum plan called "Marco Curricular Nacional" which intends to provide a blueprint for the education that the system should deliver during the schooling years while also providing flexibility to adapt to a changing environment and new demands from the labor market.

In addition, the authorities have created education centers for low-income household children. These centers, called "Maria Espinola", provide students with additional education support in the form of tutoring, meals, and other interdisciplinary work.

Moreover, new programs for training and capacity development of teachers were approved in December 2022. While still in the process of being finalized and implemented, these will allow for consistency between the "Marco Curricular Nacional" and teachers' abilities.

The reform constitutes a step in the right direction. Going forward, and in line with the authorities' plans, further steps to transform the teachers' statutes and also better integrate primary and secondary education will be needed to address Uruguay's high dropout rates and improve the quality of education.

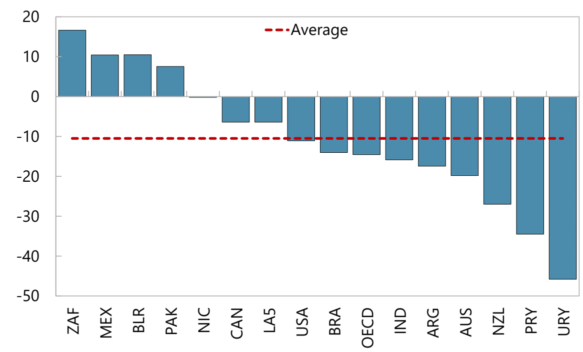
- **Trade Policy.** New trade facilitation measures include promoting the use of a one-stop shop for exports and imports and reducing in 10 percent its average import tariff in 2023. At the same time, new trade agreements under study could lead to important advances in trade integration. The authorities are seeking to consolidate and expand export markets, expressing interest in joining the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP), assessing the feasibility of bilateral free trade agreements with China and Türkiye and extending zero tariffs on free-trade zone flows with Brazil.
- **State-Owned Enterprises (SOEs)**. Recent initiatives to improve the efficiency and productivity of state-owned enterprises i.e., by updating electric meters to reduce losses and redesigning contracts for LNG packing, are welcome. Progress made since 2020 to align domestic gasoline prices and international prices should be reinvigorated as global energy prices moderate. Consistent with past Fund advice, SOEs should be professionally managed, their tariffs should be cost reflective and set by independent regulators, and the cost of social programs should be transparently financed from the budget (instead of the current practice of using cross-subsidies).[7] State-owned banks should be subject to the same resolution arrangements and corporate governance rules as private banks to reduce financial vulnerabilities.

[7] See IMF Country Report 20/51.

- **Pension Reform.** A new law was recently approved extending retirement age progressively and unifying a fragmented system (see Annex VIII). The reform will largely stabilize spending in the long-term which is necessary to ensure sustainability of the system, maintain intergenerational equity, and create space for other spending priorities.

26. Uruguay remains at the forefront of the implementation of climate change policies and has achieved a commendable reduction in its greenhouse gas (GHG) emissions intensity. This reduction was achieved without endangering the country's food security and economic development. While Uruguay is a low producer of GHG emissions, its economy is vulnerable to climate hazards, being particularly exposed to excessive rainfall and droughts, and rising sea levels (see Selected Issues Paper). The successful issuance of a sustainability-linked bond showcases the authorities' commitment to environmentally sustainable policies and the emphasis on institutional coordination and transparency (See Box 4). To achieve carbon dioxide neutrality by 2050, decarbonization efforts should focus on the transition to electric mobility, supported by green hydrogen production and e-fuels initiatives already underway. Promoting climate-smart agricultural and livestock practices will be key to meet the challenge of raising food production, while reducing methane and nitrous oxide emissions intensity, preserving the country's unique grassland ecosystem, and protecting its native forests.

Uruguay's Primary Energy GHG Emission Intensity
(Percent change; 2019 vs 1990)



Sources: WRI CAIT; OECD; and IMF staff calculations.

Box 4. The Sovereign Sustainability-Linked Bond

In October 2022, Uruguay became the second country to issue a sovereign sustainability-linked bond (SSLB)[1]. Unlike green bonds, whose proceeds are linked to specific projects, SSLB are not earmarked to a specific use but rather compensate investors in case its targets are not met.

The SSLB framework is the result of the coordinated work of 5 ministries and articulates in a consistent manner Uruguay's commitment to climate change. The bonds issued under this framework contain two key performing indicators (KPIs) and the novelty of a step-up or step-down coupon depending on the performance on each of these indicators.

The first KPI relates to reducing aggregate gross GHG emissions per real GDP unit, and the second KPI to maintaining the native forest area with respect to reference year. Depending on whether Uruguay meets, does not meet, or overperforms in each of the indicators, there will be a one-time 15bps adjustment up (does not meet) or down (overperforms) in the coupon of the bond. Based on performance through 2025, the adjustments would be applied to the coupon payments in 2027.

The issuance of a 12-year bond for US$ 1.5 billion was more than 2-times oversubscribed and priced just 170 bps above US Treasuries of similar maturities. A major achievement was that it attracted approximately 40 new investors interested in SSLBs who had not purchased Uruguay bonds in the past.

[1] Uruguay's Sovereign Sustainability-Linked Bond (SSLB) framework
https://www.mef.gub.uy/innovaportal/file/30695/11/uruguay_sslb_framework__2.pdf

27. The financial sector has potential to contribute more actively to economic growth, by fostering access to finance, promoting capital market development, and modernizing the digital payments system. While financial inclusion has steadily improved in Uruguay (74 percent of adults had a bank account in 2021), access to credit remains unequal (40 percent of firms reported access to finance as a major constraint). Further efforts to develop a benchmark yield curve and increase the liquidity of the secondary market would contribute to further deepening of the local currency bond market and to create enabling conditions for nurturing the peso capital market. The authorities are advancing a modernization plan for their payment system (Annex IX). Although Uruguay possesses essential pre-conditions for success, ensuring fair access for providers and implementing robust safeguards are vital components of a successful outcome. The authorities are enhancing their cybersecurity and fraud-prevention framework for the payments and financial system by strengthening the current regulatory structure and facilitating better information exchange among relevant entities.

Authorities' Views

28. The authorities concur on the importance of structural reforms to boost potential growth. They highlighted impactful reforms underway which include social security, education, and international trade reforms. The authorities stressed that the 2023 school year started with the implementation of the education reform, which aims at modernizing the education system to face the challenges of the knowledge society. They highlighted the creation of the innovation hub to attract investment and increase exports of global services. The authorities also stressed their efforts to professionalize and improve the performance of SOEs by transparently reporting their financial statements, improving risk management, and reducing inefficiencies. They noted a strong policy improvement arising from new fuel pricing by the Executive since 2021, based on non-binding cost-based reports from the independent energy regulator, URSEA. The authorities are pursuing a modernization plan for the payments system. They emphasized their commitment to competition among payment providers and inclusivity of the payment system.

29. The authorities emphasized that balancing economic development with environmental sustainability has become a national priority. The country's strong political commitment to integrate climate change into the different areas of public policy has contributed to the necessary institutional and regulatory framework for environmental governance and the protection of natural resources. They reaffirmed that Uruguay, guided by its strategic vision, intends to remain at the forefront of the design of economic policies and financial instruments to address climate change and nature conservation, and to mobilize resources to deliver environmental outcomes, including better estimates of net carbon capture on green-house gas emissions.

STAFF APPRAISAL

30. The authorities' strong track record of implementing sound macroeconomic policies in a challenging environment has improved the country's resilience to shocks. Uruguay has maintained favorable market access and enjoys historically low spreads despite the succession of unfavorable shocks. Progress made since 2020 on the fiscal framework, including a solid track record of achieving the fiscal rule targets and the creation of the Fiscal Council, strengthened the credibility on the authorities' commitment to fiscal prudence. Improvements to the monetary policy framework should enhance the transmission channels of monetary policy, while helping reduce dollarization overtime. Consolidating these gains should be an important priority, as they place the country in a more favorable position to address external risks.

31. While fiscal policy plans are appropriate for 2023, additional fiscal efforts would be needed to put debt on a firm downward path and rebuild policy space after the effect of the drought abates. The NFPS fiscal deficit is projected at 3 percent of GDP in 2023, while social spending remains a large fraction of total spending. Current fiscal plans would keep NFPS debt largely stable with limited near-term risks—as financing needs are manageable and market financing remains at favorable terms. IMF staff estimates that bringing NFPS debt to a range between 50-55 percent of GDP over the medium term would provide large enough buffers to respond to shocks. Within the current framework, the authorities could incorporate more explicitly the link between the calibration of the three pillars of the fiscal rule and their stated efforts to stabilize the debt-to-GDP ratio over the forecasting horizon. Going forward, in line with past IMF staff recommendations, a well-calibrated explicit debt anchor would help stabilize the debt-to-GDP ratio at a lower level over the medium term.

32. The tight monetary policy stance is appropriate and should be maintained until inflation and inflation expectations have converged to the target range in a sustained manner. The BCU should closely monitor the evolution of inflationary pressures and make sure that any further monetary easing is conditional on a firm convergence of inflation and inflation expectations to the target range, which will be crucial for building monetary policy credibility and supporting de-dollarization efforts. Recent enhancements to the monetary policy framework have increased the effectiveness of monetary policy transmission but strengthening *de jure* central bank independence would further improve credibility and support policy continuity. The exchange rate should continue to act as a shock absorber with FX interventions limited to respond to disorderly market conditions.

33. The health of the financial sector remains sound. Banks have weathered the pandemic well, and support measures expired without visible signs of increased stress, reflected in low and stable non-performing loan ratios, high profitability, and strong liquidity indicators. Profitability declined in 2022 due to the appreciation of the exchange rate and banks' positive FX net open position. Ample liquidity buffers allow banks to sustain severe funding pressures while contagion risks appear limited. Further efforts are needed to continue improving financial sector resilience, in line with the recent FSAP recommendations. The authorities' efforts to create a comprehensive

AML/CFT national action plan that incorporates the recommendations from GAFILAT and the FSAP should continue. Staff welcomes the establishment of the Special Prosecutor's Office and recommends that the authorities provide adequate resources to ensure its effectiveness.

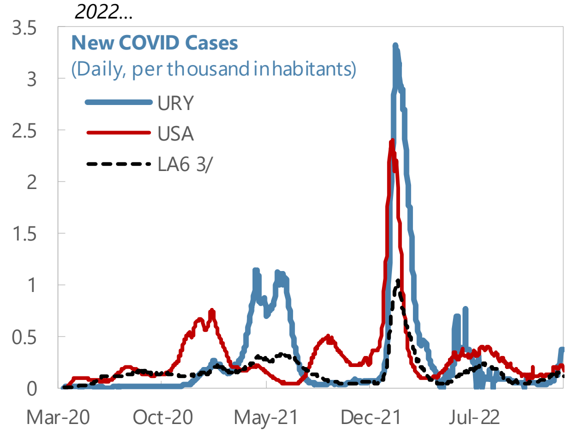
34. Structural reforms remain critical to increase productivity, educational attainment, investment, and growth. Recent reform efforts aimed at enhancing the sustainability of the pension system, improving education outcomes, and supporting the innovation ecosystem. Despite the recent improvements in the efficiency and productivity of state-owned enterprises, further efforts are needed. Recent initiatives to foster access to finance, promote capital market development, and modernize the digital payments system could also contribute to boost investment and growth. At the same time, new trade agreements under study could lead to important advances in trade integration. Efforts to transform Uruguay into a climate-resilient, green, and sustainable economy should remain a priority.

35. Past Fund advice. The recent upgrading of the monetary policy framework, including improvements in the BCU communication strategy and the move to using the short-term interest rate as the instrument for monetary policy are in line with past Fund advice. The updating of the supervisory framework, in line with international initiatives, and the implementation of a broad range of macroprudential tools are in line with previous Fund advice. Recent efforts to improve the performance and efficiency of SOEs are also in line with Fund advice. Staff and the authorities agree with the need to maintain fiscal prudence while safeguarding social cohesion.

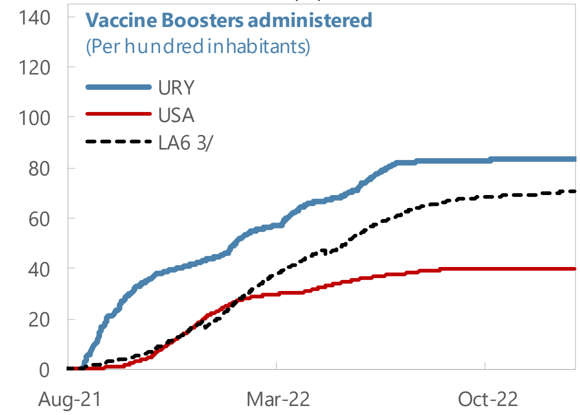
36. Staff recommends that the next Article IV consultation take place on the standard 12-months cycle.

Figure 1. Uruguay: COVID-19 Developments

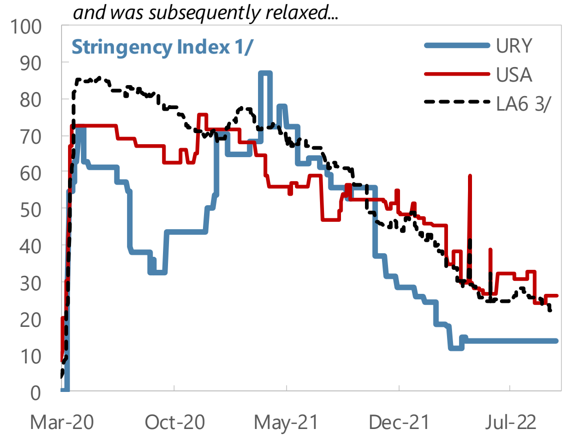
Uruguay suffered two big waves in 2021 and early 2022…



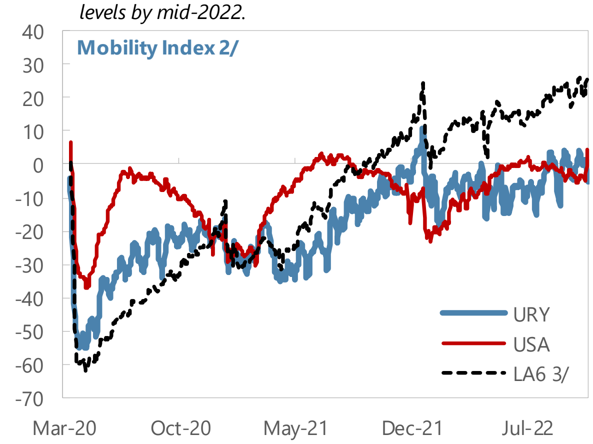
… while vaccination campaigns, including boosters, reached most of the adult population.



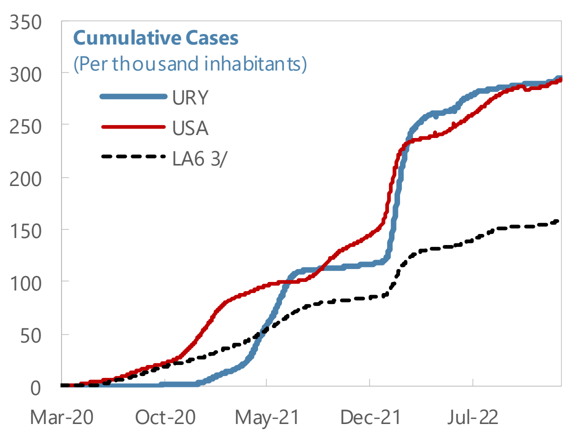
Stringency of containment measures peaked in mid-2021 and was subsequently relaxed…



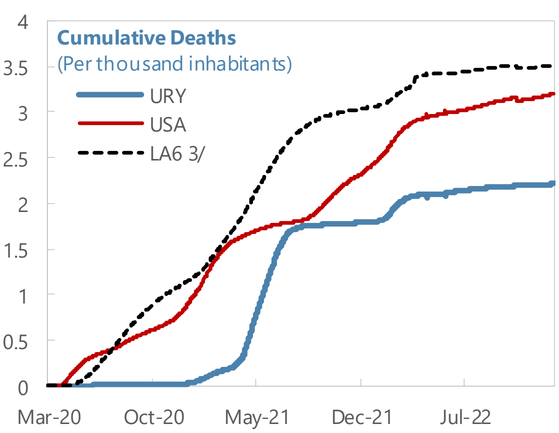
… while mobility kept increasing, reaching pre-pandemic levels by mid-2022.



Overall, total cases were relatively high …



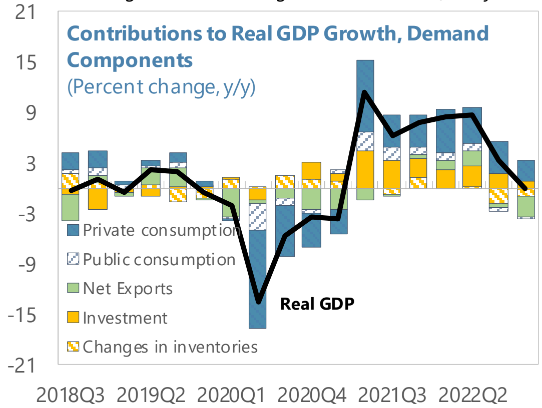
… although death statistics compare favorably.



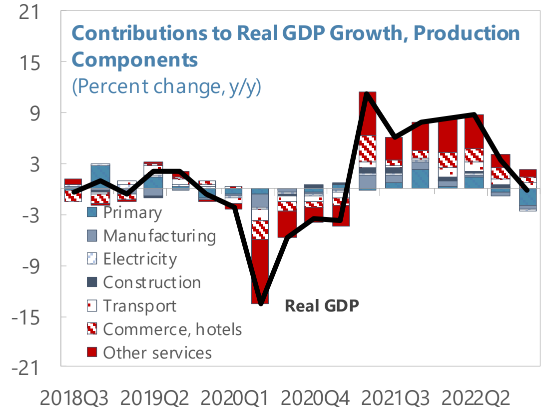
Sources: Google, OWID, John Hopkins University, and IMF staff calculations.
1/ Thomas Hale, Noam Angrist, Rafael Goldszmidt, Beatriz Kira, Anna Petherick, Toby Phillips, Samuel Webster, Emily Cameron-Blake, Laura Hallas, Saptarshi Majumdar, and Helen Tatlow. (2021). "A global panel database of pandemic policies (Oxford COVID-19 Government Response Tracker)." Nature Human Behaviour.
2/ Index of mobility reported by Google LLC "Google COVID-19 Community Mobility Reports".
3/ LA6 group is comprised of Argentina, Brazil, Chile, Colombia, Mexico and Peru.

Figure 2. Uruguay: Real Sector

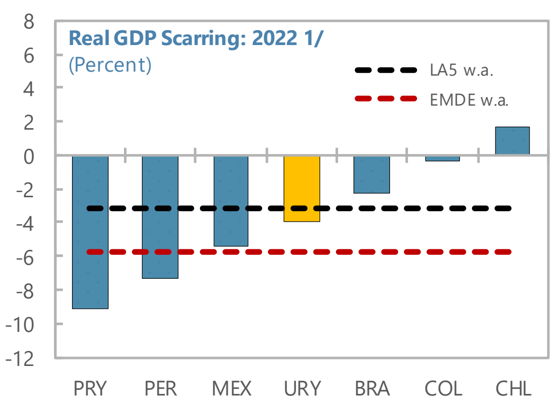
The economy grew at a healthy pace in the first half of 2022, but growth turned negative at the end of the year...



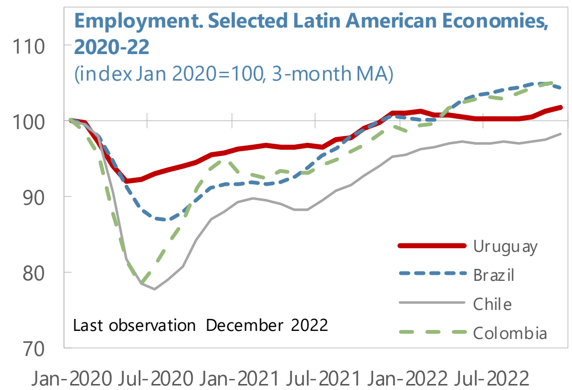
...driven by the dynamics in service sectors and a contraction in the primary sector.



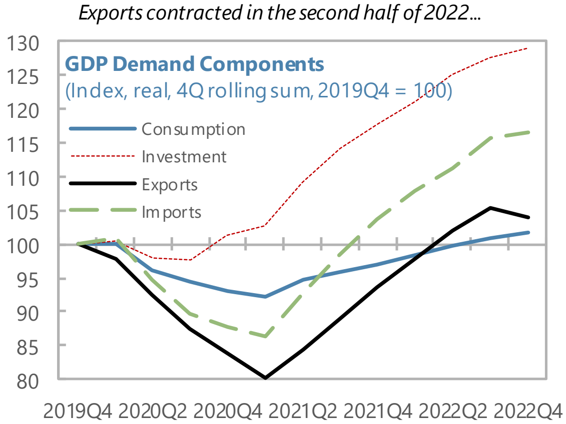
Real GDP remains below pre-pandemic trends.



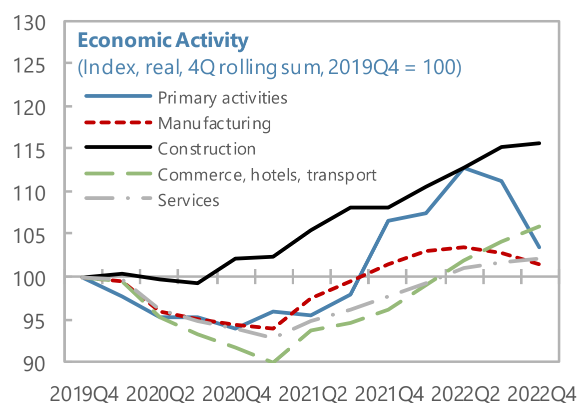
Employment losses during the pandemic were comparatively lower in Uruguay



Exports contracted in the second half of 2022...



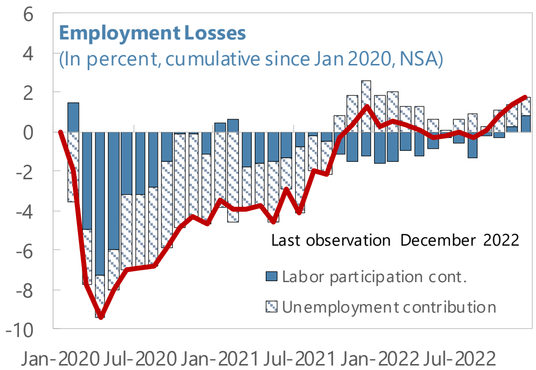
... as well as agricultural production.



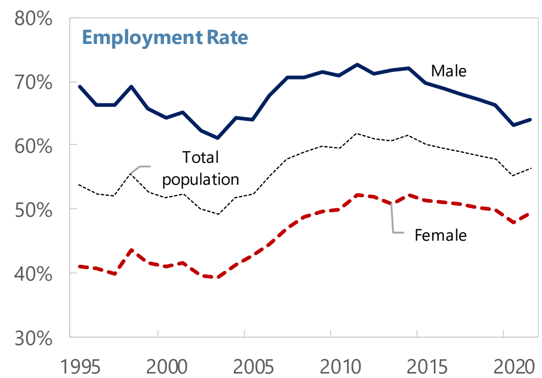
Sources: World Economic Outlook, Haver Analytics, Banco Central del Uruguay (BCU), Instituto Nacional de Estadistica, Bloomberg L.P., and IMF staff estimates and calculations.
1/ Percent difference from Jan-2020 WEO projections.

Figure 3. Uruguay: Labor Market

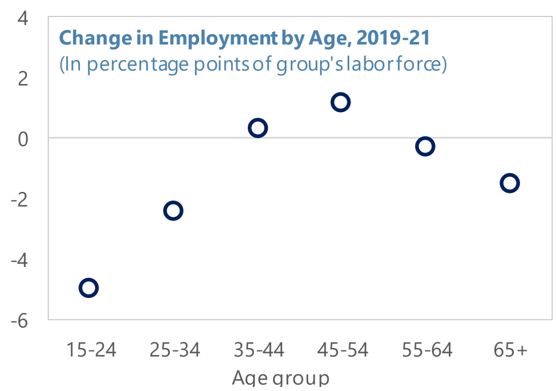
Employment is above pre-pandemic levels.



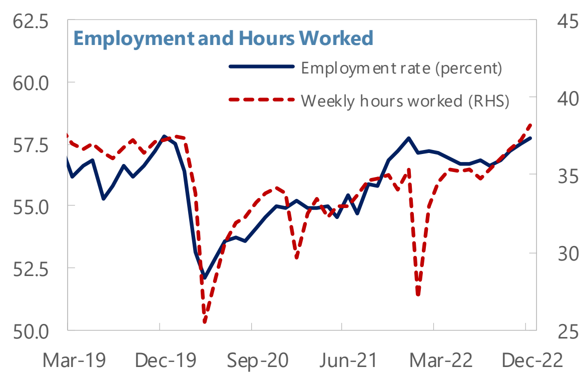
With a comparable performance across men and women,



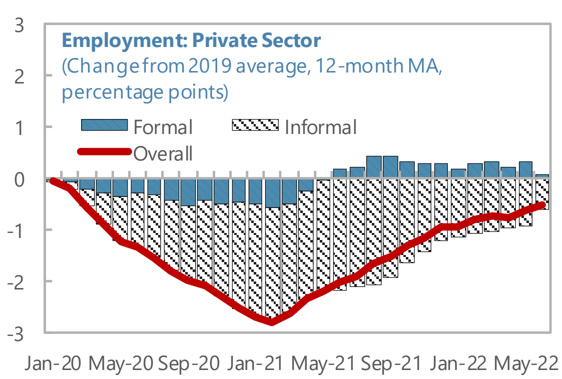
... yet young workers appear to have been affected disproportionately



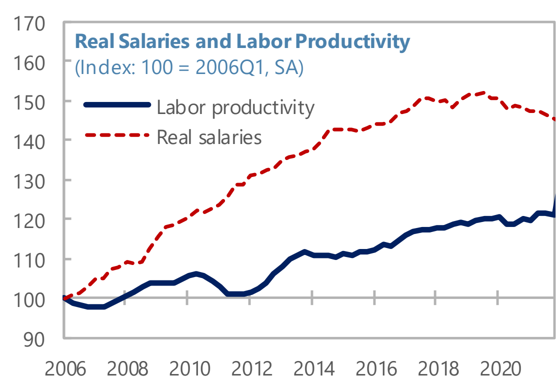
Hours worked have also recovered substantially during 2022..



...and informality, traditionaly low, has declined further.

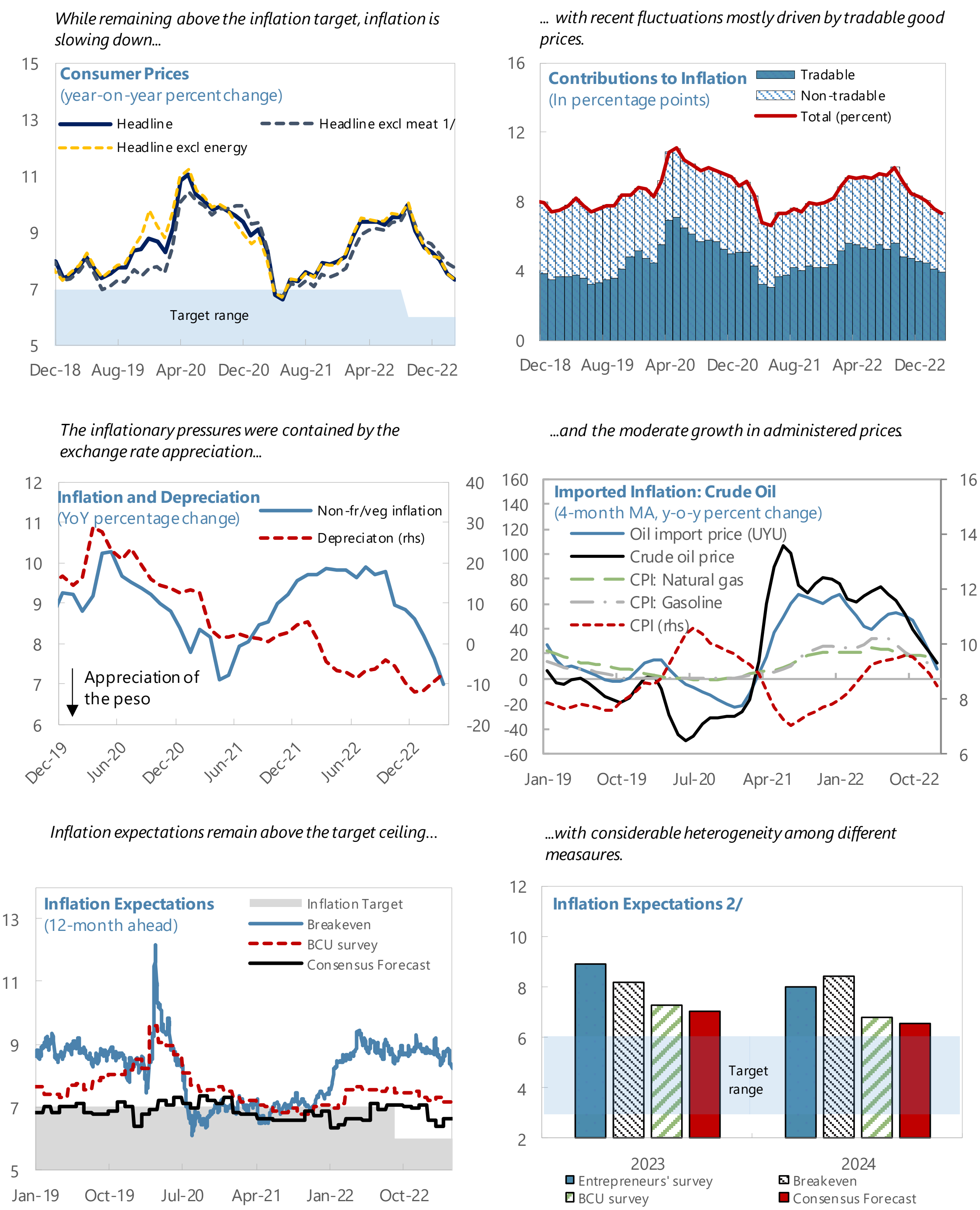


Losses in real wages have not fully recovered yet.



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

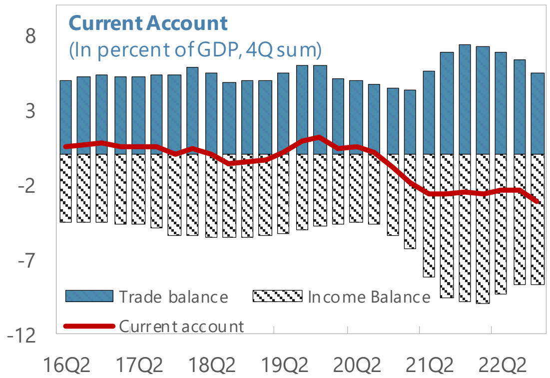
Figure 4. Uruguay: Inflation



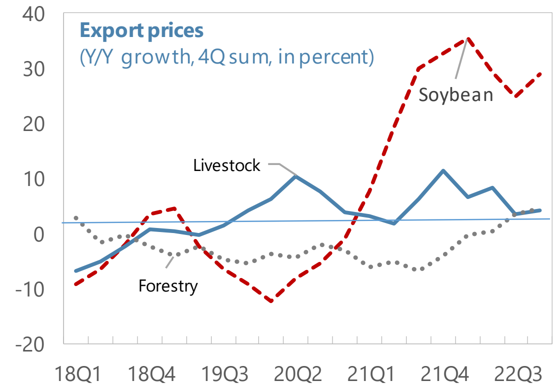
Sources: World Economic Outlook, Haver Analytics, Banco Central del Uruguay (BCU), Instituto Nacional de Estadistica, Bloomberg L.P., and Fund staff estimates and calculations.
1/ Excluding meat and meat products.
2/ As of December 2022.

Figure 5. Uruguay: External Accounts

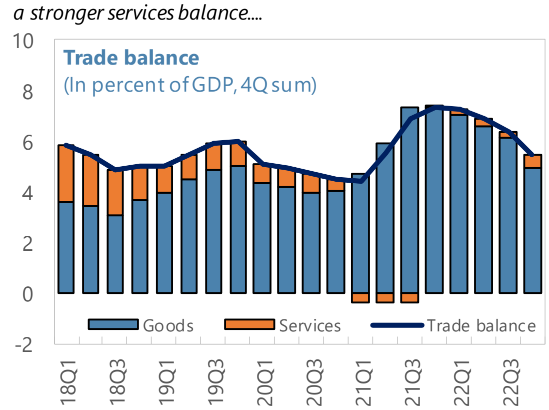
The CA deficit increased towards the end of 2022, with a weaker trade balance surplus offset by a lower primary income deficit.



In 2022, favorable agricultural prices and external demand underpinned historically high merchandise exports.

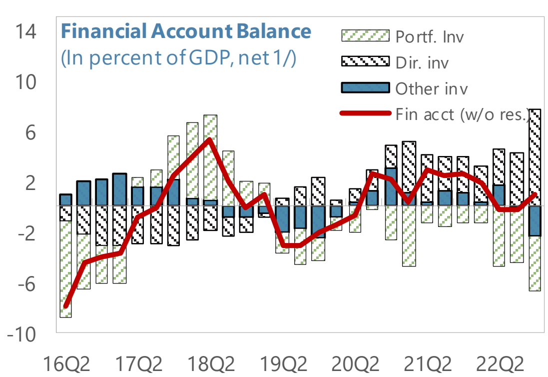


The softening of goods exports in 2022Q4 was partially offset by a stronger services balance....

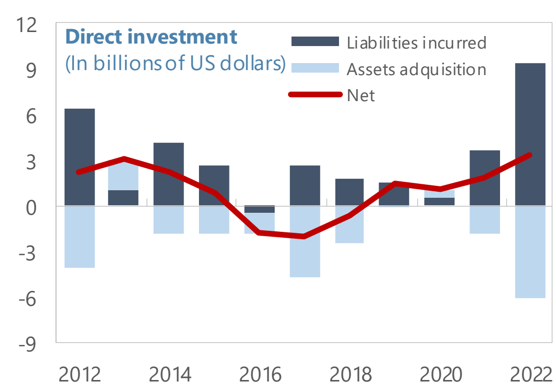


...driven mainly by the recovery in tourism revenues.

Financial flows proved resilient, with portfolio outflows fully offset by large FDI inflows...

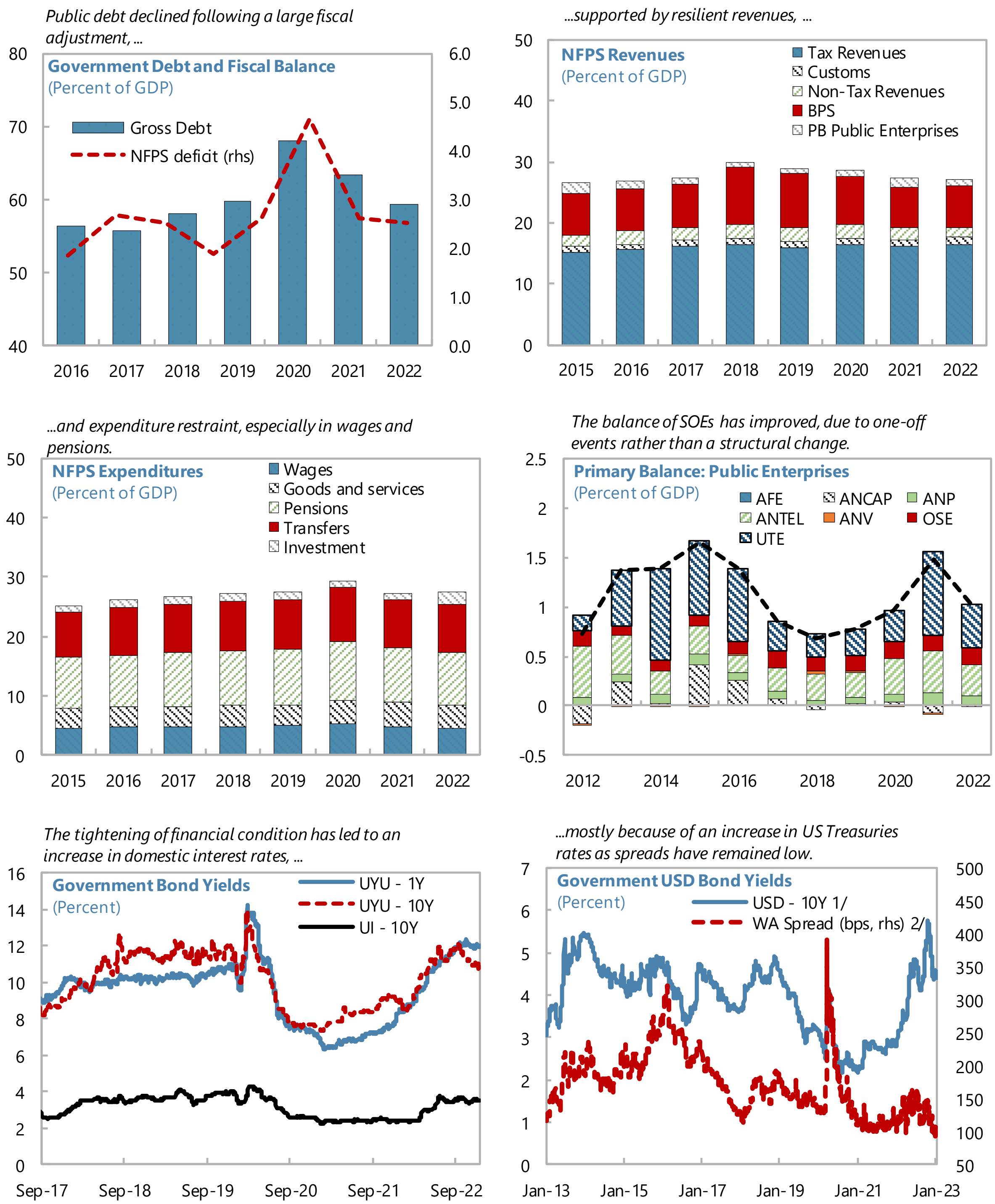


... underpinned by the large UPM pulp mill investment.



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

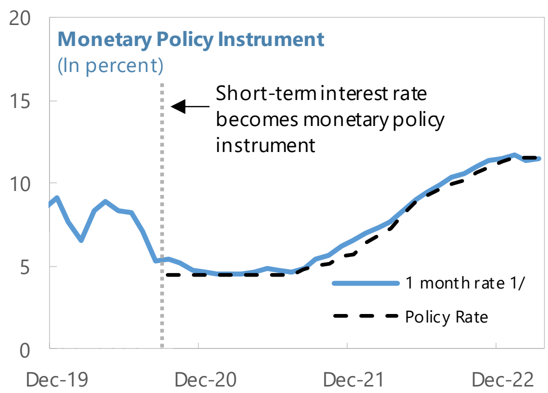
Figure 6. Uruguay: Fiscal Developments



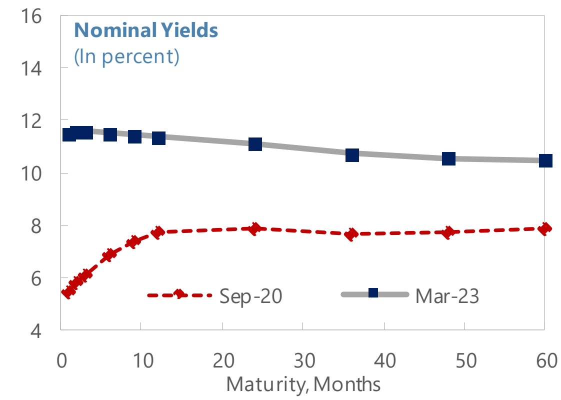
1/ USD-10Y: Yield on 10-year dollar-denominated securities.
2/ WA Spread: Weighted average spread vis-à-vis US Treasuries of comparable maturity.
Source: Uruguayan authorities, Bloomberg, Bolsa Electrónica de Valores del Uruguay, and IMF staff calculations.

Figure 7. Uruguay: Monetary Policy

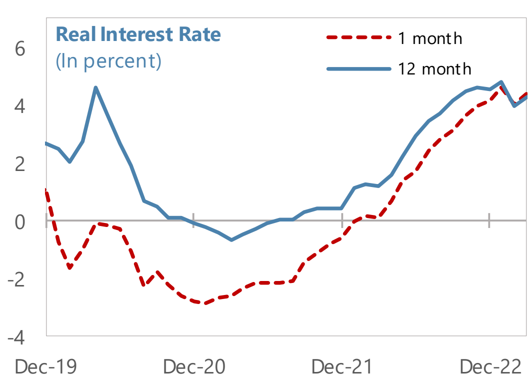
The central bank has progressively raised the policy rate...



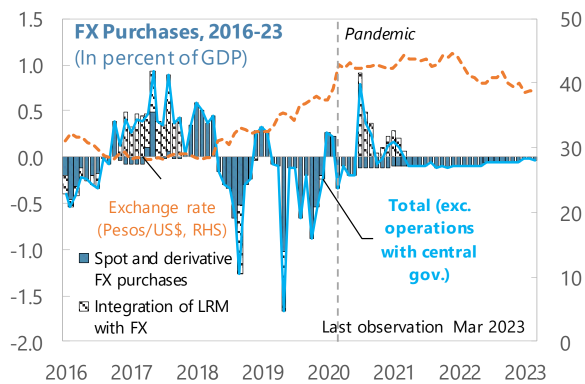
... resulting in an inversion of the yield curve...



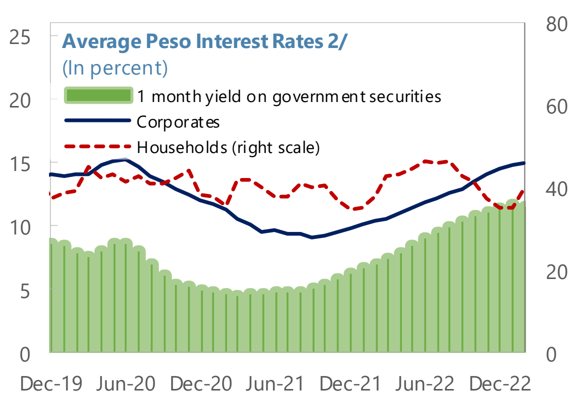
... and positive short-term real rates.



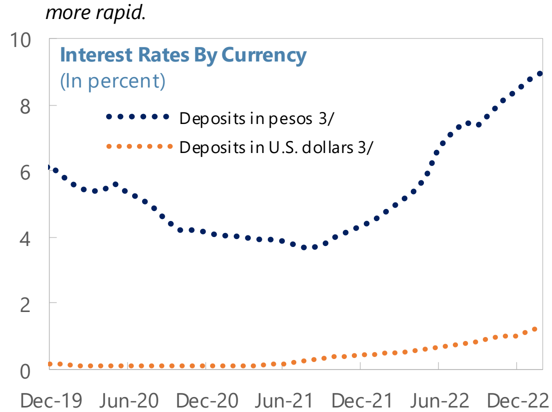
Since the onset of the pandemic, the central bank has limited FX intervention.



The transmision to credit loan rates was gradual...



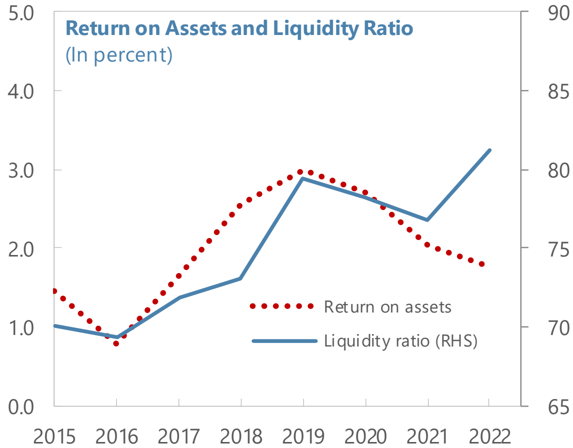
...although the trasmission to deposit rates was more rapid.



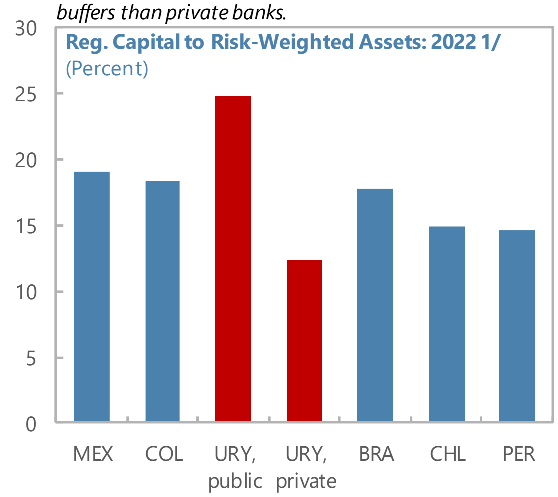
Sources: IMF, World Economic Outlook; Banco Central del Uruguay (BCU); and Fund staff estimates and calculations.
1/ Yields on BCU paper issued in nominal pesos (Letras de Regulación Monetaria).
2/ Average interest rates on new peso loans of up to one year.
3/ Weighted average rate on totality of fixed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

Figure 8. Uruguay: Credit and Banking

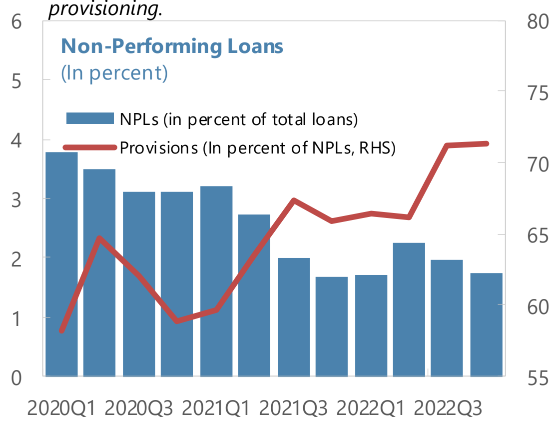
Uruguayan banks remain highly liquid and profitable...



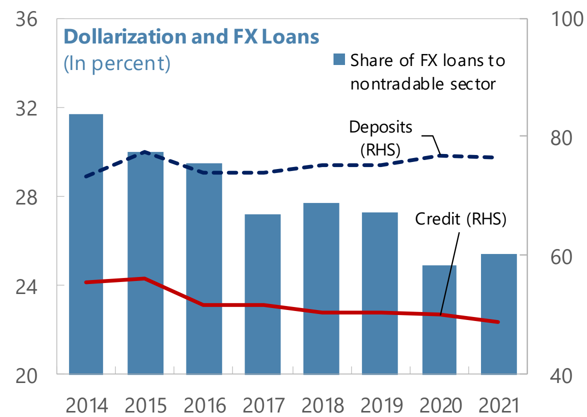
... while state-owned banks maintain higher capital buffers than private banks.



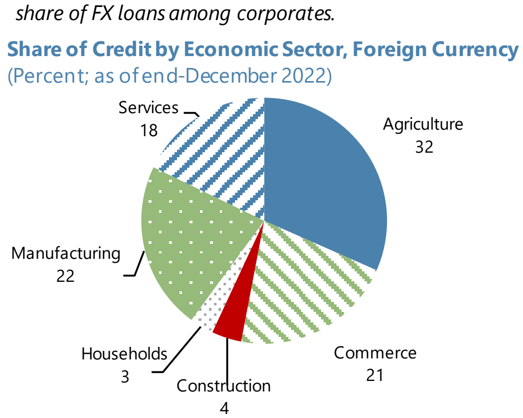
Non-performing loans remained low, amid increased provisioning.



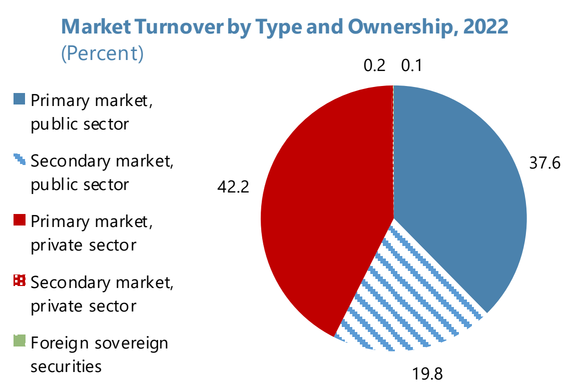
Dollarization, especially for deposits, remains high...



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



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

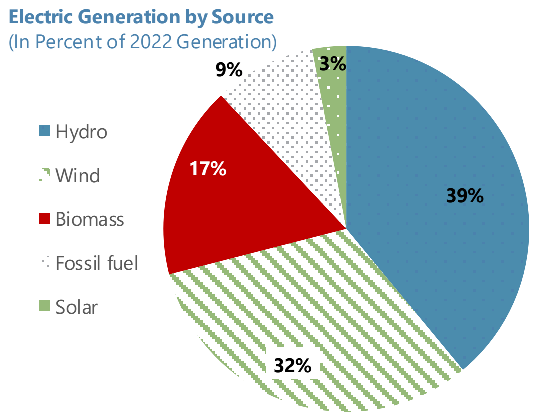


Sources: IMF, *World Economic Outlook*; Banco Central del Uruguay (BCU); and Fund staff estimates and calculations.

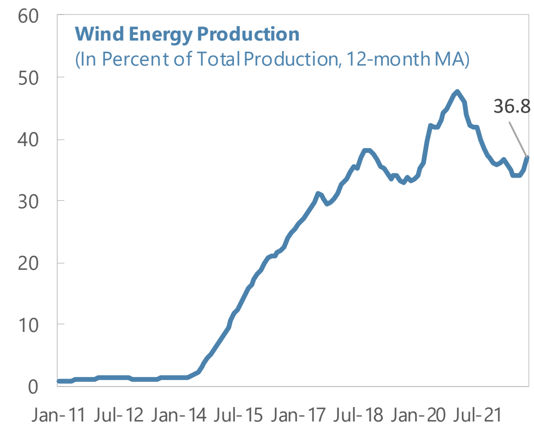
1/ Latest data available for Chile is for end-2021.

Figure 9. Uruguay: Climate

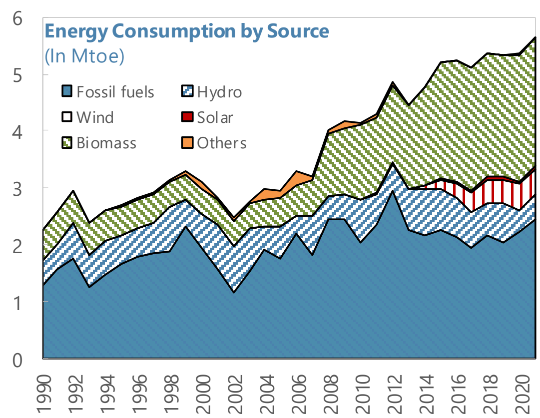
Most Uruguay's electricity production comes from renewable sources...



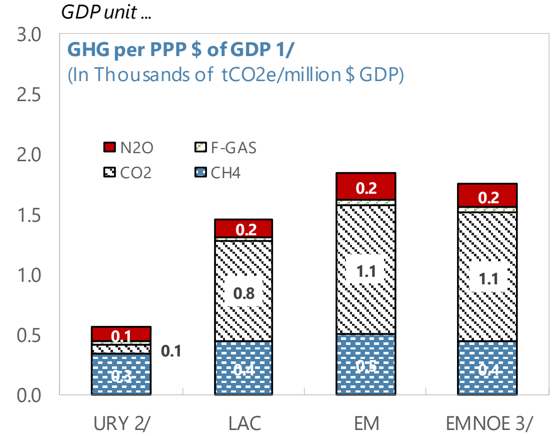
... partly reflecting the fast progress with wind energy.



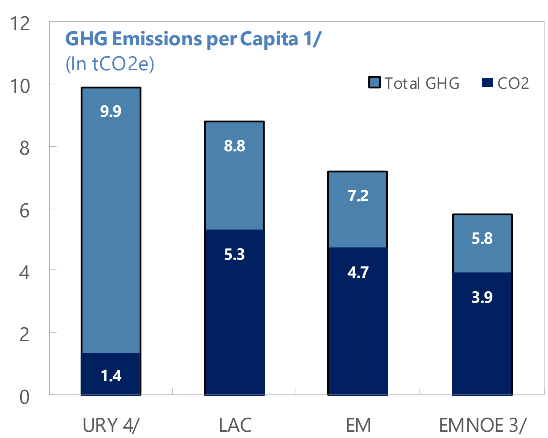
Similarly, energy consumption has shifted towards green power sources.



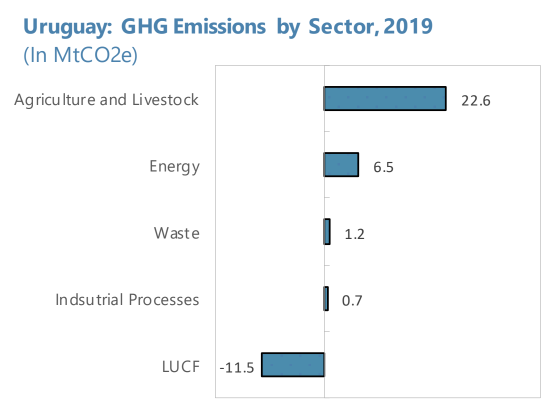
GHG emissions are lower than in peers in terms of per GDP unit ...



... although higher in per capita terms.



GHG emissions are concentrated in agriculture.



Sources: UNFCCC, WRI CAIT, Ministerio de Industria Energia y Mineria, WEO, IEA, INGEI.
1/ GHG emissions are net (include LUCF).
2/ Net GHGs per GDP unit for Uruguay are 0.3 thousands of tCO_2e/mln $GDP according to (INGEI 2019).
3/ EMNOE = Emerging markets non-oil exporting economies.
4/ Net GHGs per capita unit for Uruguay are 5.6 tCO_2e (INGEI 2019).
Note: Mtoe stands for millions of tonnes of oil equivalent. tCO_2e stands for tonnes of carbon dioxide equivalent. $MtCO_2e$ stands for millions of tonnes of carbon dioxide equivalent. CO_2e is defined as the equivalent of each different greenhouse gas in terms of the amount of CO_2 that would create the same amount of global waming impact.

Table 1. Uruguay: Selected Economic Indicators, 2021-24

	2021	2022	Projections 2023	2024
Output, prices, and employment				
Real GDP (percent change)	5.3	4.9	2.0	3.0
GDP (US$ billions)	61.4	71.2	76.5	80.5
Unemployment (in percent, pa)	9.4	7.9	8.2	8.1
Output gap (percent of potential output)	-2.0	-0.4	-0.6	-0.2
CPI inflation (in percent, end of period))	8.0	8.3	7.0	5.7
	(Percent change, unless otherwise specified)			
Monetary and banking indicators 1/				
Base money	9.1	1.7	...	...
M2	16.2	1.7	...	...
Growth of credit to households (in real pesos)	4.4	6.4	...	...
Growth of credit to firms (in US$)	7.0	19.1	...	...
Bank assets (in percent of GDP)	74.2	67.1	...	...
Private credit (in percent of GDP) 2/	27.0	26.1	...	...
	(Percent of GDP, unless otherwise specified)			
Fiscal sector indicators 3/				
Revenue CG-BPS (A)	27.0	27.1	26.1	26.5
excluding *cincuentones*	26.7	27.0	26.1	26.5
Primary expenditure CG-BPS (B)	27.9	27.8	27.3	27.5
Primary balance of local governments (C)	0.1	0.1	0.1	0.1
Primary balance of BSE (D)	0.1	0.0	0.2	0.2
Primary balance NFPS (A-B+C+D)	-0.6	-0.5	-1.0	-0.7
excluding *cincuentones* 4/	-0.9	-0.6	-1.0	-0.7
Interest NFPS	2.0	2.0	1.9	2.0
Overall balance NFPS	-2.6	-2.5	-2.9	-2.7
excluding *cincuentones* 4/	-3.0	-2.7	-3.0	-2.8
Gross debt NFPS	63.4	59.3	61.6	61.9
Net debt NFPS	53.3	50.5	52.9	53.3
External indicators				
Merchandise exports, fob (US$ billions)	15.7	17.2	15.5	16.6
Merchandise imports, fob (US$ billions)	11.2	13.6	13.3	14.5
Terms of trade (percent change)	1.9	-4.7	1.0	0.7
Current account balance	-2.5	-3.2	-3.2	-3.0
Total external debt + non-resident deposits	79.4	78.0	79.1	77.4
Of which: External public debt	34.7	29.1	33.6	32.4
External debt service (in percent of exports of g&s)	57.7	53.7	61.8	52.7
Gross official reserves (US$ billions)	17.0	15.1	16.1	16.3
In months of imports of goods and services	13.7	9.7	10.4	9.8
In percent of:				
Short-term external (STE) debt	221	169	221	215
STE debt plus banks' non-resident deposits	298	265	249	243

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

1/ Percent change of end-of-year data on one year ago.

2/ Includes bank and non-bank credit.

3/ Non-financial public sector (NFPS) includes the Central Government, Banco de Prevision Social, Banco de Seguros del Estado, and Non-Financial Public Enterprises.

4/ Temporary proceeds resulting from the pension reform that allowed workers above 50 years old (and with certain income level) to voluntarily move back to the public pension system. Proceeds are projected to end in 2022.

Table 2. Uruguay: Balance of Payments and External Sector Indicators, 2019-28

					Projections					
	2019	2020	2021	2022	2023	2024	2025	2026	2027	2028
	(In billions of U.S. dollars, unless otherwise indicated)									
Balance of Payments										
Current account	0.7	-0.4	-1.5	-2.3	-2.4	-2.4	-2.4	-2.3	-2.2	-2.1
Trade balance	3.1	2.2	4.5	3.5	2.2	2.2	2.7	3.0	3.3	3.5
Exports of goods	11.9	9.9	15.7	17.2	15.5	16.6	17.9	18.9	19.8	20.8
Imports of goods	8.8	7.9	11.2	13.6	13.3	14.5	15.2	15.9	16.6	17.3
Of which*:* Fuel products	1.0	0.8	1.3	2.0	1.6	1.6	1.7	1.7	1.8	1.9
Of which*:* Non-fuel products	7.8	7.1	9.9	11.6	11.7	12.9	13.6	14.2	14.8	15.4
Services balance	0.6	0.3	0.0	0.3	0.8	1.0	1.2	1.3	1.3	1.4
Exports, f.o.b.	5.4	3.7	3.7	5.4	6.1	6.6	7.0	7.4	7.7	8.1
Imports, f.o.b.	4.8	3.4	3.7	5.1	5.4	5.6	5.8	6.1	6.4	6.7
Income balance	-3.0	-2.9	-6.0	-6.2	-5.4	-5.7	-6.2	-6.5	-6.8	-7.0
Financial and capital account balance	-0.2	0.6	-0.8	-2.2	-2.4	-2.4	-2.3	-2.2	-2.1	-2.0
Foreign direct investment	-1.4	-1.0	-1.8	-3.3	-2.2	-2.1	-1.7	-1.0	-1.0	-1.0
Portfolio investment	1.0	1.5	0.9	1.5	0.8	1.1	1.1	1.0	1.1	1.1
Financial derivatives and other investments (net)	1.6	-1.6	-0.7	1.1	-2.0	-1.6	-2.0	-2.4	-2.4	-2.3
Change in reserve assets	-1.1	1.6	0.8	-1.6	1.0	0.2	0.2	0.2	0.2	0.2
Net errors and omissions	-0.2	0.9	0.8	0.1	0.0	0.0	0.0	0.0	0.0	0.0
Reserve Adequacy and External Indicators										
Gross official reserves (stock)	14.5	16.2	17.0	15.1	16.1	16.3	16.5	16.7	16.9	17.1
In months of imports of goods and services	12.9	17.1	13.7	9.7	10.4	9.8	9.4	9.1	8.8	8.6
In percent of short-term debt	211.7	229.3	220.6	168.6	221.2	215.4	209.7	205.5	201.4	197.5
	(In percent of GDP)									
Balance of Payments										
Current account	1.2	-0.8	-2.5	-3.2	-3.2	-3.0	-2.8	-2.6	-2.4	-2.2
Trade balance	5.0	4.0	7.3	5.0	2.9	2.7	3.2	3.4	3.6	3.7
Exports of goods	19.1	18.7	25.6	24.1	20.3	20.7	21.2	21.4	21.6	21.8
Imports of goods	-14.1	-14.7	-18.3	-19.1	-17.4	-18.0	-18.0	-18.0	-18.0	-18.1
Of which*:* Fuel products	1.6	1.4	2.2	2.8	2.1	2.0	2.0	2.0	2.0	1.9
Of which*:* Non-fuel products	12.5	13.3	16.1	16.3	15.3	16.0	16.0	16.1	16.1	16.1
Services balance	1.0	0.5	0.0	0.5	1.0	1.3	1.4	1.4	1.4	1.4
Exports	8.6	6.9	6.0	7.7	8.0	8.2	8.3	8.4	8.4	8.4
Imports	7.7	6.4	6.0	7.2	7.0	6.9	6.9	7.0	7.0	7.0
Income balance	-4.8	-5.3	-9.8	-8.7	-7.1	-7.0	-7.4	-7.4	-7.4	-7.3
Financial and capital account balance	-0.4	1.0	-1.2	-3.1	-3.1	-3.0	-2.7	-2.5	-2.3	-2.1
Foreign direct investment	-2.2	-1.9	-2.9	-4.6	-2.9	-2.6	-2.0	-1.2	-1.1	-1.1
Portfolio investment	1.7	2.8	1.4	2.2	1.0	1.3	1.3	1.1	1.2	1.1
Financial derivatives and other investments (net)	2.6	-3.0	-1.1	1.6	-2.6	-2.0	-2.3	-2.7	-2.6	-2.4
Change in reserve assets	-1.8	3.0	1.4	-2.2	1.3	0.2	0.2	0.2	0.2	0.2
Total external debt	72.8	87.7	79.4	78.0	79.1	77.4	76.1	75.7	75.0	74.8
Of which: Short-term debt (residual maturity)	11.0	13.2	12.5	12.6	9.5	9.4	9.3	9.2	9.2	9.1
Of which: External public debt	31.5	37.6	34.7	29.1	33.6	32.4	31.5	31.5	31.2	30.8
	(In percent of annual exports of goods and services)									
External Debt										
Total external debt (including non-resident deposits)	262	342	251	246	280	268	259	254	250	248
Debt service	61.4	76.9	57.7	53.7	61.8	52.7	52.9	51.3	51.5	50.2
Of which: Interest payments	1.4	1.3	1.2	1.4	1.6	1.9	2.2	2.5	2.6	2.8
	(Annual percent changes)									
External Trade										
Exports of goods in US$	0.7	-15.2	56.1	9.3	-9.5	7.2	7.6	5.5	5.0	4.9
Imports of goods in US$	-6.8	-9.7	41.9	21.4	-2.3	8.7	5.3	4.4	4.2	4.4
Export prices in US$	1.1	0.8	17.4	5.9	-2.8	1.5	2.7	2.5	2.3	2.6
Import prices in US$	-0.3	-3.6	12.7	11.5	-1.4	1.9	1.4	1.4	1.2	1.6
Terms of trade for goods	3.8	7.3	1.9	-4.7	1.0	0.7	1.9	1.6	1.7	1.5
Export volume (goods and non-factor services)	-2.3	-18.8	25.4	0.2	-4.4	3.9	3.1	1.9	1.6	1.4
Import volume (goods and non-factor services)	-5.6	-3.8	22.1	7.7	1.4	6.9	4.1	3.1	3.3	3.0
Export volume (goods)	-0.4	-15.9	32.9	3.2	-6.9	5.7	4.8	2.9	2.7	2.3
Import volume (goods)	-5.6	-3.8	22.1	7.7	1.4	6.9	4.1	3.1	3.3	3.0
Of which*:* Non-fuel products	-5.9	-5.2	25.5	9.3	0.2	7.0	3.9	3.2	3.0	2.6
Of which*:* Fuel products	-3.2	11.8	6.0	12.5	5.0	7.5	7.0	6.2	5.8	5.5

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

Table 3. Uruguay: Main Fiscal Aggregates, 2019-28

	2019	2020	2021	2022	2023	2024	2025	2026	2027	2028
					Projections					
	(In billions of pesos, unless otherwise indicated)									
Revenues	610	631	723	794	815	904	981	1,049	1,119	1,195
Taxes	390	416	479	536	564	615	666	713	760	810
Other	43	45	54	60	63	69	75	80	85	91
Non tax	29	30	33	30	32	35	38	41	43	46
Social security (BPS)	175	163	173	199	203	220	240	256	273	294
of which: *cincuentones*	23	13	8	3	0	0	0	0	0	0
Primary balance NFPE	17	22	38	29	16	34	37	40	42	45
Primary expenditures	622	680	746	813	853	938	1,011	1,074	1,138	1,206
Current	573	635	698	744	797	876	945	1,003	1,062	1,124
Wages	110	118	125	134	149	161	169	177	185	193
Goods and services	78	89	116	114	117	128	138	145	155	165
Pensions	205	226	244	261	283	318	345	368	388	410
Transfers	180	202	214	235	248	270	292	313	334	356
Capital	49	45	48	69	57	62	67	72	76	81
Central government	29	29	29	45	34	37	40	43	46	49
Public enterprises	20	16	19	24	23	25	27	29	31	33
Primary balance of CG, BPS and NFPE 1/ 2/	-12	-49	-23	-19	-39	-34	-30	-25	-19	-10
Primary balance of local governments	-1	2	3	3	3	4	4	5	5	5
Primary balance of BSE 3/	3	0	3	1	5	7	7	8	8	9
Primary balance NFPS	-11	-47	-17	-15	-31	-23	-19	-13	-6	4
excluding *cincuentones*	-34	-60	-25	-18	-31	-23	-19	-13	-6	4
Interest of the NFPS 4/	47	58	53	59	60	69	72	79	85	90
Overall balance of the NFPS 4/	-57	-105	-70	-74	-90	-92	-91	-92	-91	-86
excluding *cincuentones*	-80	-121	-81	-80	-94	-95	-95	-96	-95	-91
Gross debt NFPS	1,308	1,535	1,695	1,738	1,926	2,111	2,289	2,458	2,629	2,811
Net debt NFPS	1,094	1,293	1,425	1,481	1,655	1,818	1,976	2,127	2,280	2,439
	(In percent of GDP, unless otherwise indicated)									
Revenues	27.9	28.0	27.0	27.1	26.1	26.5	26.6	26.5	26.5	26.6
Taxes	17.8	18.5	17.9	18.3	18.0	18.0	18.0	18.0	18.0	18.0
Other	2.0	2.0	2.0	2.1	2.0	2.0	2.0	2.0	2.0	2.0
Non tax	1.3	1.3	1.2	1.0	1.0	1.0	1.0	1.0	1.0	1.0
Social security (BPS)	8.0	7.2	6.5	6.8	6.5	6.5	6.5	6.5	6.5	6.5
of which: *cincuentones*	1.0	0.6	0.3	0.1	0.0	0.0	0.0	0.0	0.0	0.0
Primary balance NFPE	0.8	1.0	1.4	1.0	0.5	1.0	1.0	1.0	1.0	1.0
Primary expenditures	28.4	30.2	27.9	27.8	27.3	27.5	27.4	27.2	27.0	26.8
Current	26.2	28.2	26.1	25.4	25.5	25.7	25.6	25.4	25.2	25.0
Wages	5.0	5.2	4.7	4.6	4.8	4.7	4.6	4.5	4.4	4.3
Goods and services	3.6	4.0	4.3	3.9	3.7	3.8	3.7	3.7	3.7	3.7
Pensions	9.4	10.0	9.1	8.9	9.1	9.3	9.3	9.3	9.2	9.1
Transfers	8.2	9.0	8.0	8.0	7.9	7.9	7.9	7.9	7.9	7.9
Capital	2.3	2.0	1.8	2.4	1.8	1.8	1.8	1.8	1.8	1.8
Central government	1.3	1.3	1.1	1.6	1.1	1.1	1.1	1.1	1.1	1.1
Public enterprises	0.9	0.7	0.7	0.8	0.7	0.7	0.7	0.7	0.7	0.7
Primary balance of CG, BPS and NFPE 1/ 2/	-0.5	-2.2	-0.8	-0.7	-1.2	-1.0	-0.8	-0.6	-0.5	-0.2
Primary balance of local governments	-0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Primary balance of BSE 3/	0.1	0.0	0.1	0.0	0.2	0.2	0.2	0.2	0.2	0.2
Primary balance NFPS	-0.5	-2.1	-0.6	-0.5	-1.0	-0.7	-0.5	-0.3	-0.1	0.1
excluding *cincuentones*	-1.5	-2.7	-0.9	-0.6	-1.0	-0.7	-0.5	-0.3	-0.1	0.1
Interest of the NFPS	2.1	2.6	2.0	2.0	1.9	2.0	2.0	2.0	2.0	2.0
Overall balance of the NFPS	-2.6	-4.7	-2.6	-2.5	-2.9	-2.7	-2.5	-2.3	-2.1	-1.9
excluding *cincuentones*	-3.7	-5.3	-3.0	-2.7	-3.0	-2.8	-2.6	-2.4	-2.2	-2.0
Gross debt NFPS	59.8	68.1	63.4	59.3	61.6	61.9	62.0	62.2	62.4	62.5
Net debt NFPS	50.0	57.3	53.3	50.5	52.9	53.3	53.5	53.8	54.1	54.2
Memorandum Items:										
Real revenues growth (in percent)	-1.8	-5.9	1.7	5.1	-1.9	4.9	3.0	2.4	2.3	2.4
Real primary spending growth (in percent)	2.1	0.6	1.7	-0.5	-2.2	3.6	2.2	1.6	1.3	1.3
GDP (in billions of pesos)	2,188	2,255	2,675	2,930	3,126	3,408	3,694	3,952	4,216	4,497

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

1/ Banco de Prevision Social (BPS).

2/ Non-financial public enterprises (NFPE).

3/ Banco de Seguros del Estado (BSE).

4/ Banco Central del Uruguay (BCU).

Table 4. Uruguay: Monetary Survey, 2016-22

	2016	2017	2018	2019	2020	2021	2022
	(End of period, in billion of pesos)						
Banco Central del Uruguay (BCU)							
Net foreign assets	399	461	565	560	705	764	615
Gross international reserves	394	459	546	542	687	758	606
Net domestic assets	-285	-330	-443	-413	-542	-584	-421
Net credit to the public sector	60	104	112	108	66	35	63
Net credit to the financial system	-202	-176	-272	-284	-323	-346	-288
Credit to the private sector	1	1	1	1	1	0	0
Securities issued by the BCU	-125	-250	-222	-205	-280	-291	-283
Other	-55	-56	-162	-105	-76	-30	94
Peso monetary liabilities 1/	113	131	122	147	163	180	194
Public and Private Banks 2/							
Net foreign assets	177	168	318	281	395	477	449
Net domestic assets	611	633	735	757	899	1,039	998
Net credit to the public sector	39	36	62	56	63	77	70
Net credit to the financial system	250	285	339	351	439	497	403
Credit to the private sector	445	445	548	554	627	706	773
Other	-123	-133	-214	-204	-229	-241	-248
Liabilities to the private sector (residents)	788	801	1,051	1,038	1,293	1,516	1,491
Banking System (Central, Private, and Public Banks)							
Net foreign assets	575	629	883	841	1,100	1,241	1,064
Net domestic assets	236	197	195	230	229	313	425
Credit to the public sector	98	140	174	164	129	112	133
Credit to the rest of financial system	-6	50	70	24	57	57	-44
Credit to the private sector	445	446	549	555	627	706	773
Other	-302	-439	-598	-514	-585	-562	-438
Broad money (M3)	811	826	1,078	1,070	1,329	1,554	1,528
	(In percent of total private credit) 3/						
Composition of Credit							
Credit to firms	60.9	57.3	56.7	57.9	60.3	63.2	62.0
Credit to households	39.1	42.7	43.3	42.1	39.7	36.8	38.0
Consumption	46.6	45.8	44.5	44.2	55.0	50.5	51.1
Car loans	0.0	0.0	0.0	0.3	3.6	4.2	5.4
Mortgages	25.9	25.8	25.1	25.4	41.5	45.3	43.4
	(Percentage change) 3/						
Memorandum Items:							
Base money	9.7	3.6	-6.5	27.2	5.8	9.1	1.7
M1	6.6	10.3	2.8	8.8	15.7	16.4	1.7
Broader M1 (M1 plus savings deposits)	8.4	15.0	5.7	8.3	18.5	17.8	7.0
M2	14.4	13.3	9.9	6.3	16.8	16.2	1.7
M3	3.9	1.9	30.4	-0.7	24.2	16.9	-4.2
Credit to firms (in US$)	1.5	-4.2	2.4	-3.7	1.1	7.0	19.1
Credit to households (in real pesos) 4/	-0.5	2.7	1.3	1.9	-0.6	4.4	6.4

Source: Banco Central del Uruguay.

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

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

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

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

Table 5. Uruguay: Medium-Term Macroeconomic Framework, 2019-28

					Projections					
	2019	2020	2021	2022	2023	2024	2025	2026	2027	2028
	(Annual percent change, unless otherwise indicated)									
National Accounts										
Real GDP	0.7	-6.3	5.3	4.9	2.0	3.0	2.8	2.5	2.3	2.2
Total domestic demand	-0.3	-4.7	6.5	5.1	3.7	3.4	2.9	2.9	2.7	2.6
Final consumption expenditure	0.9	-6.9	4.0	5.0	3.7	3.4	2.8	2.9	2.6	2.4
Private final consumption expenditure	0.6	-6.8	2.9	6.0	3.7	3.2	3.0	2.3	2.0	1.8
Public final consumption expenditure	1.9	-7.1	8.4	1.6	3.7	3.8	2.2	4.9	4.6	4.5
Gross capital formation	-6.3	7.7	18.3	5.2	3.6	3.4	3.3	2.7	3.2	3.2
Gross fixed capital formation	-2.0	1.2	16.4	9.5	2.0	3.4	3.3	2.7	3.2	3.2
Private fixed capital formation	-2.2	1.3	16.3	7.4	4.1	3.2	3.1	2.6	3.1	3.1
Public fixed capital formation	0.8	-0.5	17.7	36.2	-19.3	5.7	5.7	4.7	4.6	4.3
Change in inventories (contribution to growth)	-0.7	0.9	0.4	-0.7	0.3	0.0	0.0	0.0	0.0	0.0
Net exports (contribution to growth)	1.0	-1.9	-0.9	0.0	-1.6	-0.3	-0.1	-0.3	-0.4	-0.4
Consumer Prices										
CPI inflation (average)	7.9	9.8	7.7	9.1	7.6	6.1	5.5	4.5	4.5	4.5
CPI inflation (end of period)	8.8	9.4	8.0	8.3	7.0	5.7	5.0	4.5	4.5	4.5
Balance of Payments										
Current account balance (percent of GDP)	1.2	-0.8	-2.5	-3.2	-3.2	-3.0	-2.8	-2.6	-2.4	-2.2
Exports of goods and services (volume)	-2.3	-18.8	25.4	0.2	-4.4	3.9	3.1	1.9	1.6	1.4
Export of goods (volume)	-0.4	-15.9	32.9	3.2	-6.9	5.7	4.8	2.9	2.7	2.3
Imports of goods and services (volume)	-3.1	-12.8	16.4	12.6	1.2	5.2	3.6	3.2	3.1	2.7
Imports of goods (volume)	-5.6	-3.8	22.1	7.7	1.4	6.9	4.1	3.1	3.3	3.0
Terms of trade (goods)	1.4	4.5	4.2	-5.1	-1.3	-0.4	1.2	1.1	1.1	1.0
	(In percent of GDP, unless otherwise indicated)									
Non Financial Public Sector										
Revenues	27.9	28.0	27.0	27.1	26.1	26.5	26.6	26.5	26.5	26.6
of which: cincuentones transactions	1.0	0.6	0.3	0.1	0.0	0.0	0.0	0.0	0.0	0.0
Primary expenditures	28.4	30.2	27.9	27.8	27.3	27.5	27.4	27.2	27.0	26.8
Primary balance NFPS 1/	-0.5	-2.1	-0.6	-0.5	-1.0	-0.7	-0.5	-0.3	-0.1	0.1
excluding cincuentones transactions	-1.5	-2.7	-0.9	-0.6	-1.0	-0.7	-0.5	-0.3	-0.1	0.1
Cyclically adjusted primary balance	-1.6	-0.6	0.9	-0.1	-0.8	-0.6	-0.5	-0.3	-0.2	0.1
Overall balance NFPS	-2.6	-4.7	-2.6	-2.5	-2.9	-2.7	-2.5	-2.3	-2.1	-1.9
excluding cincuentones transactions	-3.7	-5.3	-3.0	-2.7	-3.0	-2.8	-2.6	-2.4	-2.2	-2.0
Gross NFPS debt	59.8	68.1	63.4	59.3	61.6	61.9	62.0	62.2	62.4	62.5
Net NFPS debt (gross debt minus financial assets)	50.0	57.3	53.3	50.5	52.9	53.3	53.5	53.8	54.1	54.2
External Debt										
Gross external debt	72.8	87.7	79.4	78.0	79.1	77.4	76.1	75.7	75.0	74.8
NFPS gross external debt	31.5	37.6	34.7	29.1	33.6	32.4	31.5	31.5	31.2	30.8
Gross international reserves (US$ billions)	14.5	16.2	17.0	15.1	16.1	16.3	16.5	16.7	16.9	17.1
Saving and Investment										
Gross domestic investment	14.3	16.4	19.2	18.8	18.2	17.9	17.5	17.2	17.0	16.8
Public sector gross investment	3.1	3.4	3.7	5.0	3.8	3.8	3.8	3.8	3.8	3.8
Private sector gross investment	11.2	13.0	15.5	13.8	14.4	14.1	13.7	13.4	13.2	13.0
Gross national saving	15.5	15.6	16.7	15.6	15.1	14.8	14.7	14.6	14.6	14.6
Public sector gross saving	-0.4	-2.7	-0.8	-0.2	-1.1	-0.9	-0.7	-0.5	-0.3	-0.1
Private sector gross saving	15.9	18.2	17.6	15.8	16.1	15.7	15.4	15.1	15.0	14.8
Unemployment and Output Gap										
Population (Mil)	3.5	3.5	3.5	3.6	3.6	3.6	3.6	3.6	3.6	3.6
Labor force participation (percent)	62.2	60.5	61.4	61.9	62.2	62.2	62.2	62.2	62.2	62.2
Employment growth (percent)	-0.7	-3.9	2.9	2.8	0.4	0.5	0.3	0.4	0.4	0.3
Unemployment rate (percent)	8.9	10.4	9.4	7.9	8.2	8.1	8.1	8.0	8.0	8.0
Output gap (percent of potential output)	-0.9	-4.3	-2.0	-0.4	-0.6	-0.2	-0.2	-0.1	0.0	0.0

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

Table 6. Uruguay: Selected Financial Soundness Indicators, 2015-22

	2015	2016	2017	2018	2019	2020	2021	2022
Capital Adequacy								
Regulatory capital in percent of risk-weighted assets	12.6	15.1	15.6	16.6	16.8	17.7	16.3	16.9
Regulatory Tier 1 capital to risk-weighted assets	11.4	13.8	14.5	15.6	15.7	12.5	15.4	15.8
Capital to assets	7.4	8.6	9.2	11.1	10.4	7.3	8.9	9.6
Asset Quality								
Non-performing loans in percent of total loans	1.6	2.4	2.7	2.8	2.6	2.3	1.3	1.4
Specific loan-loss provisions in percent of non-performing loans	148.0	152.0	158.3	159.7	177.1	177.4	283.9	272.4
Earnings and Profitability								
Return on assets	1.5	0.8	1.7	2.6	3.0	2.7	2.0	1.8
Return on equity	11.8	2.7	11.4	19.1	21.5	20.8	15.4	11.6
Interest marging to gross income	62.9	60.2	61.7	66.4	65.0	63.7	63.3	69.2
Trading income to total income	4.9	6.1	5.6	1.1	0.7	2.4	0.5	-2.5
Liquidity								
Liquid assets to total assets	52.1	50.7	52.0	53.4	70.2	59.4	59.5	55.9
Liquid assets to short-term liabilities	70.1	69.4	71.9	73.1	79.5	78.2	76.8	81.2
Customer deposits to total (noninterbank) loans	188.4	180.4	179.1	169.9	182.4	205.5	205.8	178.9
Net open position in foreign exchange to capital	50.6	36.1	34.5	35.7	36.2	32.6	29.9	30.6
Dollarization								
Foreign-Currency-Denominated Loans to Total Loans	67.3	64.9	62.0	70.4	57.0	55.8	53.8	51.2
Foreign-Currency-Denominated Liabilities to Total Liabilities	78.2	74.0	70.6	70.0	73.3	74.3	73.8	71.1

Sources: Uruguayan authorities and IMF Financial Soundness Indicators.

Annex I. External Sector Assessment

Overall Assessment: *The external position in 2022 was broadly in line with the level implied by medium-term fundamentals and desirable policies.* The CA deficit is expected to remain at 3.2 percent of GDP in 2023, as the impact of the drought would offset the normalization of the services balance, particularly led by the recovery of tourism and the reduction of transportation costs. The CA balance is forecasted to converge to a deficit of about 2.2 percent of GDP in the medium term, driven by a positive goods and services balance and a negative primary income balance.

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

Foreign Asset and Liability Position and Trajectory

Background. Uruguay's NIIP was –23 percent of GDP at the end of 2022, modestly stronger than the 2017–21 average (–25.1 percent of GDP) stemming from higher GDP growth and the appreciation of the peso. Foreign assets in 2022 were mostly comprised of direct investment (47 percent of GDP) while international reserves accounted for 21 percent of GDP. Foreign direct investment accounted for almost 63 percent of the country's liabilities. Over the medium term, as real GDP growth converges to its potential and the current account stabilizes around its norm, the NIIP is projected to hover around –31 percent of GDP.

Assessment. While Uruguay's NIIP is negative, the composition of its liabilities (mainly FDI) and low sovereign risk spreads create favorable conditions. Over the medium term, underpinned by a strong institutional framework and a prudent macroeconomic management, the NIIP-to-GDP ratio is expected to remain broadly stable. Vulnerabilities arise from financial dollarization and relatively large share of foreign-currency public debt.

2022 (% GDP)	NIIP: -22.6	Gross Assets: 116.0	Debt Assets: 81.8	Gross Liab.: 138	Debt Liab.: 78.8

Current Account

Background. The CA deficit reached 3.2 percent of GDP in 2022, widening compared to 2021. A recent data revision increased the current account deficit to 2.5 percent in 2021 from 1.8 percent previously reported. This large increase reflects newly available survey data from large corporations. Despite two years of historically high goods exports, imports have also rebounded strongly while the services balance has deteriorated owing to subdued tourism proceeds and increased maritime freight costs. From 2018 to 2022, the current account has also widened on the back of stronger FDI payouts, with a primary income balance shifting from –5.6 to –8.8 percent of GDP during that period. In 2023, the drought will weigh on exports, offsetting partially the benefits from the recovery of tourism to pre-pandemic levels and declining transportation costs, leaving the CA deficit unchanged at 3.2 percent of GDP. Over the medium term, the CA deficit is expected to gradually converge to about 2.2 percent of GDP.

Assessment. The EBA model estimates a cyclically adjusted CA norm of –2.2 percent of GDP in 2022. This implies an EBA CA gap of -1.4 percent of GDP, with a range from -1.9 to -0.9 percent of GDP. Staff adjustments were made to account for the transitory impact of the COVID-19 pandemic and its aftermath on travel (-0.5 percent of GDP) and transportation services (-0.3 percent of GDP). Including these adjustments, staff assesses the midpoint CA gap at -0.6 percent of GDP, with a range of -1.1 to -0.1 percent of GDP.

2022 (% GDP)	CA: -3.2	Cycl. Adj. CA: -3.6	EBA Norm: -2.2	EBA Gap: -1.4	COVID-19 Adj.: 0.8	Other Adj.: 0.0	Staff Gap: -0.6

Real Exchange Rate

Background. In 2022, the peso appreciated 10 percent, decreasing from 44.7 to 40.1 pesos per US dollar. After a cumulative 7 percent real depreciation between 2018 and 2021, the REER in 2022 appreciated on average by about 9.6 percent compared with the 2021 average, mostly driven by a nominal appreciation.

Assessment. The IMF staff CA gap implies a REER gap of 3.2 percent of GDP (applying a semi-elasticity of 0.19). The EBA REER level and index models estimate an overvaluation of 30.4 percent and of 12.9 percent, respectively, in 2022. The IMF staff's overall assessment, based on the CA gap, is a REER gap in the range of 0.5 to 5.8 percent, with a midpoint of 3.2 percent.

Capital and Financial Accounts: Flows and Policy Measures

Background. In 2022, Uruguay recorded net financial account inflows around 3.2 percent of GDP, slightly larger than 2021 (2.6 percent of GDP). Net capital inflows were mainly originated from foreign direct investment (4.6 percent of GDP) and the drawdown of reserve assets (2.2 percent of GDP) held by the central bank. These movements were partially offset by portfolio and other investments.

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

FX Intervention and Reserves Level

Background. Uruguay has a floating exchange rate. Following the 2020 enhancement of the monetary policy framework, which switched to the short-term interest rate as the main policy instrument, the exchange rate has gradually been allowed to act as shock absorber. In 2022, the central bank did not conduct FX interventions in the spot market, while reserves remained high at US$15 billion. The central bank conducted forward operations with SOEs in the amount of US$550 million or 0.8 percent of GDP.

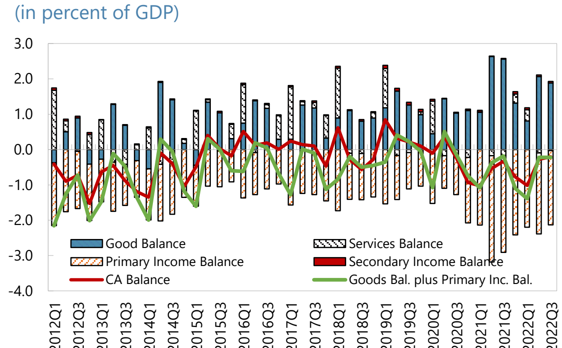
Assessment. Reserves are adequate relative to various criteria, including the IMF's reserve adequacy metric (around 160 percent as of the end of 2022) and serve as insurance against external shocks. The exchange rate should continue to act as a shock absorber and FX interventions should be limited to respond to disorderly FX market conditions.

Annex II. Drivers of the Primary Income Balance

The income balance (IB) is a key component of Uruguay's current account balance (CAB). In net terms, the IB deficit has offset trade balance surpluses and explains the negative CAB in most years since 2012. Uruguay's relatively high primary income deficit is explained by the composition of its International Investment Position (IIP), underpinned by high FDI liabilities with higher yields than those from FDI foreign assets. Also, the large share of exports related to FDI and the rising importance of net exports sold under merchanting explain the correlation between goods exports and income debits.

1. Uruguay's current account (CA) fluctuations have been characterized by persistent surpluses in the goods trade balance, offset by recurrent deficits in the primary income balance. Gross flows of goods exports, goods imports and primary income debit are the most important components behind the variability of the current account between 2012 and 2022. Interestingly, the co-movement between the flows of goods exports and primary income debit (PID), with opposite effects on the CA balance, is strong (correlation=0.72). Other components of the CA have less relevance because of their lower magnitudes or smaller variability. Services balance has been, on average, positive but relatively small during this period. Meanwhile, the role of the primary income credit and the secondary income gross flows have been negligible to explain variations in the CAB.

Current Account Composition
(in percent of GDP)



Source: IMF staff calculations based on BCU BOP data.
The chart shows the quarterly BOP accounts as percent of the corresponding annual GDP.

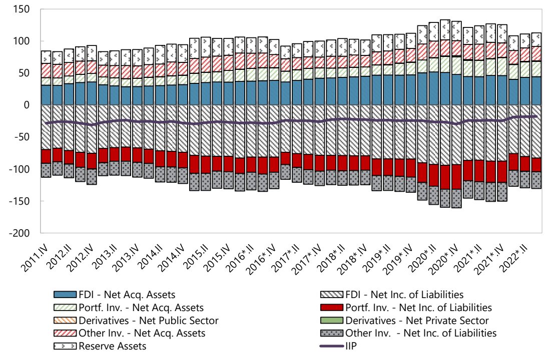
Current Account Principal Components Analysis

	1st Component (PCA - Variance)	1st Component (PCA - Correl.)
Goods Credit	0.80	0.43
Goods Debit	-0.50	-0.34
Services Credit	-0.06	0.13
Services Debit	-0.11	-0.43
Primary Income Credit	0.03	0.35
Primary Income Debit	-0.31	-0.46
Secondary Income Credit	0.00	0.33
Secondary Income Debit	0.00	-0.25

Source: IMF staff calculations based on BCU BOP quarterly data. The 1st PCA-variance component explains 70 percent of the total variance of the series. The 1st PCA component (correlation) explains 40 percent of the total variance of the correlation matrix.

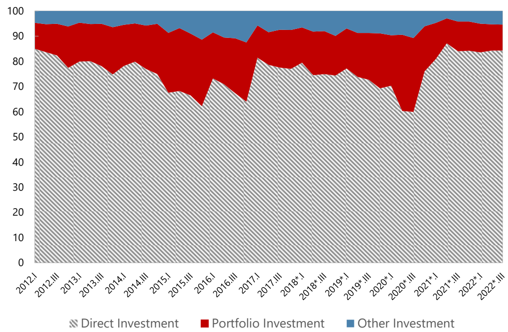
2. IIP liabilities have been dominated by the role of FDI, which has important implications for explaining the relevance of the IB in Uruguay's external position. Meanwhile, IIP assets have been more balanced between FDI, portfolio, and other investment assets. According to IIP statistics, the average stock of FDI liabilities (around 80 percent of GDP) is about twice the size of FDI assets (40 percent of GDP). Moreover, FDI returns are the PID account's dominant component. That makes FDI inflows (and stock liabilities) the natural candidate to explain variations in the IB.

International Investment Position
(percent of GDP)



Source: IMF staff estimates based on quarterly BCU IIP data.

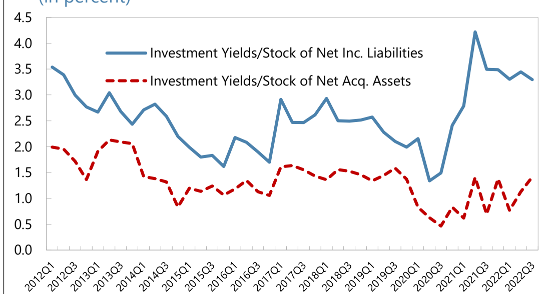
Primary Income Debit by Type of Investment
(in percent)



Source: IMF staff calculations based on BCU data.

3. The implicit returns on FDI liabilities have increased since 2021. Both PID and FDI liabilities have risen strongly since 2021. However, the rise of PID was faster than the one seen in FDI liabilities. That resulted in higher FDI yields (as a percent of the stock of FDI net liabilities). In addition, FDI yields of Uruguayan investments abroad (FDI net assets) have been consistently lower than those of the foreigners investing in Uruguay, exacerbating the deficit in the primary income balance.

FDI yields
(in percent)

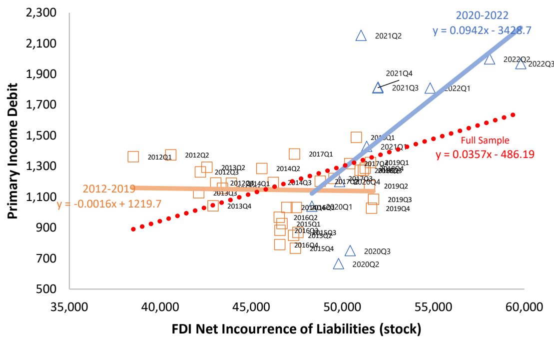


Source: IMF staff calculations based on quarterly BCU BOP and IIP data. Yields are measured as the rates between Primary Income Credit (debit) and the Stock of net Acq. (Inc) of Assets (Liabilities).

4. The increase in FDI yields and the PID appears to be driven by the recent strong performance of goods exports. The high correlation between the exports of goods and the PID could be explained by the large share of FDI companies in export activities in Uruguay. According to reports from the Uruguayan government, in 2018, 70 percent of the total exports of goods were related to foreign capital companies. This figure increased from 24 percent in 2003.[1] In that regard, the stock of FDI liabilities would capture the quantity effect or extensive margin on FDI implicit returns, while the flows of goods exports would be a proxy for the intensive margin of those investments.

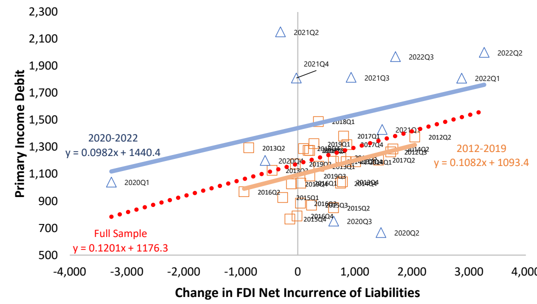
[1] See "Informe Inversión Extranjera Directa", Uruguay XXI, 2022, and; "Boom del IED en Uruguay y su Impacto en las Exportaciones de Bienes", Uruguay XXI, Documento de Trabajo N 13.

FDI Net Incurrence of Liabilities vs Primary Income Debit (in $US million)



Source: IMF staff calculations based on BCU data.

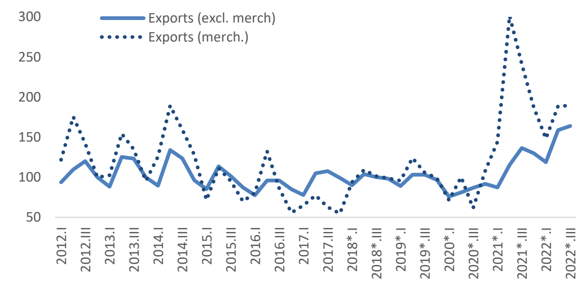
Change in FDI Net Incurrence of Liabilities vs Primary Income Debit
(in $US million)



Source: IMF staff calculations based on quarterly BCU BOP and IIP data.

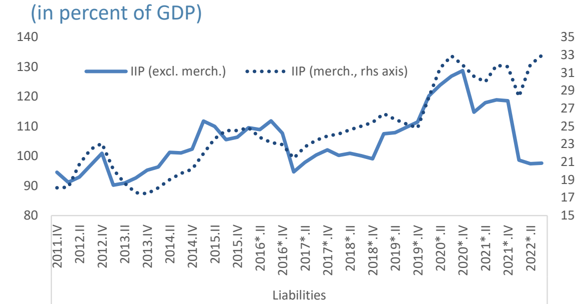
5. **Exports of goods related to merchanting transactions gained relevance in the last decade.** The breakdown of export of goods shows that the merchanting modality has been growing at a faster pace and has been more volatile than non-merchanting exports, especially in recent years.[2] Consequently, since 2012, the corresponding merchanting-related IIP liabilities have nearly doubled, in percent of GDP, while non-merchanting IIP liabilities have stayed almost flat.

Exports of Goods (index 2012Q4 =100)



Source: IMF staff estimates based on quarterly BCU IIP data.
* Preliminary data

International Investment Position
(in percent of GDP)



Source: IMF staff estimates based on quarterly BCU IIP data.
* Preliminary data

6. **The strong relationship between PID, the composition of goods exports, and FDI liabilities can be incorporated into current account projections.** A cointegration analysis finds evidence of a robust long-term relationship between these three components of the BOP and IIP. Under the preferred specification to explain the PID, where all variables are expressed as a percent of GDP (specification 3 in Table 1), merchanting and non-merchanting exports of goods, separately, increase PID. Similarly, a one p.p. increase in the stock of FDI liabilities to GDP ratio would be associated with a 0.04 percent of GDP higher PID. The table of results also shows marginal effects from specifications of the PID in USD. An additional interesting result is that the association between exports of goods and PID is stronger than between the stock of FDI and PID. These findings have been incorporated into the staff's macroframework projections.

[2] According to the Balance of Payments manual, 6th edition (BP6), merchanting refers to the purchase of goods by a resident (a person or business entity) of one country from a nonresident, and the subsequent resale of those goods to another nonresident without the goods entering the domestic economy of the merchant.

Table 1. Uruguay: Regression Results

	(1)	(2)	(3)	Statistics	
Method:	FMLS	FMLS	FMLS	Mean	Std. Dev.
Dep. Var:	PID	PID	PID/GDP		
Exports of Goods (merchanting) 1/	0.63	0.46		492	209
	(0.27)**	(0.27)*			
Exports of Goods (excl. merchanting) 1/	0.19	0.34		2,681	517
	(0.11)*	(0.12)***			
FI inc. of Liabilities-IIP (merchanting, lagged) 1/	0.05	0.05		13,436	2,536
	(0.02)**	(0.02)**			
Exports of Goods as % of GDP (merchanting) 2/			0.6	0.8	0.3
			(0.27)**		
Exports of Goods as % of GDP (excl. merchanting) 2/			0.33	4.4	0.7
			(0.15)**		
FI inc. of Liabilities-IIP as % of GDP (merchanting, lagged) 2/			0.04	22.0	4.0
			(0.02)**		
Quarterly Dummies	No	Yes	Yes		
Observations:	41	41	41	43	43
R-squared:	0.7	0.81	0.73		

Source: IMF staff calculations based on BCU data.
In parenthesis, robust standard errors. Standard errors that are significant at the 10%, 5% or 1% level noted with an asterix *, double asterix ** and triple asterisk ***, respectively.

1/ Quarterly data. Variables in levels expressed in millions of USD.

2/ Quarterly data. Measured in percent of annual GDP.

Annex III. External Sector DSA

1. External debt in Uruguay reached 78 percent of GDP in 2022 after peaking in 2020 (see Table). In 2022, the economic recovery and fiscal consolidation contributed to bringing down the level of debt. About 42 percent of the external debt is owed by the public sector.

2. Gross external debt is forecasted to slightly increase in 2023, leveling at around 79.1 percent of GDP. Over the medium term, external debt is projected on a downward trend owing to favorable automatic debt dynamics as well as narrower fiscal and current account deficits.

3. Gross external financing requirements are expected to gradually converge to 14 percent of GDP. This reduction would be underpinned by a stronger non-interest current account surplus and stable amortizations of longer-term debt.

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

5. The main risk to Uruguay's external debt sustainability is an exchange rate depreciation. A one-off 30 percent exchange rate depreciation would increase the external debt-to-GDP ratio to 114.8 percent of GDP in the short-term, while stabilizing in the medium-term around 109 percent of GDP (see Figure).

6. Overall, the outlook for external debt sustainability has improved on the back of stronger macroeconomic performance, fiscal consolidation and favorable debt dynamics. Despite an external context marked by higher interest rates, under the baseline scenario, the medium-term external debt is lower in almost 10 percentage points when compared to the previous external DSA in 2021. Considering that Uruguay's external liabilities are mainly comprised of foreign direct investments and that the country maintains sizeable gross international reserves and fiscal liquidity buffers, risks to external debt sustainability remain limited.

Table 1. Uruguay: External Debt Sustainability Framework, 2016–2028

(In percent of GDP, unless otherwise indicated)

	Actual									Projections						
	2016	2017	2018	2019	2020	2021	2022			2023	2024	2025	2026	2027	2028	Debt-stabilizing non-interest current account 7/
Baseline: External debt 1/	70.2	65.0	66.0	72.8	87.7	79.4	78.0			**79.1**	**77.4**	**76.1**	**75.7**	**75.0**	**74.8**	**1.2**
Change in external debt	-5.0	-5.2	1.0	6.8	14.9	-8.4	-1.4			1.1	-1.7	-1.3	-0.4	-0.7	-0.2	
Identified external debt-creating flows	-12.0	-9.1	2.5	4.6	9.7	-4.4	-6.9			4.0	1.4	0.7	0.4	0.2	0.5	
Current account deficit, excluding interest payments	-3.0	-1.9	-1.7	-3.5	-1.7	0.5	1.2			1.1	0.7	0.2	-0.2	-0.5	-0.7	
Deficit in balance of goods and services	-5.3	-5.3	-5.0	-6.0	-4.5	-7.3	-5.5			-3.9	-4.0	-4.6	-4.8	-5.0	-5.1	
Exports	26.9	25.9	26.4	27.8	25.7	31.6	31.8			28.3	28.9	29.4	29.8	30.0	30.2	
Imports	-21.6	-20.5	-21.4	-21.8	-21.2	-24.3	-26.3			-24.4	-24.9	-24.9	-25.0	-25.0	-25.1	
Net non-debt creating capital inflows (negative)	-3.2	-3.1	-1.1	2.2	1.8	2.7	4.4			2.8	2.4	1.9	1.1	1.0	1.0	
Automatic debt dynamics 2/	-5.8	-4.0	5.4	5.9	9.6	-7.7	-12.5			0.0	-1.7	-1.4	-0.5	-0.4	0.2	
Contribution from nominal interest rate	1.9	2.0	2.3	2.3	2.4	2.0	1.9			2.1	2.3	2.6	2.8	2.8	2.9	
Contribution from real GDP growth	-1.1	-1.1	-0.1	-0.5	5.0	-4.1	-3.2			-1.5	-2.3	-2.1	-1.8	-1.7	-1.6	
Contribution from price and exchange rate changes 3/	-6.6	-4.9	3.2	4.1	2.2	-5.6	-11.2			-0.6	-1.8	-1.9	-1.4	-1.6	-1.1	
Residual, incl. change in gross foreign assets 4/	6.9	3.9	-1.6	2.2	5.2	-3.9	5.5			-2.9	-3.1	-2.1	-0.8	-0.8	-0.7	
External debt-to-exports ratio (in percent)	260.7	251.2	249.5	262.4	341.7	251.3	245.7			279.7	268.2	258.5	253.8	250.2	247.8	
Gross external financing need (in billions of US dollars) 5/	11.1	10.0	9.9	8.4	9.7	11.5	11.5			14.3	12.8	13.3	13.3	13.7	13.8	
in percent of GDP	19.1	17.4	15.3	12.9	15.6	21.5	18.8			18.6	15.9	15.8	15.1	14.9	14.4	
Scenario with key variables at their historical averages 6/								7-Year Historical Average	7-Year Standard Deviation	**71.6**	**65.1**	**59.7**	**55.8**	**51.9**	**48.2**	**-1.5**
Key Macroeconomic Assumptions Underlying Baseline																
Real GDP growth (in percent)	1.7	1.7	0.2	0.7	-6.3	5.3	4.9	1.2	3.8	2.0	3.0	2.8	2.5	2.3	2.2	
GDP deflator in US dollars (change in percent)	9.6	7.5	-4.7	-6.0	-3.0	6.7	16.5	3.8	8.5	0.7	2.3	2.5	1.9	2.1	1.5	
Nominal external interest rate (in percent)	2.8	3.1	3.4	3.2	2.9	2.6	2.9	3.0	0.3	2.8	3.1	3.5	3.8	3.9	4.0	
Growth of exports (US dollar terms, in percent)	-6.7	8.6	2.4	-0.2	-20.0	40.8	16.5	5.9	19.2	-4.2	7.4	7.1	5.6	4.8	4.8	
Growth of imports (US dollar terms, in percent)	-13.5	7.4	4.5	-3.4	-15.9	31.2	25.6	5.1	18.1	-0.2	7.2	5.1	4.7	4.3	4.4	
Current account balance, excluding interest payments	3.0	1.9	1.7	3.5	1.7	-0.5	-1.2	1.4	1.7	-1.1	-0.7	-0.2	0.2	0.5	0.7	
Net non-debt creating capital inflows	3.2	3.1	1.1	-2.2	-1.8	-2.7	-4.4	-0.5	3.0	-2.8	-2.4	-1.9	-1.1	-1.0	-1.0	

1/ External debt includes non-resident deposits.

2/ Derived as [r - g - r(1+g) + ea(1+r)]/(1+g+r+gr) times previous period debt stock, with r = nominal effective interest rate on external debt; r = change in domestic GDP deflator in US dollar terms, g = real GDP growth rate, e = nominal appreciation (increase in dollar value of domestic currency), and a = share of domestic-currency denominated debt in total external debt.

3/ The contribution from price and exchange rate changes is defined as [-r(1+g) + ea(1+r)]/(1+g+r+gr) times previous period debt stock. r increases with an appreciating domestic currency (e > 0) and rising inflation (based on GDP deflator).

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

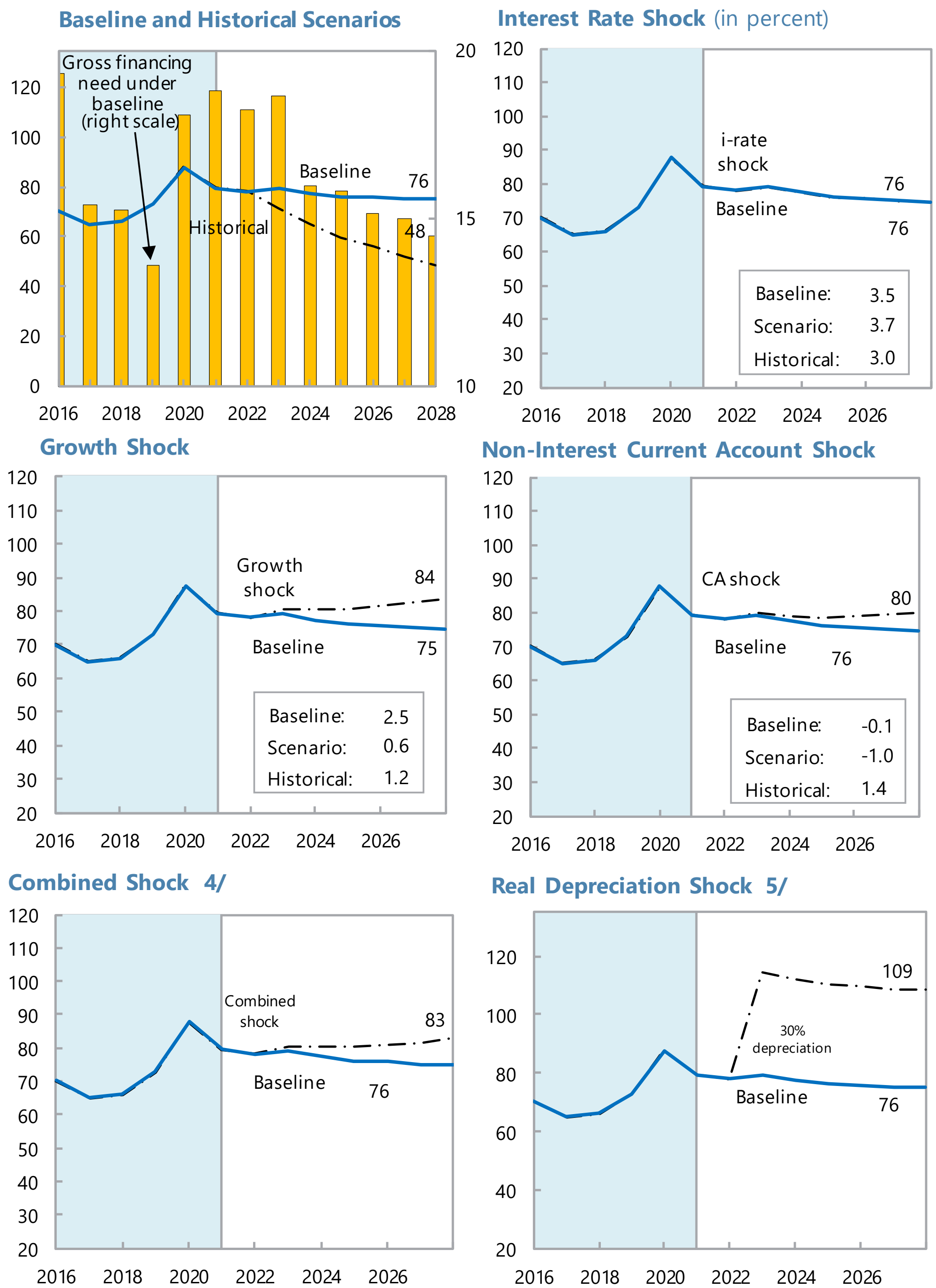
5/ Defined as current account deficit, plus amortization on medium- and long-term debt, plus short-term debt at end of previous period. Projections assume that 10% of long-term private debt is amortized every year and 10% of total private debt stock is short-term debt.

6/ The key variables include real GDP growth; nominal interest rate; dollar deflator growth; and both non-interest current account and non-debt inflows in percent of GDP.

7/ Long-run, constant balance that stabilizes the debt ratio assuming that key variables (real GDP growth, nominal interest rate, dollar deflator growth, and non-debt inflows in percent of GDP) remain at their levels of the last projection year.

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

(External debt in percent of GDP)



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

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

2/ For historical scenarios, the historical averages are calculated over the six-year period, and the information is used to project debt dynamics five years ahead.

3/ External debt includes non-resident deposits.

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

5/ One-time real depreciation of 30 percent occurs in 2023.

Annex IV. Risk Assessment Matrix

Source of Risks	Likelihood	Impact	Horizon	Policy Advice
External Risk				
Systemic financial instability. Sharp swings in real interest rates, risk premia, and assets repricing amid economic slowdowns and policy shifts trigger insolvencies in countries with weak banks or non-bank financial institutions, causing markets dislocations and adverse cross-border spillovers.	Medium	Medium	ST	Continue monitoring the financial sector for possible areas of vulnerability. Over the medium-term, continue improving financial sector resilience, in line with the recent FSAP recommendations.
Monetary policy miscalibration. Amid high economic uncertainty and volatility, major central banks slow monetary policy tightening or pivot to loosen monetary policy stance prematurely, de-anchoring inflation expectations and triggering a wage-price spiral in tight labor markets.	Medium	Medium	ST	Tighten monetary policy to anchor inflation expectations and limit second-round effects. Fiscal policy should remain neutral while supporting the most vulnerable. The exchange rate should be allowed to act as a shock absorber.
Abrupt global slowdown or recession. Global and idiosyncratic risk factors combine to cause a synchronized sharp growth downturn, with recessions in some countries, adverse spillovers through trade and financial channels, and markets fragmentation.	Medium	High	ST	Provide a fiscal-monetary policy mix consistent with bringing inflation expectations within the target while supporting the economy and protecting the vulnerable, within the limits of the fiscal rule. Allow the exchange rate to adjust.
Structural Risk				
Extreme climate events. Extreme climate events cause more severe than expected damage to infrastructure (especially in smaller vulnerable economies) and loss of human lives and livelihoods, amplifying supply chain disruptions and inflationary pressures, causing water and food shortages, and reducing growth.	Medium	High	ST,MT	Continue the implementation of climate change strategies focused on mitigation and adaptation.
Domestic Risk				
Insufficient fiscal adjustment. Leading to sovereign-rating downgrades and higher yields, as there is no credible plan to regain macroeconomic stability in the medium run.	Low	Medium	ST,MT	Recalibrate plans to introduce a credible adjustment plan, underpinned by concrete measures that will lead to macroeconomic stability.
Delayed progress in structural reforms. Growth remains anemic due to competitiveness problems.	Medium	Medium	ST,MT	Implement envisaged structural reforms (to education, labor market, business environment, SOEs), which are urgently needed to raise potential growth.

Annex V. Public Sector DSA

Figure 1. Uruguay: Risk of Sovereign Stress

Horizon	Mechanical Signal	Final Assessment	Comments
Overall	...	Low	The overall risk of sovereign stres is low. Staff's assessment is that on balance the low near-term rating combined with mitigating factors such as high liquidity buffers, precautionary contingent lines, and long maturities, compensate the medium-term moderate rating which results mostly from the high share of foreign currency and indexed debt.
Near Term 1/			
Medium Term	Moderate	Moderate	Medium-term vulnerabilities are moderate as about half of the debt is denominated in foreign currency and also the share of holdings by non-residents are large. Staff expects that the authorities will continue to work hard to reduce the share of FX debt and also smooth the profile of amortizations while extending maturities in order to minimize risks which informs our assessment of overall low risk despite these vulnerabilities.
Fanchart	Moderate	...	
GFN	Moderate	...	
Stress test	...	...	
Long Term	...	Moderate	Long-term risks are moderate reflecting the recently approved pension reform. The impact of the reform has not been yet incorporated in the baseline, but based on current projections it would stabilize pension spending in the long term. IMF staff is working with the authorities to reflect the impact in the medium-long term.
Sustainability Assessment 2/		Sustainable	
Debt stabilization in the baseline			Yes

DSA Summary Assessment

Uruguay is at a low overall risk of sovereign stress and debt is sustainable. Uruguay's access to liquid buffers and precautionary lines constitute strong mitigators against sovereign stress should external conditions suddenly deteriorate. Debt increased in 2020 as a result of the impact of the pandemic on GDP and higher spending. Since then, spending restraint and reduction of temporary COVID-realted spending, combined with high growth and a favorable context have led to a reduction in debt of 8.8 p.p. in two years. In the MT, projections assume that spending to mitigate the impact of high food and energy prices on vulnerable people is removed and that wage and pension increeases will follow current announcemnts. The yields of the recently approved pension reform have not been incorporated but will be critical to mitigate longer term risks.

Source: Fund staff.

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

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

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

Figure 2. Uruguay: Debt Coverage and Disclosures

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

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

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

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

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

5. Debt consolidation across sectors:	Consolidated	Non-consolidated

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

Reporting on Intra-government Debt Holdings

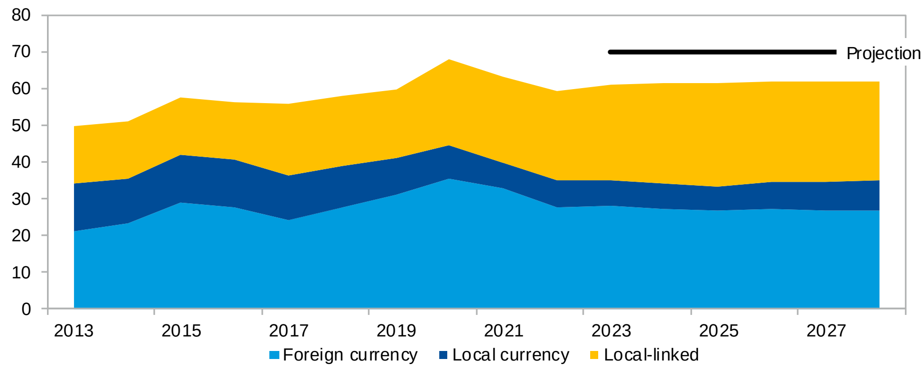
Issuer \ Holder	Budget. central govt	Extra-budget. funds (EBFs)	Social security funds (SSFs)	State govt.	Local govt.	Nonfin. pub. corp.	Central bank	Oth. pub. fin corp	Total
1 Budget. central gov									0
2 Extra-budget. funds									0
3 Social security fund:									0
4 State govt.									0
5 Local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

1/ CG=Central government; GG=General government; NFPS=Nonfinancial public sector; PS=Public sector.
2/ Stock of arrears could be used as a proxy in the absence of accrual data on other accounts payable.
3/ Insurance, Pension, and Standardized Guarantee Schemes, typically including government employee pension liabilities.
4/ Includes accrual recording, commitment basis, due for payment, etc.
5/ Nominal value at any moment in time is the amount the debtor owes to the creditor. It reflects the value of the instrument at creation and subsequent economic flows (such as transactions, exchange rate, and other valuation changes other than market price changes, and other volume changes).
6/ The face value of a debt instrument is the undiscounted amount of principal to be paid at (or before) maturity.
7/ Market value of debt instruments is the value as if they were acquired in market transactions on the balance sheet reporting date (reference date). Only traded debt securities have observed market values.

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

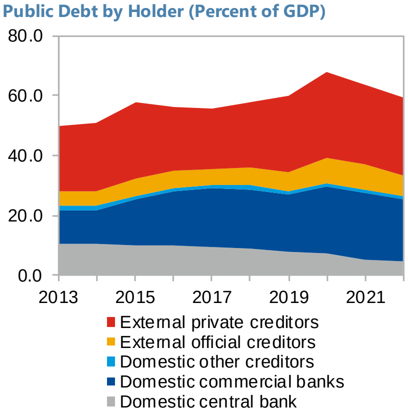
Figure 3. Uruguay: Policy Debt Structure Indicators

Debt by Currency (Percent of GDP)



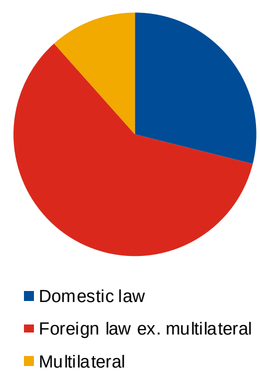
Note: The perimeter shown is nonfinancial public sector.

Public Debt by Holder (Percent of GDP)



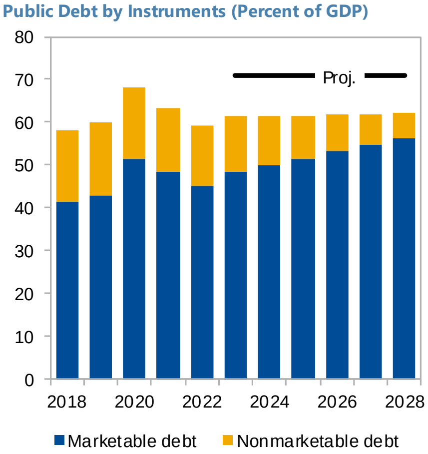
Note: The perimeter shown is NFPS

Public Debt by Governing Law, 2022 (Percent)



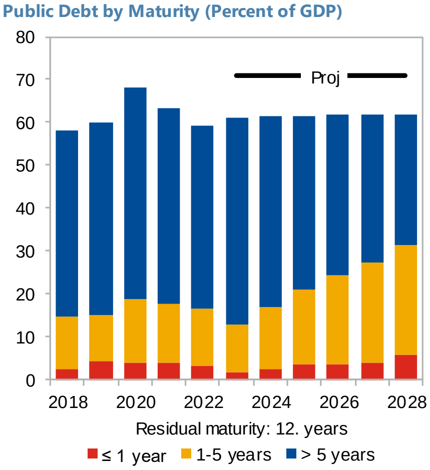
Note: The perimeter shown is NFPS

Public Debt by Instruments (Percent of GDP)



Note: The perimeter shown is NFPS

Public Debt by Maturity (Percent of GDP)



Note: The perimeter shown is NFPS

The composition of public debt by currency is expected to remian fairly stable with an almost fifty-fifty split in local currency and foreign currency debt. In terms of maturity, due to higher expected interest rates in 2023-24, issuances are assumed to be of a shorter maturity also to adopt a conservative approach.

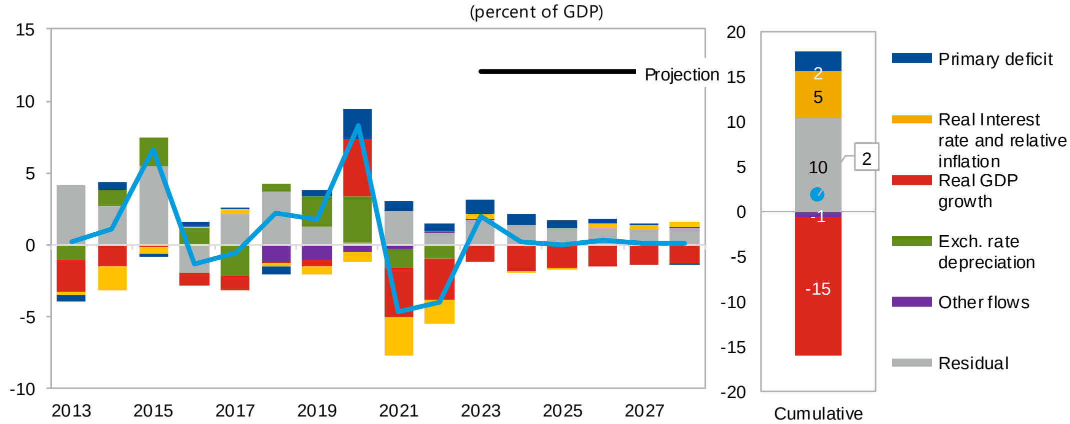
Figure 4. Uruguay: Baseline Scenario

(percent of GDP unless indicated otherwise)

	Actual	Medium-term projection						Extended projection			
	2022	2023	2024	2025	2026	2027	2028	2029	2030	2031	2032
Public debt	59.3	61.3	61.5	61.5	61.8	61.9	62.0	61.2	60.9	60.8	60.8
Change in public debt	-4.1	2.0	0.2	0.0	0.3	0.1	0.1	-0.8	-0.3	-0.1	0.1
Contribution of identified flows	-4.9	0.3	-1.2	-1.2	-0.9	-0.9	-1.0	-1.2	-0.9	-0.7	-0.5
Primary deficit	0.5	1.0	0.7	0.5	0.3	0.1	-0.1	-0.1	-0.1	-0.1	-0.1
Noninterest revenues	27.1	25.6	26.2	26.3	26.3	26.4	26.4	26.4	26.4	26.4	26.4
Noninterest expenditures	27.6	26.6	26.9	26.8	26.7	26.5	26.3	26.3	26.3	26.3	26.3
Automatic debt dynamics	-5.5	-0.8	-1.8	-1.7	-1.2	-1.1	-1.0	-0.9	-0.7	-0.5	-0.3
Real interest rate and relative inflat	-1.6	0.3	0.0	0.0	0.3	0.3	0.3	0.4	0.6	0.9	1.0
Real interest rate	-2.1	-0.2	-0.9	-0.8	-0.3	-0.3	-0.3	-0.2	0.1	0.3	0.5
Relative inflation	0.5	0.6	0.9	0.8	0.6	0.6	0.6	0.6	0.6	0.6	0.6
Real growth rate	-3.0	-1.2	-1.8	-1.7	-1.5	-1.4	-1.3 .	-1.3	-1.3	-1.3	-1.3
Real exchange rate	-0.9	...	...	...	...	...	... .	...	...	...	...
Other identified flows	0.1	0.1	0.0	0.0	0.0	0.1	0.1	-0.2	-0.2	-0.2	-0.2
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 transactions	0.1	0.1	0.0	0.0	0.0	0.1	0.1	-0.2	-0.2	-0.2	-0.2
Contribution of residual	0.8	1.7	1.4	1.2	1.2	1.0	1.1	0.4	0.6	0.6	0.6
Gross financing needs	4.3	5.6	5.5	5.9	6.8	6.8	6.7	9.9	10.9	11.1	11.8
of which: debt service	3.8	5.0	5.2	5.7	6.6	6.9	7.0	10.2	11.2	11.4	12.0
Local currency	0.4	0.8	0.7	1.0	0.8	0.9	0.9	1.7	1.6	2.1	1.7
Foreign currency	1.6	2.4	2.6	2.8	2.3	2.5	2.5	3.4	3.3	3.3	3.2
Memo:											
Real GDP growth (percent)	4.9	2.0	3.0	2.8	2.5	2.3	2.2	2.2	2.2	2.2	2.2
Inflation (GDP deflator; percent)	4.4	4.6	5.8	5.4	4.4	4.3	4.4	4.4	4.4	4.4	4.4
Nominal GDP growth (percent)	9.6	6.7	9.0	8.4	7.0	6.7	6.7	6.7	6.7	6.7	6.7
Effective interest rate (percent)	0.8	4.2	4.2	4.0	3.9	3.8	3.8	4.0	4.5	4.8	5.2

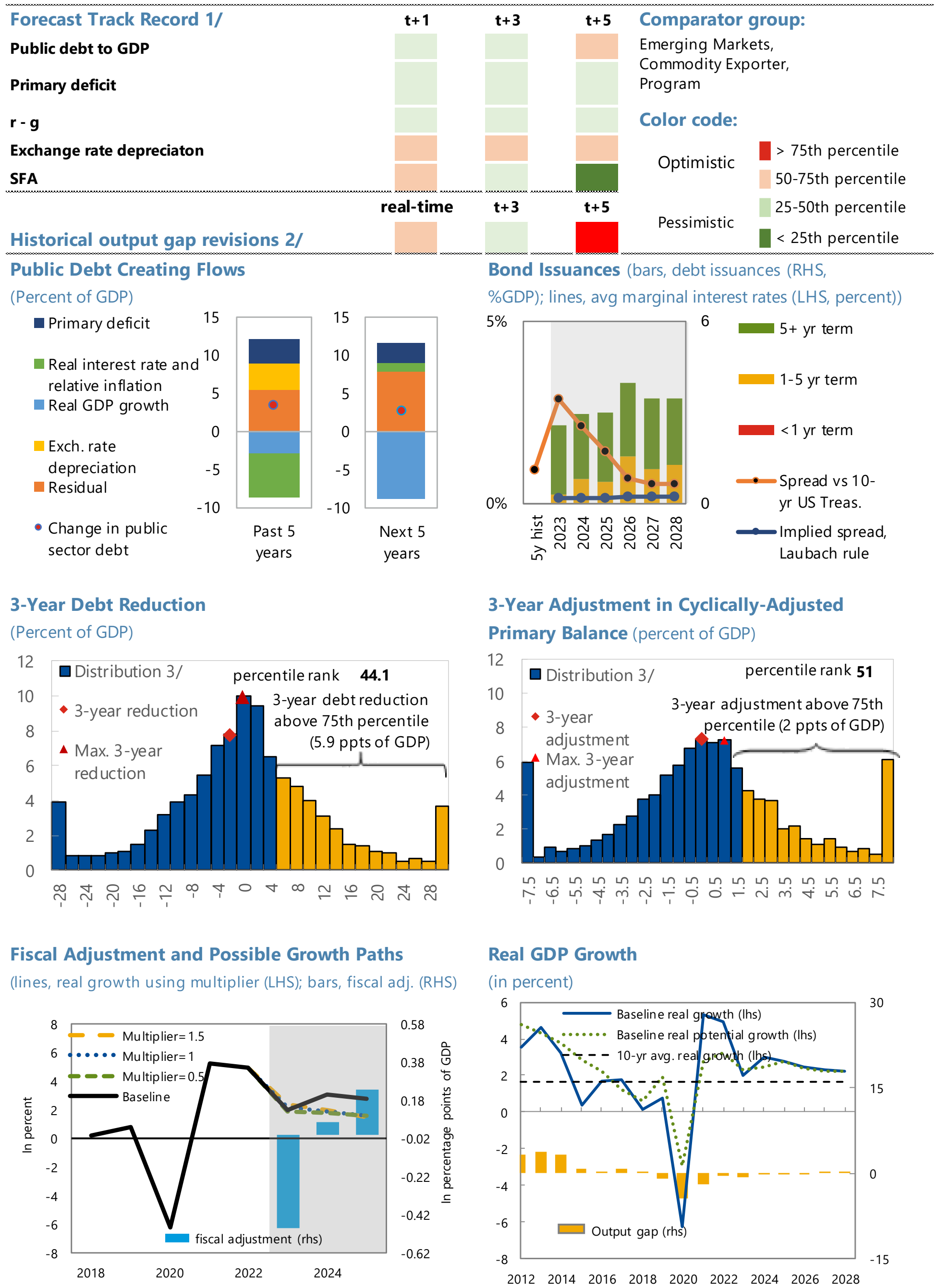
Contribution to Change in Public Debt

(percent of GDP)



Public debt is expected to remain largely unchanged during the projection period. Growth in 2023 is expected to decelerate as a result of the drought and rebound in 2024 before converging again to potential. The primary balance is expected to increase as some remaining pandemic spending is withdrawn as well as the measures implemented in 2022 to mitigate the impact of inflation on the vulnerable. The residual incorporates the effect of changes in the value of indexed-debt and for that reason is non-zero during the projection period.

Figure 5. Uruguay: Realism of Baseline Assumptions



The realism charts show that assumptions behind the projections are in line with history and balanced. The large residual in the decomposition of debt incorporates the impact of adjustments to the principal of linked-bonds. The forecast track-record is broadly neutral with no large biases.The assumption for interest rates reflects the expected path for US rates while spreads on FX debt remain constant. For peso debt, staff assumption is that these would decline with inflation during the projection period. The result of the fiscal adjustment and growth is biased by the very strong growth performance in 2022 which has already realized.

Source: IMF Staff.
1/ Projections made in the October and April WEO vintage. Program status not used in creating comparator group due to lack of data.
2/ Data cover annual obervations from 1990 to 2019 for MAC advanced and emerging economies. Percent of sample on vertical axis.
3/ Starting point reflects the team's assessment of the initial overvaluation from EBA (or EBA-Lite).

Figure 6. Uruguay: Medium Term Risk Analysis

Debt Fanchart and GFN Financeability Indexes

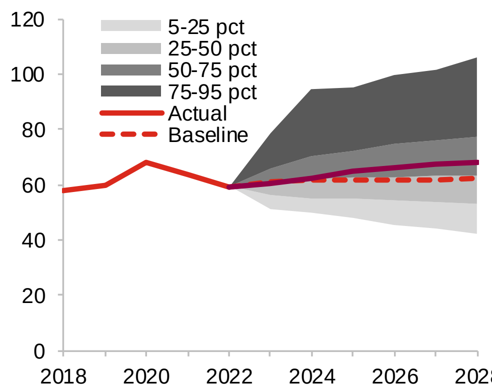
(percent of GDP unless otherwise indicated)

Module	Indicator	Value	Risk index	Risk signal
Debt fanchart module	Fanchart width	64.1	0.9	...
	Probability of debt not stabilizing (pct)	18.4	0.2	...
	Terminal debt level x institutions index	24.5	0.5	...
	Debt fanchart index	**...**	**1.6**	**Moderate**
GFN finance-ability module	Average GFN in baseline	6.2	2.1	...
	Bank claims on government (pct bank assets)	3.6	1.2	...
	Chg. in claims on govt. in stress (pct bank asse	30.6	10.2	...
	GFN financeability index	**...**	**13.5**	**Moderate**

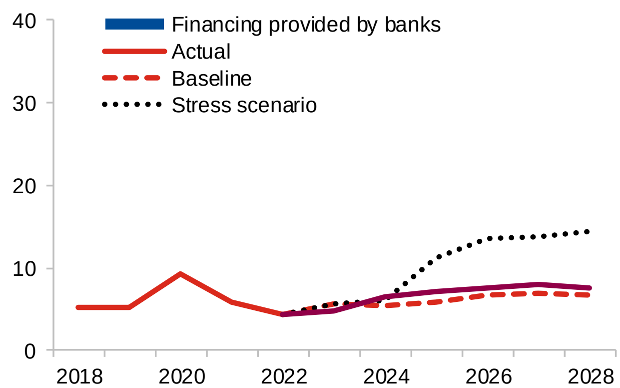
Adv. Econ., Non-Com. Exp, Program: 0, 25, 50, 75, 100

Legend: Interquartile range; Uruguay

Final Fanchart (pct of GDP)



Gross Financing Needs (pct of GDP)

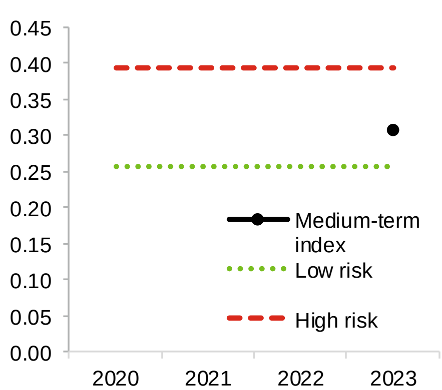


Triggered stress tests (stress tests not activated in gray)

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

Medium-term Index

(index number)



Medium-term Risk Analysis

	Low risk threshold	High risk threhsold	Weight in MTI	Normalized level
Debt fanchart index	1.1	2.1	0.5	0.4
GFN finaceability index	7.6	17.9	0.5	0.3
Medium-term index (MTI)	0.3	0.4	...	0.3, Moderate

Prob. of missed crisis, 2023-2028 (if stress not predicted): 18.2 pct.

Prob. of false alarm, 2023-2028 (if stress predicted): 26.1 pct.

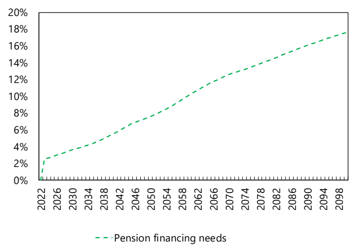
The medium-term analysis shows that risks increase but remain moderate. In particular, there is a non-negligible probability that debt will not stabilize. Risks mostly arise as the probability that debt increases to historically high levels is non-negligible considering the history of shocks and the structure of debt. GFNs on the other hand are expected to remain relatively stable but given the level of debt there are inherent rollover risks.

Figure 7. Uruguay: Long-Term Modules

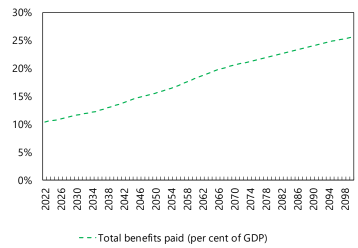
Demographics: Pension

Permanent adjustment needed in the pension system (pp of GDP per year)	To keep pension assets positive for:		
	30 years	50 years	Until 2100
	4.72%	6.82%	9.47%

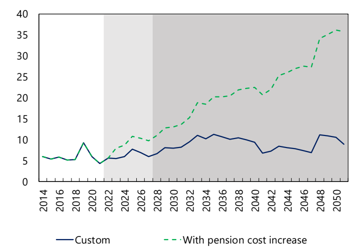
Pension Financing Needs



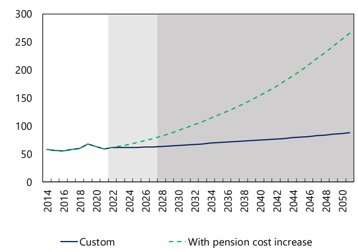
Total Benefits Paid



GFN-to-GDP Ratio

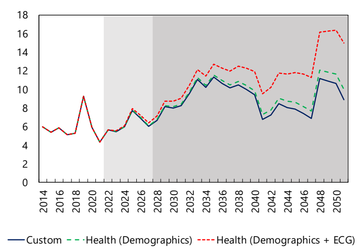


Total Public Debt-to-GDP Ratio

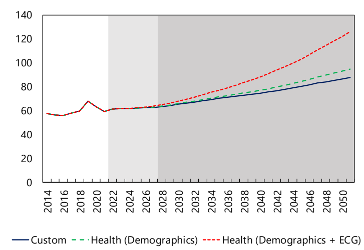


Demographics: Health

GFN-to-GDP Ratio

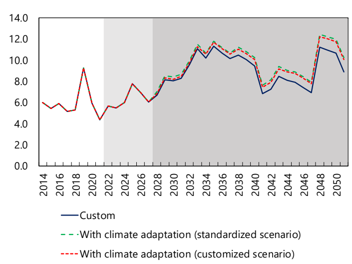


Total Public Debt-to-GDP Ratio

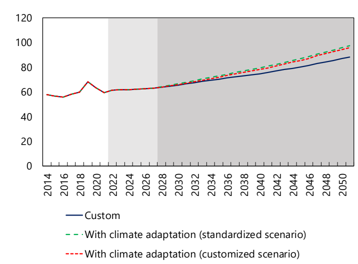


Climate Change: Adaptation

GFN-to-GDP Ratio

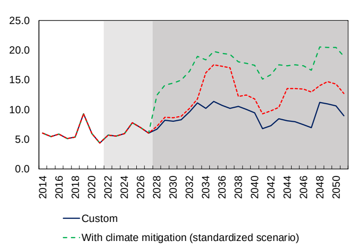


Total Public Debt-to-GDP Ratio

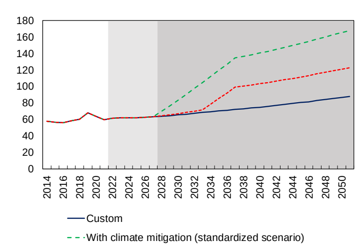


Climate Change: Mitigation

GFN-to-GDP Ratio

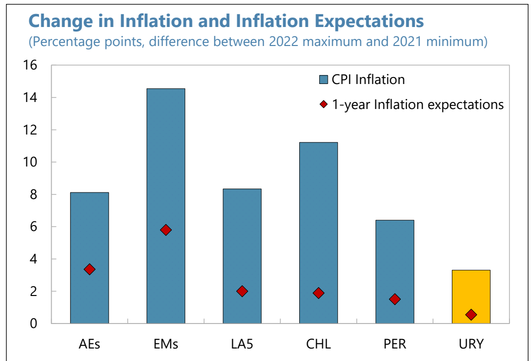


Total Public Debt-to-GDP Ratio



Annex VI. Anchoring of Inflation Expectations: Considerations for Uruguay[1]

1. Following the pandemic and the war in Ukraine, inflation and inflation expectations in Uruguay increased less than in other countries. The recent years witnessed a surge in inflation across the globe, driven by monetary and fiscal stimulus during the pandemic, the post-pandemic global supply chain constraints, and the war in Ukraine. As inflation turned out to be more persistent than initially anticipated, inflation expectations also started increasing in most countries. This de-anchoring of expectations would call for a stronger monetary policy response to bring inflation back to target and avoid inflation pressures becoming entrenched. However, in Uruguay, inflation and inflation expectations increased by significantly less than in other countries, both advanced economies and emerging markets.



Sources: Country authorities, Consensus Forecasts and IMF staff calculations.

2. This annex analyzes the expectations' formation process in Uruguay in comparison with other countries. The analysis is based on quarterly and monthly inflation expectations data from the Continuous Consensus Survey and observed annual CPI inflation during 2000-2022 for a sample of advanced economies (AEs) and emerging markets (EMs).[2] To understand how changes in actual inflation affect expectations of future inflation, the following equation is estimated:[3]

$$\Delta\mathbb{E}_t\left(\pi_{\tau+j}\right) = \alpha_j + \beta_j \Delta\pi_t + \epsilon_t$$

where: $\Delta\mathbb{E}_t\left(\pi_{\tau+j}\right)$ are changes in inflation expectations at horizon *j* between periods *t-1* and *t*, and $\Delta\pi_t$ are changes in CPI inflation, also between periods *t-1* and *t*. The passthrough coefficient, β_j, is estimated separately for each country and horizon, and describes the degree to which agents adjust their expectations following a change in observed inflation (Figure 1).[4] Robustness checks including using market-based inflation compensation and inflation surprises computed using analysts' inflation expectations do not alter the main conclusions.

3. Passthrough from inflation to short-term inflation expectations in Uruguay is comparable to other EMEs. While the passthrough describes a statistical relationship between realized and expected inflation, its magnitude is associated with inflation volatility and persistence,

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[1] Prepared by Chiara Fratto (WHD), based on Adler, Caruso Bloeck, and Fratto (forthcoming).

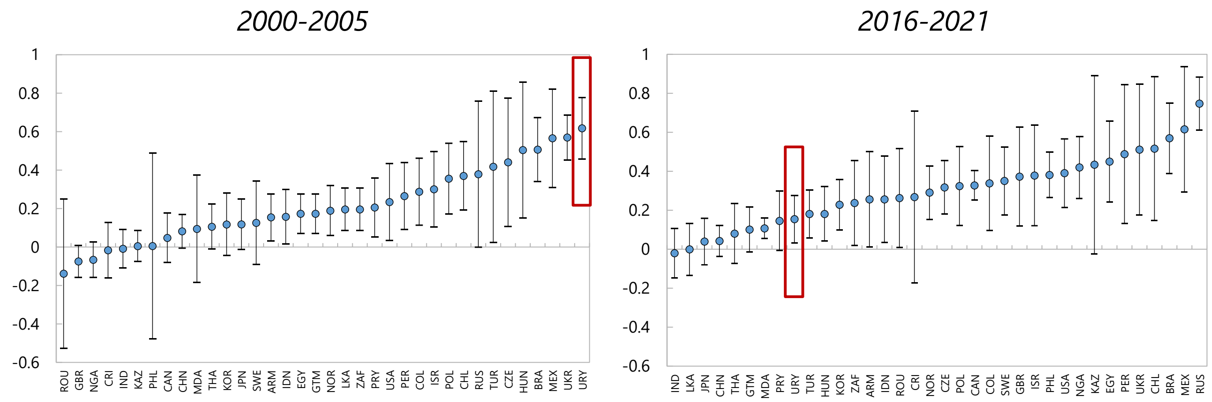
[2] The sample includes Armenia, Canada, Chile, China, Colombia, Costa Rica, Czech Republic, Egypt, Guatemala, Hungary, India, Indonesia, Israel, Japan, Kazakhstan, Korea, Mexico, Moldovia, Nigeria, Norway, Paraguay, Peru, Philippines, Romania, Russia, South Africa, Sri Lanka, Sweden, Thailand, Turkey, Uruguay, United Kingdom, and the United States of America.

[3] The estimates are based on an OLS regression with robust standard errors.

[4] Figure 1 reports coefficients for 3-month changes in inflation and end-of-year inflation expectations. Robustness checks, not included in the annex, with different time horizons do not alter the results.

which underlie countries' structural characteristics, exposure to shocks, and monetary policy credibility. Uruguay's short-term passthrough decreased from its peak following the 2002-crisis, when the country abandoned an exchange rate peg, and has remained relatively stable since 2005, when an inflation-targeting was adopted. As such, there is no evidence that agents adjust their inflation expectations is a different way than in other countries.[5]

Figure 1. Uruguay: Passthrough from Inflation to End-Of-Year Inflation Expectations



Source: Consensus Economics, Haver, IMF staff calculations.

4. However, inflation expectations are tightly anchored above the inflation target range in Uruguay. The previous specification does not allow for studying systematic deviations of the level of inflation expectations from target. Instead, a modified relationship is estimated, relating observed inflation and end-of-year expectations in deviations from the inflation target, π_t^*:[6]

$$\mathbb{E}_t(\pi_{\tau+j}) - \pi_{t+j}^* = \alpha_j + \beta_j(\pi_t - \pi_t^*) + \epsilon_t,$$

Figure 2 reports the coefficients α, and β_j estimated as country-by-country regressions on monthly data for the period 2016-2021. In a hypothetical scenario where agents expect the central bank to achieve the inflation target over the horizon j, both α_j and β_j would be zero. In practice, even highly credible central banks are not expected to fully stabilize inflation and inflation expectations in the short run, depending on the nature and persistence of the shock. The results for the case of Uruguay stand out: a combination of a relatively small β_j and a large α_j suggests that while inflation expectations are relatively well-anchored, agents do not think that the central bank will stabilize inflation close to the mid-range point of the target. Similar results are described in Labat and Licandro (2021).

5. The anchoring of inflation expectations outside the target is consistent with the behavior of inflation from a long-run perspective. The proportion of time when inflation has been outside the inflation target band is higher than its peers (Figure 3). Between 2008 and 2022, inflation has been outside the target band almost 90 percent of the time, compared to 60 percent

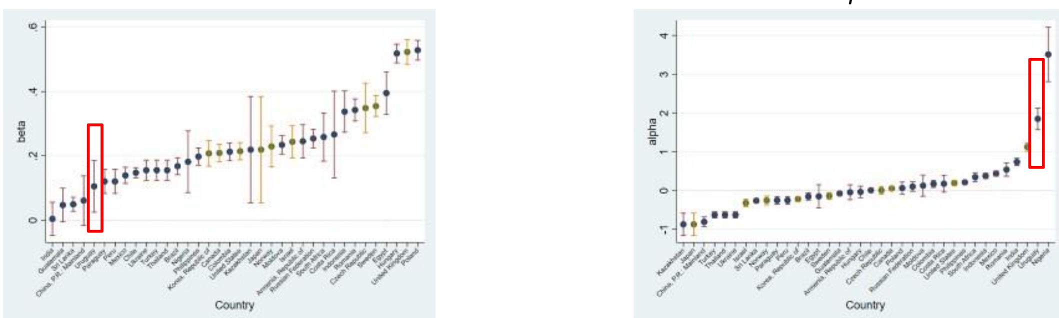
[5] For more research on inflation expectation formation in Uruguay, see Caruso Bloeck et al. (2023) on the firms' inflation expectation and Carotta et al. (2023) on the role of central bank communication.

[6] Or the mid-range point in case of target ranges.

for the average EM. Similarly, inflation expectations have been outside the inflation target range more than 60 percent of the time, also higher than other EMs and in the region. This track record may have undermined the central bank's credibility over the long-term.

Figure 2. Uruguay: End-of-year Inflation Expectations Anchoring

beta *alpha*



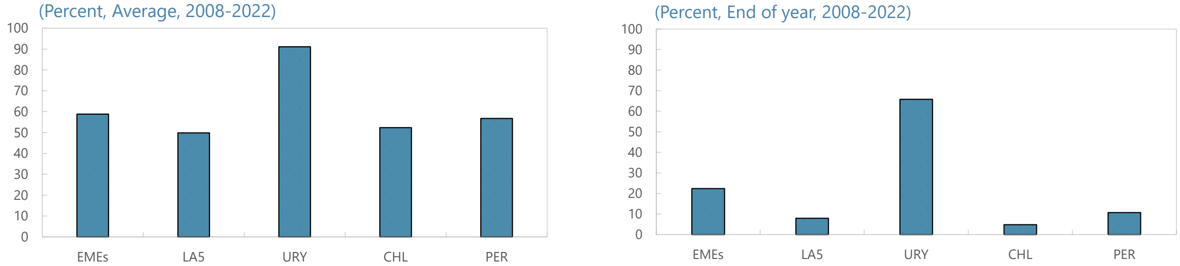
Source: Consensus Economics, Haver, IMF staff calculations.

6. Strong anchoring of inflation expectations sheds some light on recent inflation dynamics. The strong anchoring of inflation expectations accounts for Uruguay's relatively low inflation volatility, particularly when considering its comparatively high level with respect to other countries. Moreover, it can also explains why, over the last two years, the increase in inflation in Uruguay was more muted than in other countries. The strong anchoring of inflation expectations outside of the target range poses important challenges for monetary policy, and it will require a stronger and more durable effort to bring inflation within the target range, compared to other central banks in countries where inflation expectations are already anchored within the target range.

Figure 3. Uruguay: Inflation and Inflation Expectations

Share of Months y-on-y Inflation Outside Target
(Percent, Average, 2008-2022)

Share of Months Inflation Expectations Outside Target
(Percent, End of year, 2008-2022)



7. Recent improvements to the monetary policy framework may have helped re-anchor inflation expectations. Since 2020, the BCU has improved the monetary framework, including moving to using a short-term rate as monetary policy instrument (instead of monetary aggregates) which helped provide reference interest rates to market participants. The BCU has also improved its communication strategy, which has helped provide clarity on the objectives of monetary policy and has recently helped better anchor inflation expectations. Further improvements to the framework, including enhancing *de jure* central bank independence, would allow to continue building credibility and facilitating the convergence of inflation expectations to the target.

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Caruso Bloeck, Martin, Miguel Mello, and Jorge Ponce, "News of disinflation and firms' expectations: new causal evidence."

Carotta, Gianni, Miguel Mello, and Jorge Ponce, "Monetary policy communication and inflation expectations: new evidence about tone and readability."

Labat, Diego and Gerardo Licandro, 2021. "Towards a quality currency," Documentos de trabajo 2021005, Banco Central del Uruguay.

Annex VII. List of FSAP Recommendations

Key Recommendations	Agency	Time[1]
Macroprudential Policy, Systemic Risk Analysis and De-Dollarization		
Develop a comprehensive macroprudential framework: (i) clearly assign a mandate for macroprudential policy, (ii) strengthen powers for data collection and implementation of tools.	MEF, BCU, SSF, COPAB	ST
Close data gaps to enable comprehensive risk analysis of system-wide FX liquidity risk, climate risks and risks in the non-financial sectors.	BCU, MOE, SSF	ST
Incorporate enhanced solvency stress tests into risk-based supervision, including for calibration of Pillar 2 capital add-ons and restrictions on dividend distribution for banks that fail the tests.	BCU, SSF	ST
Continue progress on de-dollarization by strengthening the monetary policy framework and developing peso capital markets.	MEF, BCU, SSF	I
Banking Supervision and Regulation		
Increase and protect SSF's operational autonomy and provide budgetary autonomy.	MEF, BCU	I
Establish a fixed mandate for the Directors of the BCU and define a list of justified causes for dismissal of BCU Directors and of the Superintendent.	MEF, BCU	MT
Increase resources, including to strengthen work on credit risk reviews.	MEF, BCU, SSF	ST
Redesign the *"Impuesto al Patrimonio"* (wealth tax) for banks.	MEF	ST
Expand early intervention powers over SOBs and strengthen SOBs' governance.	MEF	ST
Expand the prudential consolidation perimeter.	SSF	ST
Develop Pillar 2-type of supervisory expectations on capital levels.	SSF	ST
Crisis Management, Resolution and Safety Nets		
Fully include SOBs in the resolution framework and redefine the government's role in funding resolution.	MEF	ST
Design an effective ELA framework.	BCU, MEF	I
Strengthen COPAB's operational independence and expand its resolution tools.	MEF, COPAB	ST
Introduce a Recovery and Resolution Planning framework.	SSF, COPAB	I
Financial Integrity		
Ensure availability of accurate and current beneficial ownership information on companies and trusts, including by increasing the resources of supporting authorities, and strengthen AML/CFT supervision for higher risk sectors.	SSF, SENACLAFT, UIAF, AIN	ST
Financial Development Issues		
Improve BROU's corporate governance practices, operational autonomy and encourage the gradual increase of its domestic lending portfolio to creditworthy firms based on robust and sound solvency, profitability and risk analysis criteria.	MEF, BCU	MT
Increase the role of SoEs in the capital markets.	MEF, BCU	ST
Continue adapting capital markets regulations to the size and capacity of Uruguayan companies.	MEF, BCU	I
Strengthen monitoring, regulatory and supervisory frameworks for new Fintech entrants, ensure a level playing field and fast-track implementation of full range of open banking services and expand to open finance and open data.	BCU, SSF, CC	MT
Improve the quality of MSME data available in private credit bureaus and credit registry and unify movable asset and pledges registries to support asset-based finance.	MOED, TA	ST

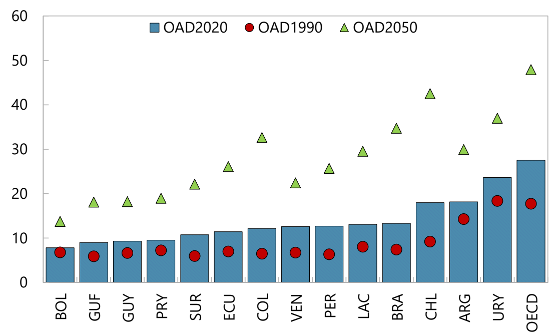
[1] I —Immediate (within 1 year), ST—Short term (within 1-2 years), MT—Medium term (within 3-5 years)

Annex VIII. Pension Reform[1]

1. A pension reform law was recently approved. Following approval by the Senate in late 2022, the law was finally approved with some modifications by the lower house and again by the Senate in late April. The law follows recommendations of the Commission of Experts in Social Security (CESS) report. The CESS, a multi-partisan group of experts, was created in 2020 with a mandate to analyze the Uruguayan pension system and come up with recommendations for reform. The CESS put forward a number of recommendations with input from the BPS secretariat providing estimates of the effects of the reforms on pension spending.

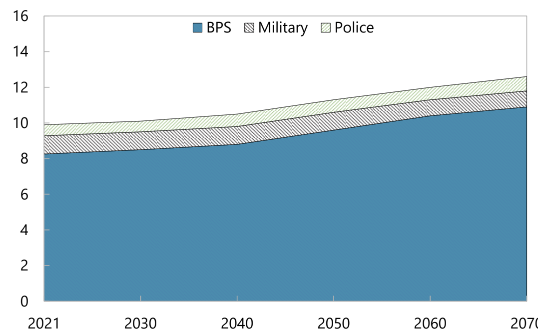
2. The population of Uruguay is relatively old and continues to age fast. Currently, Uruguay has the highest old-age dependency ratio in Latin America.[2] According to UN projections, Uruguay has a population that is younger and is projected to remain younger than OECD countries on average, while it is only projected to be overtaken by Chile in the region. At the same time, Uruguay has a relatively low rate of informality, especially when compared to the region.[3] This means that there is both a sizable pool of contributors but also a significant number of people who will be eligible for an earnings-related pension.

Old-Age Dependency Ratio
(Percentage of population aged 65 years or over)



Sources: UN Population Prospects 2022

Pensions Spending Projections
(Percent of GDP)



Sources: CESS (2021a)

3. Uruguay spends a relatively large and rising share of GDP on pensions. As a result of generous pension benefits, low retirement ages and high coverage, Uruguay spent 12.9 percent of GDP on pensions in 2021. Spending composition is as follows: 8.3 percentage points of GDP come from earnings-related pensions administered by the Banco de Prevision Social (BPS), while 0.5 percentage points are non-contributory pensions, 1.7 percentage points come from the regimes for the armed forces and police, and the rest comes from other occupational schemes (*cajas*).[4] Total

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[1] Prepared by Boele Bonthuis (FAD).

[2] Uruguay has 24 people aged 65+ per 100 people aged 15-64, compared to 13 on average in Latin America and the Caribbean.

[3] In Uruguay informality is estimated to be 22 percent of employment in 2020 compared to for instance 47 percent in Argentina and 38 percent in Brazil.

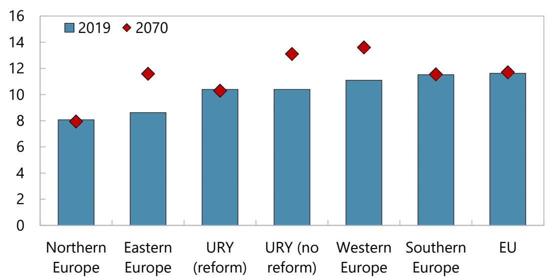
[4] Police, armed forces, bank workers, university professionals and notaries have their own schemes.

spending on the three biggest schemes – BPS, armed forces and police – is projected to steadily increase from 10 to 12.6 percent in 2070 under current policies.

4. Uruguay currently spends a similar share of GDP on pensions as the EU on average. The EU is projected to reach a peak in all pension spending of 12.8 percent in 2040 followed by a slow decline to 11.7 percent in 2070 (EC 2021), while Uruguay's spending is projected to rise further without reform. As the CESS remarks in its 2021 report: "In this comparison, the level of Uruguayan public spending is similar to that of Spain, despite still being far from its aging level, and is higher than that of countries with a long tradition of social protection such as Denmark, Norway, the Netherlands and Sweden." However, Spain's pension spending is projected to fall while Uruguay's pension spending is projected to rise without reform.

Gross Pension Spending 1/

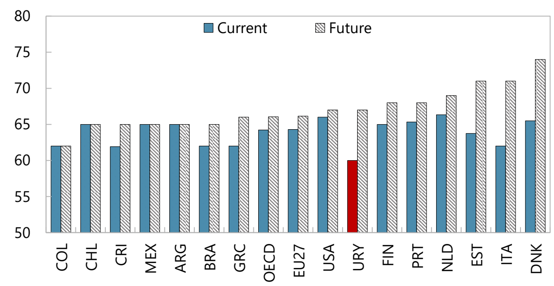
(Percent of GDP)



1/ Only EU countries are included in regional averages. Regional average is unweighted, EU average is weighted. Uruguay's figures are for 2021 and include BPS, armed forces, police and non-contributory pensions.
Sources: EC (2021) and authority's projections.

Current and Future Retirement Age 1/

(Percent of GDP)



1/ Denmark, Estonia, Finland, Greece, Italy, Portugal and the Netherlands all have linked their retirement age to life expectancy. For Greece this rule is overruled by earlier retirement for long careers.
Sources: OECD (2021) and authority's data.

5. Total revenue for the pension system amounts to 8.3 percent of GDP. About a half of revenue comes from contributions, while more than a third comes in the form of earmarked taxes, with the remainder being deficit-financed. The total of tax and deficit financing exceeds any spending on non-contributory pension benefits. Deficit financing is projected to rise further in the future, reaching almost 5 percent of GDP by 2070 under current policies.

New Pension System

6. A key objective of the new system is to reduce fragmentation by applying the same rules gradually to all workers, regardless of occupation. It envisions a transition to the new pension system over a period of 11 years starting from 2033, prorating benefits for those who contributed before and after the reform. In 2033 retirement benefits will be made up of 50 percent using the new rules and 50 percent the old rules. Each year thereafter, the new (old) rules will gain (lose) 5 percent in weight. No retiree born before 1973 will be affected by the reform. Given its long lead time, savings from the reform materialize over the medium term (starting in 2033).

7. Under the reform, contributions going to the funded system and BPS would be reshuffled.[5] At the moment, lower earners contribute to BPS (15 percent of earnings) with the option to divert half of contribution to the funded system. In the new system contribution rates will be fixed with 10 percent of contributions below a certain threshold going to the BPS while the remaining 5 percent will go to the funded system. The effect on total contribution revenue for the BPS will depend on the earnings distribution in the economy interacting with the distribution of choice to currently divert part of contributions to the funded system.

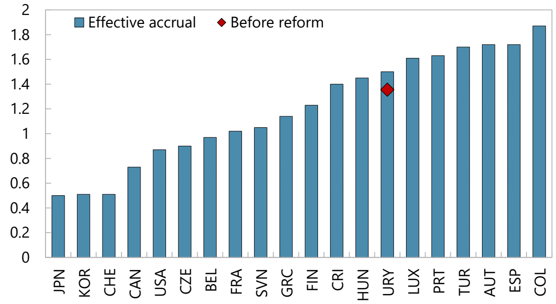
8. The normal retirement age will start to increase from 2034. The normal retirement age, currently at 60, will first go up to 61 for the cohort born in 1973. Afterwards, it will increase in one-year increments until reaching 65 in 2042. From 2042 onwards, the retirement age will be linked to life expectancy gains at retirement. This would lead to a retirement age of about 67 for someone born in 1998, provided that this person reaches the minimum years of contribution requirement. This is slightly above the average for both the EU, the OECD and other countries in the region but below most OECD countries with retirement ages linked to life expectancy. The minimum years of contributions to retire at the normal retirement age will remain at 30, but fewer years are required for late retirement. Early retirement up to 3 years is possible for those with long careers (40 years or more) or people in certain arduous professions.

9. The length of the period considered for the reference wage is increased and accrual is adjusted. The new reference wage will be based on the best 20 years of covered earnings, instead of the current final 10 (or 105 percent of the best 20). Past earnings remain revalorized with average wage growth. Accrual rates are equalized at 1.5 percent per year at the normal retirement age. This is equal to the current 45 percent accrual for the first 30 years of contributions; however, it is higher for subsequent years. Different rates will be applied to early and late retirement, resulting in a roughly 4.8 percent penalty or bonus respectively. In addition, mothers will be credited with one year of additional service for each child, with a maximum of five years.

10. While the reference wage slowly moves in the direction of OECD countries the accrual rate will be high compared to OECD countries. The majority of OECD countries with PAYGO DB pension systems use lifetime earnings for the reference wage. But among those with shorter reference wages, using the best 25 years is not uncommon. Effective accrual rates for those earnings the average wage for a full career will only be higher in a number of OECD countries, all of which index their pension benefits to prices or some combination of wages and prices.

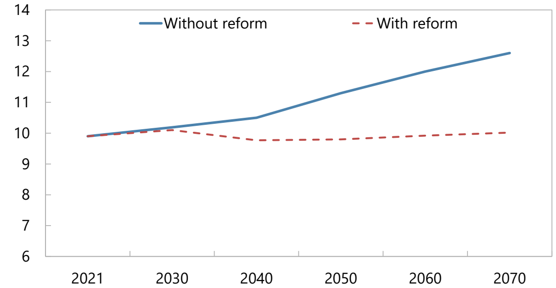
[5] Uruguay has a mixed PAYGO-funded system introduced in 1996. The PAYGO part of the system is administered by the BPS and the different occupational schemes, while the funded part of the system is run by pension funds known as AFAP (*Administradora de Fondos de Ahorro Previsional*).

Effective Accrual Rates and Reference Wage 1/
(Percent)



1/ The effective accrual rates is calculated for someone who earns the average wage for a full career from age 22 to the normal retirement age.
Sources: OECD and IMF staff calculations.

Projected Spending with and without Reform 1/
(Percent)



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

11. Criteria to receive a survivor benefit will be tightened and the minimum pension will be adjusted. Permanent survivor benefits would be received from the age of 45 with temporary benefit for younger widow(er)s. The new minimum value would be 14000 pesos per month (roughly the amount of the social pension) for those with virtually no own pension. This amount is slowly withdrawn against own income, reaching a maximum of 42000 pesos combined minimum and own pension. The minimum pension will be fully paid from general taxation.

References

Comisión de Expertos en Seguridad Social (2021a), Diagnóstico del Sistema Previsional Uruguayo, Informe de la Comisión de Expertos en Seguridad Social, Technical Note.

Comisión de Expertos en Seguridad Social (2021b), Recomendaciones para la Reforma del Sistema Previsional Uruguayo, Informe de la Comisión de Expertos en Seguridad Social, Technical Note.

European Commission (2021), "The 2021 Ageing Report: Economic and Budgetary Projections for the EU Member States (2019-2070)", European Economy Institutional Papers

World Bank (2020), Cobertura del sistema previsional en el Uruguay, Apuntes sobre el sistema previsional del Uruguay N° 4, Technical Note, The World Bank.

Annex IX. A Modern Instant Digital Payments System in Uruguay: Some Initial Considerations[1]

1. The Central Bank of Uruguay (BCU) is pursuing a modernization plan for its payment system.[2] The BCU's 2023-25 payments roadmap aims to create an inclusive payment system with instant settlement of payments 24/365, whilst promoting competition among providers, preserving financial stability, and fostering compliance with AML/CFT regulations and standards. The BCU has also requested banks to introduce immediate transfers within the banking system 24/7 instead of only during working hours starting from June 2023. While Uruguay has key pre-conditions to modernize and expand its payment system, the success will depend on some key policy decisions (such as participant's access to the system) and sound risk management and oversight.

2. The objectives of the BCU's roadmap are consistent with the benefits offered by a modern digital payment system:

- One of the key advantages is the ability to instantly settle transactions 24/365 using a smartphone, website, or a card. In contrast, the current system operates during weekdays with only 2.5 percent of transfers being made instantly.

- It can simplify financial planning and liquidity management for users and enhance the economy's resilience.

- It can lead to a potential reduction in fees both for individuals and merchants. Currently fees on purchases made with debit or credit cards reach 1 and 3 percent, respectively, in Uruguay (Figure 1, left) and banking transfers of more than USD500 dollars have different fees depending on the type of a transfer. In Brazil, the implementation of the instant payment system Pix lowered digital payment fees from 2.5 percent to 0.2 percent.

- It can enhance financial inclusion for individuals and small businesses who are not currently banked. Although the rate of bank account ownership in Uruguay in 2021 was 74 percent (Figure 1, right), which is on par with the average for Latin America and the Caribbean, it is still below the 96 percent in high-income countries.

- It can increase access to credit by enabling financial companies to use digital payment transactions history to evaluate creditworthiness.

- Lastly, the system can supply policymakers with high-frequency data on consumption and sales.[3]

[1] Prepared by Dmitry Vasilyev and Jesús Sánchez (WHD).

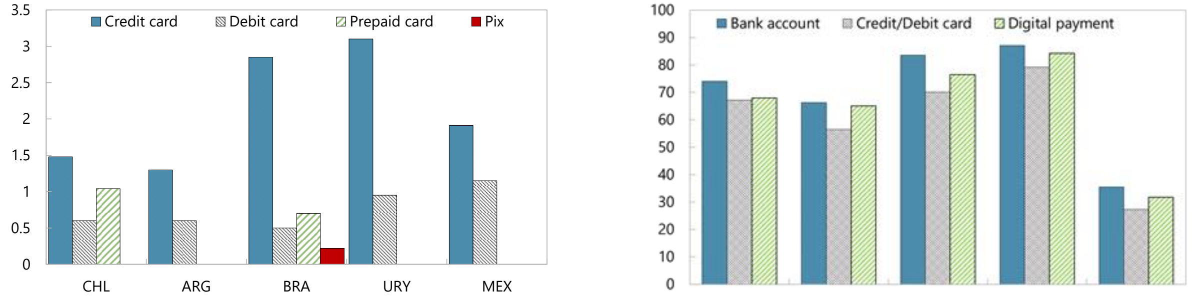
[2] The mission understands this is the focus of the authorities at this stage but will inquire about any plans in terms of introduction of a CBDC (following the 2018 pilot) and the regulation of crypto assets.

[3] Household Financial Transaction Data | NBER

Figure 1. Uruguay: Payment Fees and Financial Indicators

Interchange Fees by Payment Methods 1/
(Percent)

Financial Inclusion: 2021
(Percent of population: Age +15 years)

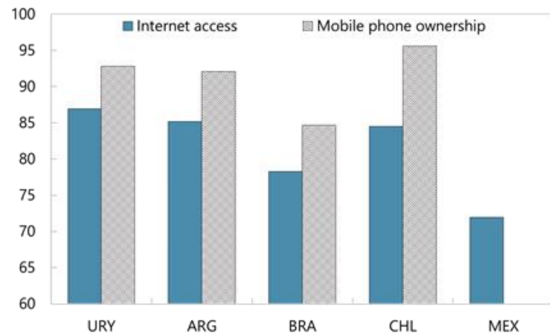


1/ Argentina, Chile and Mexico set a regulatory cap on interchange fees for card payments. Brazil sets a regulatory cap for debit and prepaid card payments only.
Sources: Country authorities, El País.

1/ Latest data available for Mexico is from 2017.
Sources: Global Financial Inclusion.

3. **Uruguay has key pre-conditions to modernize its payment system.** According to the IPET index monitored by the BCU, 65 pesos out of every 100 spent by consumers are paid digitally. Additionally, internet penetration is high, and more than 90 percent of adults have mobile phones. Uruguay also boasts an active IT sector and has more than 60 fintech companies, including some global players, providing access to technology and expertise. Furthermore, it has a near universal legal ID (*Cédula de Identidad*) that serves as a digitally enabled ID and facilitates the use of digital wallets and e-KYC.

Internet and Mobile Phone Access: 2021
(Percent of population: Age +15 years)



Sources: Global Financial Inclusion.

4. **As the regional experience shows, the success of the new payment system will depend on some key policy choices:**

- **Access and competition.** As Brazil's experience with Pix showed, securing a critical mass of large banks and opening the system to smaller payment companies are important for providing a rapid start to the system and sufficient competition that reduces fees.[4] The BCU is committed to guarantee an open access to the payment system.

- **Requirements on capital and liquidity management.** Granting access to non-bank payment service providers to the payment system should depend on potential benefits (such as those above-mentioned) and risks. The smaller participants should be able to contribute to any credit and liquidity management arrangement set in place by the system operator in order to settle transactions when due. Moreover, they should also meet financial requirements set by the system in order to receive access (such as a minimum level of capital). However, while banks' meet high requirements necessary to ensure the smooth functioning of the payment system, smaller payment service providers may need lower capital requirements in line with a tiered risk-

[4] Currently, the Uruguayan Real-time Gross Settlement (RTGS) operated by the BCU is not available to non-bank payment service providers.

based access system. As calibrating these requirements is not trivial due to the lack of data on the distribution of risks, experience from Brazil, the UK, and other countries can be very useful.

- **Safeguards.** The BCU could establish a safeguards framework that would clarify what the main risks are and how they are mitigated. Such a framework should ensure that the system operator and participants effectively manage their financial, payment fraud, and AML/CFT risks, while the regulator provides necessary oversight. These would give users added security and confidence in the payment system. The authorities are enhancing their cybersecurity and fraud-prevention framework by fortifying the current regulatory structure and facilitating better information exchange among relevant entities.

- **Integration with other systems.** Integration with Brazil's Pix, or other regional payment systems, could bring additional benefits, but would be important to ensure legal frameworks alignment and have an appropriate government structure and a clear agreement on the management of the integrated systems, access to information, and other aspects to ensure a smooth operation. The G20 roadmap for enhancing cross-border payments provides an important guidance on payment systems integration.[5] Close collaboration and experience exchange with peers is crucial—Uruguay already benefits from learning from the experiences of India and Brazil.

[5] https://www.fsb.org/2022/10/g20-roadmap-for-enhancing-cross-border-payments-consolidated-progress-report-for-2022/

INTERNATIONAL MONETARY FUND

URUGUAY

April 26, 2023

STAFF REPORT FOR THE 2023 ARTICLE IV CONSULTATION—INFORMATIONAL ANNEX

Prepared By

Western Hemisphere Department (in consultation with other departments)

CONTENTS

FUND RELATIONS

(As of February 28, 2023)

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

General Resources Account:	**SDR Million**	**%Quota**
Quota	429.10	100.00
IMF's Holdings of Currency (Holdings Rate)	306.18	71.35
Reserve Tranche Position	122.93	28.65
SDR Department:	**SDR Million**	**%Allocation**
Net cumulative allocation	704.53	100.00
Holdings	633.30	89.89

Outstanding Purchases and Loans: None

Latest Financial Arrangements:

Type	Date of Arrangement	Expiration Date	Amount Approved (SDR Million)	Amount Drawn (SDR Million)
Stand-By	Jun 08, 2005	Dec 27, 2006	766.25	263.59
Stand-By	Apr 01, 2002	Mar 31, 2005	1,988.50	1,988.50
of which SRF	Jun 25, 2002	Jun 24, 2003	128.70	128.70
Stand-By	May 31, 2000	Mar 31, 2002	150.00	150.00

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

	Forthcoming				
	2023	2024	2025	2026	2027
Principal					
Charges/Interest	1.84	2.46	2.46	2.46	2.46
Total	1.84	2.46	2.46	2.46	2.46

Implementation of HIPC Initiative: Not Applicable

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

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

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

[1] When a member has overdue financial obligations outstanding for more than three months, the amount of such arrears will be shown in this section.

Ex-Post Assessment. The last Ex-Post Assessment of Longer-Term Program Engagement was considered by the Executive Board on August 29, 2007 (Country Report No. 08/47).

Exchange Rate Arrangement. The currency is the Uruguayan peso (UY$). Uruguay's de jure and de facto exchange rate arrangements are classified as floating. In September 2020, the central bank switched to the interest rate as its main policy instrument. Prior to that, and since June 2013, monetary policy targeted the growth rate of M1 plus saving deposits as the intermediate instrument. On March 27, 2023, the exchange rate in the official market was UY$38.935 per U.S. dollar. Uruguay has accepted the obligations of Article VIII and maintains an exchange rate system free of multiple currency practices and restrictions on payments and transfers for current international transactions.

Article IV Consultation. Uruguay is on the standard 12-month consultation cycle. Board discussions for the 2021 Article IV consultation took place during November 29, 2021 (IMF Country Report No. 22/16). Staff discussions for the 2023 Article IV consultation took place during March 6-17, 2023.

FSAP Participation and ROSCs. A Financial Sector Stability Assessment (FSSA) was considered by the Executive Board on December 16, 2022. A factual statement on the FSAP was published on January 23, 2023, as the authorities need more time to consider possible publication of the FSSA and Technical Notes. Previously, a Financial Sector Stability Assessment (FSSA) was considered by the Executive Board on June 28, 2006 (Country Report No. 06/187). An FSAP Update was conducted in 2012 and the FSSA was published on May 31, 2013 (Country Report No. 13/152).. A ROSC module on fiscal transparency was published on March 5, 2001. A ROSC module on data dissemination practices was published on October 18, 2001. A ROSC on Anti-Money Laundering and Combating the Financing of Terrorism (AML/CFT) was published on December 12, 2006 (Country Report No. 06/435). A data module ROSC was published on February 11, 2014 (Country Report No. 14/42).

Technical Assistance 2009–23.

DPT	**Purpose**	**Date of Delivery**
ICD	General Macroeconomic Analysis	April 2022
FAD	Public Financial Management	November 2018
	Revenue Administration (Follow-up)	November 2017
	Assist with strengthening customs' reform strategy and implementation of the governance framework	November 2015
	Tax Administration, PFM (Follow-up)	October 2015
	Treasury Management	August 2014

DPT	Purpose	Date of Delivery
	Tax, customs, and social security administration	August 2014, March 2014, November 2012, November 2011, September 2010
	Performance Informed Budgeting	March 2011
	Private public partnership	May 2010
LEG	Structures and tools for strengthening the AML/CFT capacity of the Superintendency of Financial Services and the Financial Intelligence Unit	October 2017
	Structure and tools for strengthening the AML/CFT capacity of the Superintendency of Financial Services and the Financial Intelligence Unit	November 2016
	Structure and tools for strengthening the AML/CFT capacity of the Superintendency of Financial Services and the Financial Intelligence Unit	March 2016
	Structure and tools for strengthening the AML/CFT capacity of the Superintendency of Financial Services and the Financial Intelligence Unit	October 2015
	Structure and tools for strengthening the AML/CFT capacity of the Superintendency of Financial Services and the Financial Intelligence Unit	March 2015
	Assist the authorities on strengthening the AML/CFT capacity of the Superintendency of Financial Services and the Financial Intelligence Unit	October 2014
	Follow up of the implementation of the AML/CFT National Strategy	October 2013
	Assist the authorities on the launch of the recently designed AML/CFT national strategy	June 2012
	Assist the authorities on the elaboration of a risk-based national strategy enhancing the AML/CFT regime	December 2010
	Conduct a money laundering/terrorist financing country risk assessment consistent with the objectives of the national AML/CFT strategy	January, April, and July 2009
MCM	Strengthening Monetary Policy Communications	November 2021
	Central Bank Transparency Review	September 2021

DPT	Purpose	Date of Delivery
	Sovereign Asset and Liability Management and Development of the Local Currency Government Bond Market	September 2016
	Bank resolution	June 2014
	FSAP update	September 2012
STA	Monetary and Financial Statistics	February 2020
	Trade Margins and Commercialization Channels	September 2016
	Balance of Payments and International Investment Position Statistics.	April and October 2015
	Data ROSC reassessment	August 2012

RELATIONS WITH OTHER INTERNATIONAL INSTITUTIONS

- World Bank: https://www.worldbank.org/en/country/uruguay
- Inter-American Development Bank: https://www.iadb.org/en/countries/uruguay/overview
- Development Bank of Latin America: https://www.caf.com/es/paises/uruguay/

STATISTICAL ISSUES

(As of March 27, 2023)

I. Assessment of Data Adequacy for Surveillance
General: Data provision has some shortcomings but is broadly adequate for surveillance. Most affected area is national accounts.
National accounts: In 2020, the Uruguayan authorities completed a revision of national accounts statistics, in which they updated the benchmark year (from 1997 to 2012), set the reference period for the volume estimates in 2016, and adopted the *System of National Accounts (SNA) 2008*. However, new national accounts statistics are not as detailed as before, and there are not historical numbers pre-2016 still have some shortcomings: expenditure GDP contains some residual components, fixed ratios are used for various activities, coverage of the enterprise survey is limited, the update of the business register is partial, source data for some components of GDP are of poor quality, and information on the informal economy is inadequate. Under the new methodology, GDP time series on the BCU website are available starting in 2016. Developing a monthly indicator of economic activity, as currently planned for 2023, would allow more timely surveillance.
Prices: The base period for the consumer price index was recently updated to October 2022 = 100. The CPI has national coverage, and it does not cover either the implicit rent or the net acquisitions of owner-occupied dwellings. The reselection of the sample of detailed products was also recently updated with the change in base year (the current weights are based on the 2016-2017 household income and expenditure survey). Prior to this recent update, the weights and composition had remained unchanged for several years. It would be desirable that more frequent updates take place going forward. Producer price indices (March 2010 =100) for national products are available, but do not cover utilities, construction, and services, and exported output.
Government finance statistics: Statistics are on a modified cash basis. Official data on the central administration, the state-owned enterprises and the social security system are disseminated regularly and on time. However, above-the-line data (revenue and expenditure) for local governments are not available. Monthly data for financing and quarterly data for debt for the central government and total public sector are disseminated on the BCU website from 1999 onwards, but no information is reported for publication in the *International Financial Statistics*. Annual information submitted for the *Government Finance Statistics Yearbook* covers the consolidated central government (budgetary central government plus social security funds) and consolidated general government, but COFOG is not reported, and local governments information belong to financing operations only; thereby, consolidated general government's covers only operations and stocks on financial assets and liabilities.
Monetary and financial statistics: Monetary and financial statistics are prepared in accordance with the IMF's *Monetary and Financial Statistics Manual (2000).* The authorities report monetary data for the central bank, other depository corporations, and other financial corporations (OFCs) using the standardized reporting forms (SRFs). However, data for the OFCs are limited to off-shore financial institutions. A technical assistance mission in 2020 assisted

the authorities to expand the institutional coverage of OFCs and compile the SRF for insurance companies, pension funds and credit administration companies.
Financial sector surveillance: The authorities participate in the IMF's Coordinated Direct Investment Survey (CDIS), Coordinated Portfolio Investment Survey (CPIS), and Financial Soundness Indicators (FSIs) databases. However, only annual FSIs data for deposit-takers and other financial corporations are being reported. FSIs on nonfinancial corporations, households, market liquidity, and real estate markets are not available. The BCU disseminates FSIs for individual banks on a monthly basis and generates FSIs for the banking system weighting individual bank FSIs by their asset share. Uruguay reports data on several series indicators of the Financial Access Survey (FAS) including the two indicators (commercial bank branches per 100,000 adults and ATMs per 100,000 adults) adopted by the UN to monitor Target 8.10 of the Sustainable Development Goals (SDGs).
External sector statistics: Balance of payments and international investment position statistics are compiled and published on a quarterly basis. Data are compiled following the recommendations of the sixth edition of the *Balance of Payments Manual*. Uruguay disseminates the international reserves and foreign currency liquidity data template, submits quarterly external debt statistics to the World Bank's Quarterly External Debt Statistics (QEDS) database, and participates in the Coordinated Portfolio Investment Survey (CPIS) and the Coordinated Direct Investment Survey (CDIS).

II. Data Standards and Quality	
Uruguay subscribed to the SDDS in February 2004 and is in observance.	Data ROSC published on October 1, 2001. A data reassessment ROSC on CPI, PPI and NA was published in February 2014.

III. Reporting to STA
Both the consumer and wholesale price indices are reported on a regular and timely basis for publication in the *International Financial Statistics (IFS)*. The authorities do not provide trade price and volume indices for publication in the *IFS*. Annual GFS are regularly reported to STA for publication in the *Government Finance Statistics Yearbook*. No high frequency GFS are reported for publication in the *International Financial Statistics*. Uruguay reports to STA balance of payments and IIP data for publication in the *IFS* and the *Balance of Payments Statistics Yearbook*.

Uruguay: Common Indicators Required For Surveillance
(As of April 12rd, 2023)

	Date of latest observation	Date received	Frequency of Data 7/	Frequency of Reporting 7/	Frequency of Publication 7/	Memo items: Data Quality – Methodological Soundness 8/	Memo items: Data Quality – Accuracy and Reliability 9/
Exchange Rates	04/11/23	04/12/23	D	D	D		
International Reserve Assets and Reserve Liabilities of the Monetary Authorities 1/	04/11/23	04/12/23	D	D	D		
Reserve/Base Money	04/11/23	04/12/23	D	D	D		
Broad Money	04/11/23	04/12/23	D	D	D		
Central Bank Balance Sheet	03/23	04/12/23	M	M	M		
Consolidated Balance Sheet of the Banking System	02/23	04/12/23	M	M	M		
Interest Rates 2/	04/11/23	04/12/23	D	D	D		
Consumer Price Index	02/23	04/03/2023	M	M	M	O, LO, O, O	LO, O, O, LNO,
Revenue, Expenditure, Balance and Composition of Financing 3/– Central Government 4/	02/23	03/31/2023	M	M	M		
Stocks of Central Government and Central Government-Guaranteed Debt 4/ 5/	Q4/23	03/31/23	Q	Q	Q		
External Current Account Balance	Q4/23	03/31/23	Q	Q	Q		
Exports and Imports of Goods and Services	02/23	03/23/23	M	M	M		
GDP/GNP	Q4/22	03/23/23	Q	Q	Q	LO, LO, LO, LO	LNO, LNO, LO,
Gross External Debt	Q4/23	03/31/23	Q	Q	Q		
International Investment Position 6/	Q4/23	03/31/23	Q	Q	Q		

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

Statement by Mr. Herrera and Ms. Bustillo on Uruguay Executive Board Meeting May 15, 2023

On behalf of the Uruguayan authorities, we would like to thank staff for the open and constructive dialogue during the Article IV consultation. The authorities appreciate staff's analytical work and comprehensive and insightful reports on Uruguay's economy which make a valuable contribution to policy discussions.

Economic Outlook

The Uruguayan economy has recovered rapidly from the COVID-19 shock, supported by a successful mass vaccination process and highly effective fiscal and monetary support. After expanding by 5.3 percent in 2021, the economy grew by 4.9 percent in 2022, led by exports, private consumption, and private investment. Economic activity dropped in the second half of the year following the global slowdown and the effects of the severe drought affecting the country, particularly the agricultural sector, during the fourth quarter.

The labor market improved on average during 2022 reflecting the economic recovery process with more than 40,000 net jobs created, relative to 2021. The unemployment rate for 2022 stood at 7.9 percent, down 1.5 percentage points from 2020. The continued reduction of workers in the unemployment insurance system was an additional sign of the improvement in the labor market.
Labor market informality dropped to 20.9 percent on average in 2022, down from 24.9 percent in 2019. Meanwhile, real wages are on a recovery phase. After peaking in September 2022, inflation has been decelerating and stood at 7.3 percent in March 2023.

The authorities concur with staff that despite headwinds, they expect real output growth of around 2 percent for 2023, driven mainly by tourism, increased cellulose production and exports, and private consumption as real wages continue to recover. In a challenging environment, the authorities remain committed to sound macroeconomic policies, which, as staff rightly notes, has strengthened the country's resilience to shocks and credit standing. The authorities continue with structural reforms, thus, placing the economy on a higher and more sustainable growth trajectory and improving living standards.

Fiscal Policy and Debt Management

Fiscal policy has remained prudent and focused on reigning in inefficient public spending while securing the necessary public savings to address social needs. This allowed deploying timely and well targeted measures to mitigate the impact of the pandemic and the rise in food and energy prices on vulnerable groups and micro and small firms. More recently, the authorities designed a series of tax cuts in the personal income tax (IRPF) and social security assistance tax (IASS) to benefit lower-income taxpayers and workers with dependent children. Likewise, several changes in tax measures deepened the support provided to micro and small firms.

As noted by staff, the declining fiscal deficit and indebtedness as a share of GDP reflects the authorities' commitment to fiscal discipline and the ability to deliver on fiscal targets. The fiscal deficit of the Central Government stood at 3.2 percent of GDP, improving 0.9 percentage point of GDP compared to 2021. In turn, the gross debt of the Central Government stood at 57.3 percent of GDP as of December 2022, while net debt was 53.2 percent of GDP, implying a reduction of 2.6 percentage points and 2.1 percentage points of GDP, respectively, compared to 2021. More importantly, debt to GDP is now almost back to the levels before the onset of the pandemic.

The authorities agree with staff that the rules-based fiscal framework introduced in 2020 strengthened the credibility on the commitment to fiscal prudence. This new framework is the foundation of the improvement in public finances, which had been steadily deteriorating in the years prior to the COVID-19 pandemic. In 2022, the Government met for the third consecutive year the ambitious three pillars of the fiscal rule: the structural deficit was 2.5 percent of GDP, which is below the 2.6 percent GDP target; real primary spending growth was 0.5 percent, which is below the 2.1 percent target cap (in line with the estimated potential real GDP growth); and the central government's net indebtedness was USD 1.8 billion, which is below the legally binding limit of USD 2.1 billion for 2022.

Strict compliance with the fiscal framework (restoring fiscal credibility), structural reforms underway and the handling of the pandemic, have helped the country reach its highest-ever investment grade level and among the lowest EMBI in LATAM. Three of the five credit agencies have upgraded the country's sovereign ratings over the last two years.

Going forward, the authorities' focus is to continue building the strong compliance record with the targets of the framework, which has enabled a debt reduction even under very testing circumstances. Compliance with the ambitious three targets of the fiscal rule is expected to stabilize the debt-to-GDP ratio over the forecasting horizon. The authorities underscore the importance of solidifying the ongoing implementation of the new fiscal framework, making its current debt anchor more explicit - rather than introducing a new pillar on debt stock - and continuing the work on risk analysis around debt forecasts.

On debt management, the authorities have continued proactive strategies aimed at de-risking the debt portfolio while keeping borrowing costs contained. Liability management transactions, conducted in domestic and international markets, have sustained a robust debt maturing profile, thus reducing the rollover risk. The main source of funding in 2022 was bond issuance in local and international debt markets, of which 62 percent was raised in domestic bond markets and denominated in local currency. By the end of 2022, the share of debt coming due during 2023 represented 4.4 percent of the total debt stock and the average time to maturity of the debt portfolio was 12.3 years.

Monetary and Exchange Rate Policy

The Central Bank of Uruguay (BCU) proactively responded to the shocks faced by the economy and remained committed to address above-target inflation and to rebuild central bank credibility.

After pivoting into an accommodative stance in respond to the COVID-19 health emergency, the BCU gradually began to exit the expansionary phase of monetary policy to anchor medium-term inflation expectations. During 2022, the BCU deepened the restrictive bias of monetary policy, continuing with the rate hike cycle that began in August 2021. In particular, the BCU progressively increased the policy rate from 5.75 percent in December 2021 up to 11.5 percent at the end of 2022. Following a gradual decline in inflation since October 2022, the BCU reduced the policy rate by 25 basis points, setting it at 11.25 percent in its latest meeting in April 2023. As stated in the BCU's April communiqué, the decision to lower the policy rate is consistent with continuing with a tight monetary policy and persistent efforts for the convergence of inflation and inflation expectations in the monetary policy horizon. Future movements of the policy rate will be conditioned on the evolution of inflation expectations.

Working towards low and stable inflation remains the BCU's primary focus and the most critical component of the de-dollarization agenda. The monetary authorities recognize that financial de-dollarization is a gradual process and, as the report rightly notes, it involves various policy tools. In addition, the authorities consider critical to address cultural practices, including through financial education.

The authorities concur with staff that the enhanced monetary policy framework has increased the effectiveness of monetary policy transmission. Continued efforts to improve effectiveness include upgrading the communication of monetary policy decisions and providing additional detailed information on methodologies and analysis in its monetary policy reports. The BCU participated in the IMF's Central Bank Transparency Review (CBT) pilot in 2022 and has articulated a roadmap for actions to strengthen the application of transparency practices.

At the same time, it is important to underscore that the BCU has not intervened in the foreign exchange market since August 31t, 2021, which, as noted by staff, has provided clarity to the objectives of monetary policy. The BCU remains committed to preserving exchange rate flexibility while avoiding undue and non-fundamental market volatility. Uruguay maintains elevated levels of international reserves, which remain an important backstop for external stability and a key policy anchor. At the end of December 2022, international reserves amounted to 22.1 percent of GDP.

Financial sector

The financial system remains sound, having weathered the pandemic, well supported by strong supervisory and regulatory frameworks. The banking system's profitability remains high, with low and stable non-performing loans, and strong liquidity indicators. By end-December 2022, the profitability of banks represented a return on assets of 1.1 percent and a return on equity of 11.7

percent. After peaking at 3.4 percent in April 2020, at the beginning of the COVID-19 health emergency, the general delinquency of credit fluctuated between 1.6 percent and 2.1 percent during 2022 and closed 2022 at its lowest value, as most firms are overcoming pandemic situation without a deterioration of the financial situation of the banks. The ratio of liquid assets to total assets is at a healthy 58.1 percent.

Uruguay has made considerable progress in recent years to further strengthen financial sector supervision. As staff note, this has included updating the supervisory framework in line with international standards, enhancing the macroprudential policy framework, strengthening the banking sector resilience and reducing dollarization risks. The authorities will continue these efforts to enhance financial sector resilience. Follow up on FSAP recommendations is underway.

The authorities are encouraged by the opportunities provided by modernizing its payments system. The BCU's 2023-2025 payments roadmap aims to create an efficient, integrated, and accessible payment system, promoting competition, preserving financial stability, and fostering compliance with strict AML/CFT regulations. Fostering innovation, openness, and inclusion is a key element to the modernization of the payment system.

Structural reforms

Ongoing prosperity will depend on structural reforms to increase the economy's potential GDP growth and to improve the quality of life of Uruguayans. With these objectives, the authorities have been carrying forth reforms focused on longer-term development goals and fiscal solvency that include pension reform, education reform, increasing the efficiency of state-owned enterprises, embracing openness, and trade. We highlight two recent developments that speak of reforms underway, as noted by staff.

Uruguay's Parliament passed a reform of the pension system in April 2023 that is critical to fiscal sustainability in the long run and addresses the system's main challenge most notably derived from Uruguay's low birth rate and longer life expectancy. Its passage was the outcome of an open and participatory process that started in 2020 with the establishment of a Committee of Experts on Social Security (CESS) from across the political spectrum tasked with preparing a diagnosis and reform proposals. The current pension system has high coverage rates (practically universal for the population aged 65 and over) and its benefits are in line with those observed in countries with similar demographics and social protection traditions. Without changes to the current regime, public spending on pensions, which reached 11.1percent of GDP in 2019, is projected to reach 13.5 percent by 2070. The reform provides sustainability to the system in a fair and equitable way, including through provision of a solidary supplement to benefit lower income groups.

"Transformación Educativa," the reform of the primary and secondary educational system, was implemented in March 2023. It seeks to improve learning and retention, reduce inequities in education outcomes, and provide students with necessary life skills. Its main pillars are centered around improving governance and coordination across the different education institutions, reducing inequality in the system to improve the education outcomes of students in poorer households, increasing student retention, modernizing curriculum, and improving teacher training.

Harnessing Financial Innovation in Sovereign Funding for Climate Action

Uruguay is in the forefront of environmentally friendly policies and climate action. Throughout the past two decades, the country significantly reduced the carbon intensity of its economic activity and, at present, is one of the leading countries in the world in the production of clean energy and wind energy. Uruguay now seeks to advance its second renewable energy transformation in harder-to-abate sectors, through green hydrogen production and electric mobility— in line with the aspirational goal of becoming net C02- zero by 2050. In other key sectors, most notably livestock production, Uruguay is developing sustainable production through technological changes in the beef and dairy sectors, increasing productivity and reducing the intensity of methane emissions, in line with international commitments under the Paris Agreement. The authorities welcome staff's assessment of the progress achieved thus far and agree on the importance of macro-fiscal modeling and efforts at deepening decarbonization.

A key cornerstone of the debt management strategy has been aligning sovereign funding strategies with achieving ambitious climate and nature-based objectives. In October 2022, the authorities issued a global Sovereign Sustainability-Linked Bond, linking the bond’s coupon interest rate to the achievement of climate and nature conservation targets. The bond pioneered a two-way step-up/step-down interest rate structure, whereby the coupon rate would increase if the targets were missed or decrease if the targets are outperformed. Concomitantly, the authorities are currently working with the World Bank on the design of an innovative loan instrument that will reduce the interest paid if the country succeeds in meeting economy-wide environmental targets set under the Paris Agreement (reducing the intensity of cattle green-house gas emissions and enhancing the conservation of native forests). The basic concept is to differentiate lending terms based on countries’ contribution to global public goods.

More generally, connecting debt funding with the objectives of tackling climate change is evidence of Uruguay`s commitment to meeting its sustainability goals across administrations. It also further enhances the country`s accountability and climate transparency with investors, civil society, and the global environmental community.